

**Political Connections, Financing Decisions and Cash Holdings: Empirical Evidence from
Gulf Cooperation Council**

Omar Ikbal Tawfik
Department of Accounting, Dhofar University
otawfik@du.edu.om

Hamada Elsaid Elmaasrawy
Department of Accounting, Faculty of Commerce, Tanta University, Egypt
hamadaghazi@commerce.tanta.edu.eg

Khaldoon Albitar
Faculty of Business and Law, University of Portsmouth, Portsmouth, UK
Khaldoon.albitar@port.ac.uk

Abstract

Purpose: This study aims to investigate the relationship between political connections, financing decisions and cash holding.

Design/methodology/approach: Based on historical data from 181 active non-financial firms listed on Gulf Cooperation Council (GCC) Stock Exchange Markets during the period of 2009–2016, this study uses ordinary least squares (OLS) and dynamic system-generalized method of moments (GMM) to test the research hypotheses. The final data set comprises a total of 1448 firm-year observations from 10 major non-financial industry classifications.

Findings: This study finds a positive relationship between political connections and each of internal financing proxied by retained earnings ratio and external financing proxied by short-term debt to total assets and long-term debt to total asset. The findings also show a positive relationship between political connections and cash holding.

Practical implications: The findings of the study provide a better understanding of the role of politically connected directors in financing decisions and cash holding in the GCC. Investors can consider the presence of royal family members in the board of directors when making investment decision. Policymakers are encouraged to develop more effective policies that encourage listed firms to provide information on the political positions of the board of directors, managers and major shareholders/owners of companies.

Originality/value: This study contributes to the literature by providing empirical evidence on the relationship between political connections and financing decisions by focusing on the GCC region. This study also highlights that boards in connected firms in the GCC have lower monitoring role owing to political interventions and that connected firms face higher agency problems as they have weak governance and boards compared with non-connected firms.

Keywords: political connection; financing decisions; cash holding; royal family; Gulf Cooperation Council.

1. Introduction

Cash is one of the important assets. Managers can increase the firm value if they make good use of cash, and any misuse may lead to the destruction of the company. Cash-holding decisions are critical financial decisions for the company. The level of cash holding not only reflects company's business plan and financial strategy but is closely related to the internal governance and external environment (Mohammadi et al., 2018). Cash holding literature has shown that maintaining an optimum level of cash improves performance indicators and maximizes the value of the company; deviating from this level negatively affects the value of the company, regardless of whether the deviation is negative or positive (Martinez-Sola, 2013; Iftikhar, 2017). Therefore, the decision to keep cash is a valuable discretionary decision for management. The company's management estimates the percentage of cash assets held considering its own vision of the company's circumstances (Dittmar and Mahrt-Smith, 2007). Corporate cash holding has been much-discussed topic in corporate finance owing to the large

amounts of cash reflected on the balance sheets of companies around the world. Recent trends have indicated that corporate cash holding has risen significantly in the global context. Amess et al. (2015) documented that the cash held by the 1000 largest global non-financial companies amounted to \$2.8 trillion, confirming the importance of cash holding. Hence, liquidity management is a crucial issue of company policy. Opler et al. (1999) argued that the largest cash holding is concentrated in small companies and companies with the riskiest cash flows as well as companies with strong growth opportunities.

Many studies have focused on cash holding theories that determine the optimal level of cash that a company should keep (Opler et al., 1999, Ferreira and Vilela, 2004; Bates et al., 2009; Guizani, 2017). Corporate finance researchers identified three models that explain the decision to hold cash. According to trade-off theory, the firm should seek to reach the optimum level of cash holding by balancing between the marginal costs and marginal benefits of holding cash (Opler et al., 1999). The advantages of holding cash stem from the transaction cost and precautionary motives (Bates et al., 2009). Transaction motive means the company's willingness to meet operational requirements. By holding cash, companies avoid transaction costs associated with converting non-cash financial assets into cash and use cash for payments (Drobotz and Grüniger 2007). Moreover, companies keep cash as a precaution to face any emergency conditions such as a sudden cash shortfall, a major depression, economic turmoil or uncertainty regarding their ability to obtain financing from external sources (Chireka and Fakoya, 2017; Acikgoz et al., 2018; Kusunadi, 2019; Xu et al., 2019). Keeping cash as an investment motive means being ready to seize any investment opportunity that appears before the company. This motive increases in importance among companies that face difficulties in obtaining external financing (Martínez-Sola et al., 2013; Al-Hadi et al., 2018) or if the sources of cash or other financing are unavailable or prohibitively expensive. Kim et al. (1998) examined a sample of US companies and found that 'companies that face higher costs of external financing, have more volatile earnings, have more liquid assets'. However, holding more cash has a price. Two costs are associated with holding cash. The first is the opportunity cost of capital due to the low return on liquid assets (Ferreira and Vilela, 2004). According to Dittmar et al. (2003), this cost is often called the carry cost, which means the difference between the return on cash and the interest that must be paid to fund an additional dollar of cash. On the contrary, if the managers do not maximize the wealth of the shareholders, they tend to hold more cash to increase the assets under their control and thus increase their managerial discretion. As a result, the cost of monetary assets increases (Guizani, 2017)

In contrast to trade-off theory, there is no optimum level of cash holding in the pecking order approach; instead, cash is used as a buffer between retained earnings and investment needs. Myers and Majluf (1984) suggested that a firm should choose sources of funding that are less sensitive to information asymmetry given a direct correlation between information asymmetry and the cost of funding sources. The company should start with internal sources of financing and then use external sources. Under this theory, the level of cash held depends on the outcome of financing and investment decisions. When current operating cash flows are sufficient to fund new investments, companies pay down debt, pay dividends and eventually accumulate cash. When retained earnings are insufficient to finance current investments, companies use the accumulated cash assets and, if necessary, issue new debt and eventually securities (Guizani, 2017).

Agency cost theory suggests that managers and shareholders may have different views regarding the cost and utility of cash holding. Although the large accumulation of cash reserves enables the company to finance all projects with positive NPV and avoid unexpected events such as negative economic shocks, it may lead to agency conflicts between controlling managers and external shareholders (Joshi, 2019; Salehi et al., 2020). Leaving large amounts of cash reserves at the disposal of controlling managers can lead to squandering of cash in projects that provide them with special advantages at the expense of shareholders (Stulz, 1990; Al-Dhamari and Ismail, 2015). These projects may not be in the interest of the company and lead to a decline in the value of the company. Harford (1999) found that managers in companies with large free cash flows are more likely to over-invest in passive projects (i.e. acquisitions). In this regard, Belghitar et al. (2018) argued that firms holding a large amount of surplus cash in the absence of transactions or uncertainty drivers can be interpreted as an indication of agency problem because excess cash increases the tendency of managers to waste excess money. Several previous studies have provided evidence that firms with high cash reserves suffer from reduced value, especially when the governance system is weak (Dittmar and Mahrt-Smith, 2007; Kalcheva and Lins, 2007; Pinkowitz et al., 2006). However, Harford et al. (2008) insisted that free cash flow is detrimental to shareholders only when shareholder rights are not protected. These results are confirmed by Dittmar et al. (2003) in their study which has shown that in countries where investor protection is high, companies tend to hold less cash. This result is consistent with the studies by Pinkowitz et al. (2006) and Kalcheva and Lins (2007) who found that the better protected shareholder equity, the less cash managers held, giving them less opportunity to waste company resources in pursuit of their own interests and the confiscation of the wealth of shareholders. This finding is consistent with the hypothesis that weak protection of investors' rights makes it easier for management to control their rights and expropriate the company's resources for their own benefit. Similarly, Kalcheva and Lins (2007) provided evidence that companies around the world maintain high liquidity if investor protection is weak.

Free cash flow theory indicates the existence of a conflict of interest between management and shareholders about the company's monetary policy. The theory argues that a higher level of cash holding gives management discretion and provides managers with an incentive to use the money for their own interests (Jensen, 1986) rather than paying dividends to shareholders. Ali et al. (2018) and Dittmar et al. (2003) argued that when companies have limited investment opportunities, holding a high level of cash increases the likelihood that management will control assets which then encourage them to over-invest or pursue their own interests, thereby harming the interests of shareholders.

Due to the importance of the financing structure, prior academic studies examine the financing decision of firms in the GCC countries. Ahmad (2007) uses a qualitative approach and addresses the capital structure of Islamic firms and suggests that Islamic firms follow a slightly revised version of the pecking order theory. Akinsomi et al. (2015) conducted a comparative analysis between real property companies operating under the principles of Islamic Sharia against traditional real estate companies in the Gulf Cooperation Council countries. The author finds general support for Pecking Order Theory. Guizani (2017) provides evidence that trade-off theory, pecking order theory, and agency cost theory play important roles in understanding cash holdings in developing countries. Moreover, companies quickly adapt to the target cash ratio. This is due, to the higher costs of deviation from the target and the persistence of corporate cash holdings over time. The results of the study (Alnori, et al, 2020) indicate that Sharia-compliant companies and non-compliant companies in the Gulf Cooperation Council countries have

different determinants of cash holdings. The determinants of cash retention for Sharia-compliant companies are financial leverage, profitability, capital expenditures and net working capital, while the determinants of cash holdings for non-Shari'ah-compliant companies are financial leverage and net working capital. In addition, due to sharia constraints, sharia-compliant firms rely on internal sources of financing as their first financing option since they have a limited supply of external financing. Therefore, the determinants of the cash holdings of Shariah-compliant companies can be better explained using pecking order theory than trade-off theory. Alnori, (2020) examines the relationship between cash holdings of companies and the financial performance of non-financial companies listed in Saudi Arabia. The results show that for less liquid firms, increasing the cash level improves performance as a result of the benefits of holding cash (i.e. transactions and prudential motives) until the marginal benefits of cash holdings equal the marginal costs (i.e., optimal levels of cash holdings). By contrast, for more liquid firms, cash detracts from firms' performance as a result of the cost of holding cash (that is, the carrying cost and agency cost of management estimation). In line with trade-off theory, the results suggest that the advantages and disadvantages of holding cash play a key role in explaining the relationship between a company's liquid assets and accounting performance.

The impact of political connection (PC) on business is well recognized. Businesses generally believe in the economic benefits and advantages of contacts with politicians, particularly in less developed markets (Batta et al., 2014; Faccio, 2010). The importance of PC stems from the fact that they are a source of competitive advantage for companies and a tool for politicians to enhance their competitive position. On the one hand, firms seek to form PC to benefit from the influence of politicians. On the other hand, politicians need to support the business sector through their electoral campaigns and keep them in power (Habib and Muhammadi, 2018; Amara and Khlif 2020). Previous studies have suggested that political association, if any, has a 'double-edged' effect (Mehrabanpour et al., 2020; Ding et al., 2015; Bertrand et al., 2018). Fan et al. (2008) found that political association weakens corporate board governance and reduces management incentives to maximize shareholder wealth. Batta et al. (2014) showed that politically connected companies have higher accounting quality than unrelated companies. Belghitar et al. (2019) showed that political connectivity is a valuable resource for connected firms, but it leads to higher agency problems. Newbert (2007) argued that political connections help firms obtain resources, which can be exploited to achieve a sustainable competitive advantage. These resources are financial resources such as obtaining tenders or supplying government purchases (Li et al., 2019).

We expect that political connections can enhance future cash flows and mitigate adverse shocks to future cash flows. Because political connections can affect access to capital as well as the stability of future cash flows. (Hill, et al, 2014) argue that politically connected firms have lower cash levels than unconnected firms. Moreover, the contribution of cash to the value of the firm is smaller for firms with stronger political connections. Another way in which political ties may influence liquidity behaviour is by accessing external financing. Faccio, et al, (2006) examining the impact of political connections in different countries including the United States, the results of their study show that PLCs are more likely to receive government assistance than unconnected troubled firms. Additionally, politically connected companies have a greater potential to obtain debt financing and to use more leverage in their capital structures. Faccio (2010) also found that connected firms have higher leverage (i.e., preferential access to credit). This finding is supported by Boubakri et al. (2011), which document that a company's performance and leverage increases after a politician is nominated to the board of publicly listed

companies or after an executive enters politics. They also document that a political connection is more valuable, the closer the links are to political power. Using a sample of 31 countries over the period from 1997 to 2001, Boubakri et al. (2013), found the Politically connected firms have larger cash balances than their unconnected firms. This result is consistent with those of (Dittmar et al. 2003; Kalcheva and Lins, 2007). These results conflict with those of (Harford et al., 2008) who found that US companies with weaker corporate governance structures had smaller cash reserves. Through this, we conclude that the retention of cash for politically connected companies depends on the purpose that the company seeks to obtain from the political connections. If the company's aims to support politicians in the hope of obtaining future benefits, we note that the company maintains larger cash balances, while if the aims of the company to obtain support from politicians, we note that the company maintains fewer cash balances.

The royal family has a direct impact on the economy. In GCC countries, members of the royal family have access to government resources, and they control many government companies (Sidani and Al Ariss, 2014). In Saudi Arabia, the royal family controls approximately 10% of all board seats of companies listed in the Saudi market (Alzahrani and Che-Ahmad, 2015). Thus, in royal countries, unsurprisingly, members of the royal family are on the board or in senior management positions in the GCC countries (Sidani and Al Ariss, 2014). Hertog (2012) noted that board members of some Gulf companies are selected according to their positions among ruling families or their relationships. In addition, Hadi et al. (2016) argued that members of the royal family have power over the economic and political systems in the GCC region. In this regard, Mazaheri (2013) highlighted that non-influential entrepreneurs tend to have an advantage if they are able to find a royal partner in a project to enable them to develop a company through access to business relationships and commercial trademarks. Moreover, the business interests of politically linked companies are protected by the monarchy because management will not interfere with the decisions made by the powerful directors from the ruling family. Al-Nasser (2020) found that the attendance of royal family members at board meetings negatively affects firm performance but has no effect on firm value. Al-Hadi et al. (2016) argued that a member of the royal family on the board of directors does not have to act opportunistically for personal benefit at the expense of other shareholders, particularly minority shareholders. Therefore, politically linked companies tend to have less market risks compared with unconnected companies because of protection by royal favouritism.

Previous research has also found an association between cash holding and firm value (Dittmar and Mahrt-Smith, 2007; Kusnadi, 2011; Lee and Lee, 2009; Opler et al., 1999). Small firms, firms with riskier cash flows and firms with strong growth opportunities hold more cash (Chen et al., 2014; Claessens et al., 2008; Houston et al., 2014). Bank financing is an important channel through which political connections operate. Politically connected firms can obtain financing at lower costs. Other studies have indicated a positive relationship between PC and firm performance (Boubakri et al., 2012). The main argument is that politically connected firms can obtain many advantages, the most important of which are obtaining government contracts and subsidies (Brown and Huang, 2020), conditional loans facilitated by banks with many credit benefits (Wang et al., 2018) and access to government support in times of crisis (Wang et al., 2018).

Despite the growing number of empirical studies on cash holdings. Nevertheless (Khatib, 2021; Da Cruz et al., 2019) argue that there are opportunities to make significant contributions in this field. Recent studies such as (Khatib, 2021; Khatib, 2020) confirmed the need to explore more about the issue of cash holding in emerging countries. Our study adds evidence to the literature

on cash holdings from a regional perspective by examining the impact of political connections on corporate cash holdings in the Arab Gulf states. In addition, it examined the impact of cash holdings on the financial decisions of GCC companies. We also contribute to the financial literature by providing evidence on the relationship between political linkages and financial decisions in the GCC countries.

The rest of the paper is structured as follows. Section 2 reviews the literature and develops the research hypotheses. Section 3 discusses the research method. Section 4 shows the empirical results. Section 5 presents the additional analysis and robustness check. Section 6 concludes the study.

2. Literature review and hypothesis development

According to Khuong et al. (2019) and Oláh et al. (2019), cash is one of the riskiest liquid assets. Therefore, the decision to hold cash is an important financial decision for the company. Because the company's holding cash does not only reflect on the company's business plan and financial strategy but is closely related to the company's internal governance and the external environment (Ye, 2018). The decision to hold cash is influenced by the company's financial policies such as the capital structure policy, working capital management, cash flow management, dividends, and investment decisions (Afza and Adnan 2007). The first step in examining cash holding decisions is to understand the motivations for holding cash. Do companies keep cash for their day-to-day operations, to guard against risk or for speculation? The literature offers several explanations for why companies hold cash. Joshi, (2019) and An et al. (2013) believes that companies keep cash for three reasons, they are precautionary measures, for operations, or for future investment requirements. Companies hold cash for precautionary reasons to face any emergency circumstances, such as a sudden cash shortfall, a recession or unexpected economic disruptions, or because of uncertainty regarding the company's ability to obtain external financing (Martínez-Sola et al., 2013). In addition, the company keeps cash as an investment motive to seize any investment opportunity that may appear in front of the company, the importance of this motive increases in companies that are difficult to obtain external financing. Myers and Majluf, (1984) argues the inconsistency of information between companies and external investors makes an opportunity Obtaining external financing is expensive In cases where the information asymmetry between companies and external funders is severe, companies use cheaper alternatives to fund profitable investment opportunities such as internal. So, companies with profitable growth opportunities should have more liquidity. Finally, companies may be holding cash as a strong anti-acquisition defines against hostile bidders (Faleye, 2004). Cash excess also provide opportunities for potential targets to counter unfriendly takeover offers, these include the possibility of repurchasing shares.

Political connections are one of the dominant institutional characteristics in most countries, and it represents a key element in shaping the economic environment and the functioning of the capital market (Abdul Wahab et al., 2017). Political connections contribute to operational efficiency and give the company many benefits and economic advantages (Boubakri et al., 2013, Wrona and Sinzig, 2017), especially in less developed markets (Chen et al., 2011). Where there is weak implementation of corporate governance (Bliss and Gul, 2012a, 2012b). Cheng et al. (2015), Amara and Khlif, (2020) indicates that China, Malaysia and Indonesia are typical examples of countries characterized by this phenomenon. The literature has addressed the

relationship between political ties and cash holdings, since political affiliations can affect access to capital and also the stability of future cash flows. Hill et al (2014) see that political connections enhance future cash flows and mitigate the possibility of adverse cash flow shocks in the future. In addition, through political connections, financing can be obtained at low costs and on concessional terms (Bao et al., 2016). Other studies demonstrate that firms with political connections and business group affiliations retain more liquidity and have much larger cash reserves than their unconnected counterparts (Lin et al., 2019; Saeed et al., 2014).

The financial characteristics of a company are the most direct factor affecting the level of cash holding of the company. Opler et al. (1999) found that the level of cash holding is positively correlated with investment opportunities and future cash flows. That is, a company that has more investment opportunities or cash flows in the future will usually retain more liquidity because it is easier to seize good opportunities, which also supports the speculative motive for cash assets (Ferreira and Vilela 2004). The study also found that when the size of the company or the ratio of assets to liabilities is greater, the company's cash holding are lower. García-Teruel and Solano (2004) found that firms' cash holding is positively affected by cash flows and leverage and has a negative relationship with the ratio of long-term debt, cash alternatives and short-term bank loans. Hu and Jiang (2005) found a significant positive relationship between cash holding and firm size for a sample of Chinese firms. The study also found that a large company is generally very successful, so its cash flow is more plentiful.

Corporate governance is another issue affecting cash holding. Corporate governance factors are mainly divided into external and internal. External factors include national or regional laws and market conditions, whereas internal factors include the board of directors and governance structure. Dittmar et al. (2003) found that in a country with poor protection of shareholder rights, the asymmetry of information and investment opportunities does not have a significant impact on cash holding behaviours. Aldamen and Duncan (2012) found a relationship between corporate governance and the level of debt financing. Firms with higher levels of corporate governance have higher leverage and lower cost of debt. Chen et al. (2013) found that regional government quality has a negative relationship with corporate cash holding. They also find that private company behaviours regarding cash holding are more sensitive to government quality. Harford et al. (2008) looked at US companies between 2000 and 2004. They found that the level of cash retention is positively correlated with corporate governance. When corporate governance is better, their cash holding are higher. When corporate governance is in good shape, shareholder power is strong and the agency problem is mitigated. Ozkan and Ozkan (2004) dealt with the relationship between the increase in the percentage of managers' contribution and the level of cash holding. The results show that, with the increase in the percentage of managers' contribution, the company's cash holding level shows a downward trend first, rises and then declines. Zhang and Liu (2005) chose three variables as a substitute for shareholder protection. These variables are absolute shareholding percentage of the largest shareholder, relative contribution of the largest shareholder and type of ownership. The result indicates a significant negative relationship between shareholder protection and corporate cash holding.

Financing constraints are also a critical factor influencing cash holding. Opler et al. (1999) studied the effect of financing restrictions on US corporations' cash holding. They selected the debt level to measure the financing constraints. The results indicate that the company with financing restrictions hold more cash than companies without. Han and Qiu (2007) used a two-stage investment model to study the issue of cash holding. The results show

that the cash holding of the restricted company is more sensitive to cash flow fluctuations, and it holds a large amount of cash to prevent cash flow risks. However, this relationship is not significant in companies that are not financially constrained. In a study of US companies, Dittmar and Mahrt-Smith (2007) found that companies that are funded have a higher value for holding cash compared with those that are not funded. The results also indicate that funding constraints have a certain effect on the company's behaviour of cash holding. Faulkender and Wang (2006) found that a company with funding constraints has a stronger reliance on internal cash reserves, and its cash holding are generally higher than a firm with no funding constraints. Luo and Wan (2008) studies of a Chinese listed company from 2004 to 2006 and showed that the company's cash holding has a U-shaped relationship with debt status. The level of corporate cash holding has a positive relationship with the ratio of short-term debt but a significant negative correlation with the ratio of long-term debt. Iftikhar (2017) showed that companies increase their cash holding because of growing cash flow uncertainty. The relationship between monetary assets and return on assets is positive. In addition, conservative cash holding can increase the market value of companies, but, in the long run, a very conservative liquidity management policy will erode the profitability of assets. Aslam et al. (2019) found that cash holding has a negative and significant relationship with earnings per share (EPS) and return on assets but a positive and statistically significant relationship with Tobin Q and market share price. Joshi (2019) found that cash holding is most favourable for companies experiencing financial stress and for growing companies. Qin et al. (2020) examined the impact of COVID-19 on cash holding. They found that COVID-19 has a significant positive impact on cash holding in high-impact industries. Managers must raise companies' cash holding during the pandemic to meet emergencies. Moreover, managers should be aware of the limitations of financial financing due to risk.

2.1 Hypothesis development

2.1.1 PCs and financing with retained earnings

Anecdotal evidence indicates that politically connected companies in various countries worldwide benefit from their relationships with politicians. Ling et al. (2016) considered the firm's close association with the government to be of high social value. An organisation acquires power, authority and a competitive position through social relationships (Wong et al., 2018). PC facilitates access to scarce and valuable resources, such as bank loans or government contracts (Bao et al., 2016; Qian et al., 2020; Khwaja and Mian, 2005), equity financing, government bailouts and favourable tax rates (Boubakri et al., 2012; Francis et al., 2009; Goldman et al., 2013). PCs also have a role in the behaviour and value of organisations as these connections reduce the risks they face. The more the PCs between organisations and government institutions, the lower the risks faced by the organisation. The reason is that these links are considered an insurance policy for organisations against the risks that harm them (Farag et al., 2020). Al-Hadi et al. (2016) documented that the presence of members of the royal family on the board of directors reduces the quality and extent of risk disclosure. Moreover, the presence of the director of the royal family in the board of directors decreases the disclosure of market risks (Al-Hadi et al., 2016). In addition, PCs reduce the risk of litigation and the imposition of fines on the management of the facility. Jia et al. (2019) argued that PCs are an alternative to financial leverage as the stronger the PCs, the lower the organisation's vision about keeping cash to face risks. These links are the way to develop trust between financiers and customers and amongst organisations (Kusnadi, 2019).

Debt represents one of the main tools that provide financing to companies. Debt financing means that the company resorts to borrowing money from external parties to finance

its various operations (Joshi, 2019; Graham et al., 2008). Debt financing allows existing shareholders to maintain their ownership percentage in the company's shares. Resorting to debt financing carries many risks that can lead to higher costs of loans in the future (Florou and Kosi, 2015). In recent years, an increasing number of studies showed that external financing is one of the most important factors contributing to private sector development. Beck et al. (2000) suggested that if a country's external financing to the private sector is high, then that country has higher productive efficiency and capital accumulation. Cull and Xu (2005) and Johnson et al. (2002) pointed out that external financing in China and Eastern Europe is a key factor in sustainable development.

Controversial findings of the impact of PCs on debt financing exist. For instance, Khaw et al. (2019), Harjan et al. (2019), and Houston et al. (2014) found that politically connected companies can obtain financing at lower costs. Zhang et al. (2021) found that PCs based on regulatory relationships have a significant positive effect on private corporate debt financing. Moreover, Fraser et al. (2006) found that politically linked Malaysian companies are linked with higher financial leverage, indicating that these companies are inherently more risky than unrelated ones. Hence, we investigate the use of long- and short-term debt in finance to gain a better understanding of the impact of political relationships on financing decisions.

Furthermore, according to pecking order theory, companies maximise value by arranging the financing options they use on the basis of the 'cheapest source of funds available' (Myers, 1984). Thus, in the event that inconsistency in the information between the company and the potential financiers exists, the firm faces the risk of information inconsistency for the available external financing alternatives. Managers prefer internally generated funds (retained earnings or contributions of current owners) over external financing (Cassar and Holmesb, 2003) because retained earnings are considered the first alternative to managers' sources of financing. The reason is that using such funds provides greater flexibility. In addition, Jensen (1986) argued that politically connected firms retain higher profits rather than paying high dividends. Moreover, Lin et al. (2019) demonstrated that firms with PCs and business group affiliations retain more liquidity and have significantly larger cash reserves than their unconnected counterparts. Benjamin (2016) also found that companies with PCs are associated with paying lower dividends. Thus, if companies pay lower dividends, then they keep the largest amount of profits in the form of retained earnings and reserves to use them in financing their various activities. Therefore, we develop the following hypothesis.

H1: There is a positive association between PCs and internal financing decision (the retained earnings and reserves ratio).

2.1.2 PCs and external financing

PC facilitates corporate financing and enables companies to easily obtain long-term loans. Similarly, banks prefer to give them loans because the probability of default is relatively low (Yang et al., 2014). In addition, companies with PCs can directly influence bank lending decisions and obtain more long-term loans to avoid the uncertainty inherent in the rotation of officials. Previous studies revealed the positive impact of PCs on bank borrowing. Faccio (2006), Khwaja and Mian (2005), and Charumilind et al. (2006) identified that connected firms have easier access to the debt market, particularly bank loans. Their results indicate that PLCs have The long-term loans is much higher than for unrelated firms. Moreover, the results of the studies showed that the borrowing rate increases when the PCs are strong. Khwaja and Mian (2005) indicated that politically connected Pakistani companies can obtain 45% more loans than their

unrelated counterparts. Charumilind et al. (2006) found that firms in Thailand with PCs have a greater potential to obtain long-term loans than those without the same relationships. Moreover, these companies do not need large collateral to obtain long-term loans. Feng et al. (2020) found that state ownership is negatively correlated with long-term debt but has a positive correlation with short-term debt. In addition to the above, Belghitar et al. (2019) found that a positive relationship between PCs and both the financial leverage and the long-term debt ratio (LDR). However, a non-significant relationship is found between PCs and the short-term debt ratio (SDR). According to these authors, access to long-term external financing is one of the important factors that push companies to enter political relationships. In addition, politically connected companies are likely to be treated preferentially in accessing bank financing.

In this study, the PCs of companies will be measured by the presence of members of the board of directors from the royal family. Generally, there are members of the royal family on the boards of directors in companies owned by the royal family or government ownership. Liu et al. (2011) found that the largest shareholding (the percentage of shares held by the largest shareholder) in the SOEs has a negative relationship with the leverage ratio. By contrast, the largest shareholding in non-SOEs has a nonlinear relationship with the SDR and LDR. Moreover, the Chinese government often owns major banks, so it applies pressure on the banking system to make additional lending to SOEs. Furthermore, Feng et al. (2020) found that state ownership has a negative relationship with short- and long-term debt and total debt. Therefore, we develop the following hypothesis:

H2: There is a negative association between PCs and external financing decision.

At the same time, we divide the second hypothesis into two sub-hypotheses:

H2A: There is a negative association between PCs and external financing decision (short-term debt ratio).

H2B: There is a negative association between PCs and external financing decision (long-term debt ratio).

2.1.3 PCs and cash holding

The decision to cash holding is a discretionary decision of the management. That is, the company's management estimates the percentage of cash assets held in the light of its own vision and what it deems appropriate for the company's circumstances (Dittmar and Mahrt-Smith, 2007). Faulkender and Wang (2006) and Denis provided evidence that cash is of higher value for financially constrained firms. However, the contribution of cash to the value of the company is expected to be less for politically connected companies. Hill et al. (2014) argued that politically connected firms have lower cash levels than unrelated firms. Moreover, the contribution of cash to the value of the firm is weak in firms with strong political connected linkages that provide companies with access to liquidity. Unlike cash holding, companies with strong PCs have better access to capital. Therefore, politically connected companies should reduce cash holdings as gained PCs are expected to lead to access funding and the ability to generate more stable future cash flows and mitigate the potential for adverse cash flow shocks. Thus, the results of some studies indicate that politically connected companies have lower cash levels compared with unrelated companies. Moreover, the contribution of cash to the value of the firm is weak in these firms (Hill et al., 2014; Boubakri et al., 2012). These results contradict the results of other studies. Boubakri et al. (2013) argued that the accumulation of cash holding with a weak corporate governance system would motivate the controlling managers of politically connected companies to extract political benefits by wasting excess money on activities with a political

agenda. According to the agency's view of the politically connected companies, these companies are expected to retain more liquidity.

However, these companies' cash holding is not to meet transaction costs, precautionary measures or to meet future investment requirements, as typical companies do, but rather out of private interests (Amara and Khlif, 2020). Opler et al. (1999) argued that opportunistic managers keep cash rather than pay dividends to shareholders because they tend to use cash to their advantage, such as empire building, greater rewards, job security and building political relationships. Using a sample of 50 from 31 countries from 1997 to 2001 (Boubakri et al., 2013) provided strong evidence that politically connected firms have greater cash balances than their unrelated peers. Saeed et al. (2014) found a positive relationship between cash holding and corporate PCs in Pakistan. Politically connected companies have more cash reserves than their unrelated counterparts. In addition, this correlation was stronger under the dictatorial regime (between 2002 and 2007) than under the democratic regime. Al-dhamari and Ismail (2015) found that companies that have PCs have more cash reserves, documenting a positive relationship between political engagement and cash holdings. Therefore, we propose the following hypothesis:

H3: There is a positive association between PCs and cash holdings.

2.1.4 Financing with retained earnings and cash holding

Corporate managers who make financing decisions do not consider the long-term debt-to-equity ratio (Barclay and Smith, 2005). Instead, they go the path and the least expensive financial means (debt in general), with little thought about the future consequences of these choices. Based on pecking order theory, the company relies on a hierarchy when funding is needed. According to this gradation, the company relies on internal financing as a source of financing when the level of cash held increases. Boyle and Guthrie (2003) indicated the need for a high level of cash holdings in companies to avoid dependence on external sources of financing with high costs and to benefit from internal sources of financing in obtaining positive investment opportunities, leading to an increase in the value of the company and an increase in the wealth of shareholders. Regarding cash flow and investment opportunity, pecking order theory predicts a positive effect of cash flow and investment opportunity on cash holding. Companies with high cash flow have excellent operating performance and therefore can have many investment opportunities. As a result, companies have to hold more cash (Ferreira and Vilela, 2004) because they prefer internal rather than external sources of funding (Ozkan and Ozkan, 2004). In this context, cash holding can be justified by companies' need to finance their investments (Mikkelsen and Partch, 2003). According to pecking order theory, the following hypothesis is developed:

H4: There is a positive association between internal financing decision (the retained and reserves ratio) and cash holdings

2.1.5 Debt financing and cash holding

The debt level of a particular company is not a goal pursued by the company but rather an arrangement of financing options determined by the availability and cost of resources (Carmo et al., 2016; Coffie et al., 2018). The company can use liquid assets to finance its activities and investments if other sources of funding are not available or expensive. On the contrary, the firm resorts to debt when its internal resources are unable to finance new projects and generate internal cash (Myers, 1984). An et al. (2013) noted that companies should maintain an adequate liquidity position to meet operational and investment needs to avoid costly external financing.

Kighir et al. (2015) argued that profits and cash flows are important in the financing model. Moreover, Błach et al. (2014) stated that if organisations cannot properly maintain their liquidity position, then they may face bankruptcy even if they are profitable. Myers (1984) posited that profitable firms are expected to keep more cash to use as a primary source of financing. According to pecking order theory, changes in internal resources are the driving force for changes in cash holdings. A company that has excess internal funds keeps the cash and uses it to pay off debts. In addition, the theory predicts a positive impact of cash flow and investment opportunities on cash retention. Companies with high cash flow and excellent operating performance are considered to have many investment opportunities. As a result, firms have to hold more liquidity (Ferreira and Vilela, 2004) because they prefer an internal rather than an external source of financing (Ozkan and Ozkan, 2004). As such, companies need to hold more liquidity to reduce external financing risks and to exploit available investment opportunities (Lie and Liu, 2018), which implies a negative relationship between leverage and cash holdings. Moreover, Ferreira and Vilela (2004) found a negative relationship between financial leverage and cash holdings through an applied examination of a sample of companies in Economic and Monetary Union countries. Tiago and Caldeira (2014) also found a negative relationship between cash holding and each level of debt (Short- and long-term debt and financial leverage) through an applied examination of a sample of companies listed on the stock exchange in Brazil. In the same direction, Ha and Tai (2017) found a negative relationship between cash holdings and the short-term debt ratio and long-term debt ratio through a sample of listed firms on the Ho Chi Minh stock exchange in Vietnam. Therefore, we develop the following hypothesis:

H5: There is a negative association between external financing decisions and cash holdings.

At the same time, we divide the second hypothesis into two sub-hypotheses:

H5a: There is a negative association between external financing decisions (short-term debt ratio) and cash holdings.

H5b: There is a negative association between external financing decisions (long-term debt ratio) and cash holdings.

3. Research design

3.1 Methodology and sample selection

Researchers relied on the ordinary least squares (OLS) panel data approach. The term ‘panel data’ refers to the aggregation of observations on a cross-section of individuals, families, firms and countries, among others, over several time periods (Baltagi, 2005). The panel data approach contains three regression models which are pooled regression model (PRM), fixed effects model (FEM) and random effects model (REM). According to Baltagi (2005) and Wintoki et al. (2012), the PRM assumes that we are facing a normal regression. Therefore, the results extracted from this model are expected to be less reliable and more biased. FEM and REM have many statistical advantages, including controlling the problems of unobserved heterogeneity and individual heterogeneity. Therefore, we used the OLS panel data models and compared FEM and REM using the Hausman test.

The data used in this study were manually collected from the annual reports of non-financial companies in the capital markets for six countries in the Gulf region (Saudi Arabia, the United Arab Emirates, Qatar, Oman, Bahrain and Kuwait). The study sample comprises 181

non-financial companies listed in the capital markets from 12 major non-financial industry classifications with a total of 1448 observations from 2009 to 2016, as shown in Table I.

[Insert Table I here]

The sample started in 2009 for two reasons. Firstly, it is the period after the global financial crisis of 2008. Secondly, with the exception of Oman, all the GCC countries implemented their own corporate governance laws between 2007 and 2009 (Guizani and Abdalkrim, 2021). We used a number of information sources to collect PC data. We investigated individual managers and members of the board of directors who play current or previous political roles. Alternatively, we examined whether the chairman of the board of directors, the executive director or one of the members of the board of directors belong to the ruling family.

3.2 Measurement of the variables

Our dependent variables are cash holding and financial decisions measured by different proxies. Our independent variable of interest to test is PCs, which is a dummy variable that equals 1 if the firm is politically connected; 0, otherwise. We also used a number of control variables that affect the relationship between PCs and financing decisions, PCs and cash holding and financing decisions and cash holding. Several studies (e.g. Tiago and Caldeira, 2014; Ha and Tai, 2017; Zhang and Chen, 2017; Wans, 2017; Jabbouri and Alm Mustafa, 2020; Guizani and Abdalkrim, 2021) have proven that a number of variables that affect debt financing decisions and cash holding. Hence, we used a number of control variables which are firm size, net working capital, firm profitability, cash flow from operations, market-to-book ratio, liquidity, dividend per share, duality and EPS. In addition to the above, the influence of factors are isolated at the level of each of the various Gulf countries (Saudi Arabia, Oman, Bahrain, the United Arab Emirates, Qatar and Kuwait). We used GDP and inflation as control variables (Alsharif, 2021). Table II shows the methods for measuring the dependent, independent and control variables.

[Insert Table II here]

3.3 Model construction

In order to empirically test the above, the following regression models were constructed in this paper: We use Models 1 to test H1:

$$RET_{it} = \beta_0 + \beta_1 CFO_{it} + \beta_2 SIZE_{it} + \beta_3 MTB_{it} + \beta_4 ROA_{it} + \beta_5 NWC_{it} + \beta_6 LIQ_{it} + \beta_7 PC_{it} + \beta_8 DPS_{it} + \beta_9 EPS_{it} + \beta_{10} INF_{it} + \beta_{11} GDP_{it} + \beta_{12} DUA_{it} + e_{it}$$

1
where:

RET_{it} = Retained earnings ratio for firm i in year t, and the other variables in the model are defined in Table II.

To test H2A, we use model 2 in order to explore the relationship between the political connections and short term debt ratio

$$\begin{aligned} \text{SDR}_{it} = & \beta_0 + \beta_1 \text{CFO}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{MTB}_{it} + \beta_4 \text{ROA}_{it} + \beta_5 \text{NWC}_{it} + \beta_6 \text{LIQ}_{it} + \beta_7 \text{PC}_{it} \\ & + \beta_8 \text{DPS}_{it} + \beta_9 \text{EPS}_{it} + \beta_{10} \text{INF}_{it} + \beta_{11} \text{GDP}_{it} + \beta_{12} \text{DUA}_{it} \\ & + e_{it} \end{aligned} \quad 2$$

where:

SDR_{it} = Short-term debt ratio for firm i in year t , and the other variables in the model are defined in Table II.

To test H2B, we use model3 in order to explore the relationship between the political connections and long-term debt ratio

$$\begin{aligned} \text{LDR}_{it} = & \beta_0 + \beta_1 \text{CFO}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{MTB}_{it} + \beta_4 \text{ROA}_{it} + \beta_5 \text{NWC}_{it} + \beta_6 \text{LIQ}_{it} + \beta_7 \text{PC}_{it} + \\ & \beta_8 \text{DPS}_{it} + \beta_9 \text{EPS}_{it} + \beta_{10} \text{INF}_{it} + \beta_{11} \text{GDP}_{it} + \beta_{12} \text{DUA}_{it} + e_{it} \end{aligned} \quad 3$$

where:

LDR_{it} = Long-term debt ratio for firm i in year t , and the other variables in the model are defined in Table II.

We use Models 4 and 5 to test H3, H4 and H5, respectively:

$$\begin{aligned} \text{CTA}_{it} = & \beta_0 + \beta_1 \text{CFO}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{MTB}_{it} + \beta_4 \text{ROA}_{it} + \beta_5 \text{NWC}_{it} + \beta_6 \text{LIQ}_{it} + \beta_7 \text{PC}_{it} \\ & + \beta_8 \text{RET}_{it} + \beta_9 \text{SDR}_{it} + \beta_{10} \text{LDR}_{it} + \beta_{11} \text{DPS}_{it} + \beta_{12} \text{EPS}_{it} + \beta_{13} \text{INF}_{it} \\ & + \beta_{14} \text{GDP}_{it} + \beta_{15} \text{DUA}_{it} + e_{it} \end{aligned} \quad 4$$

where:

CTA_{it} = Cash holdings for firm i in year t , and the other variables in the model are defined in Table II.

To ensure the robustness of the results and consistent with model 4, we ran the model with the alternative measure of the cash holdings and repeat the same model again

$$\begin{aligned} \text{CASHTA}_{it} = & \beta_0 + \beta_1 \text{CFO}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{MTB}_{it} + \beta_4 \text{ROA}_{it} + \beta_5 \text{NWC}_{it} + \beta_6 \text{LIQ}_{it} \\ & + \beta_7 \text{PC}_{it} + \beta_8 \text{RET}_{it} + \beta_9 \text{SDR}_{it} + \beta_{10} \text{LDR}_{it} + \beta_{11} \text{DPS}_{it} + \beta_{12} \text{EPS}_{it} + \beta_{13} \text{INF}_{it} \\ & + \beta_{14} \text{GDP}_{it} + \beta_{15} \text{DUA}_{it} + e_{it} \end{aligned} \quad 5$$

4. Empirical results

4.1 Descriptive statistics

Table III displays the descriptive statistics for the entire sample. The mean PC in the sample is 0.2685, so if the PC variable is a dummy variable (0.1), more than a quarter of the companies in the sample have political connections. The number of companies with political connections is 51 out of a total of 181 companies. This outcome confirms that companies in the GCC tend to appoint royals (politicians) to the board of directors to obtain multiple benefits, such as leveraging their knowledge and expertise in government actions (Hertog, 2012). The mean long-term debt ratio (LDR, 9.8%) is greater than the mean short-term debt ratio (SDR, 7.9%), and the mean total debt ratio (TDR, 17.5%) is greater than the mean retained earnings and reserves ratio (RET, 15.3%). These low rates of financing in interest bearing debt can be explained by the fact that a number of companies in the capital markets in the GCC are compliant with Sharia, which imposes restrictions on debt financing. In addition, the mean of cash holding ratio (CTA) is 7.7%. This percentage is slightly lower than the mean cash holding according to a study by Alnori et al. (2022) on a sample of companies in the GCC from 2005 to 2019.

[Insert Table III here]

4.2 Goodness of fit or specification tests in panel data models

The present study uses the panel data approach to test research hypotheses. Therefore, selecting the best estimator between fixed and random effects for this model is necessary. In this regard, we use the Hausman test to choose the appropriate estimator. The results of the Hausman test are reported. As the p -value of this model is less than the margin of error of 0.05 (Mardnly et al., 2021; Aladwey, 2021; Bansal, 2021; Oware and Mallikarjunappa, 2021), we choose FEM as the desirable estimator for estimating the regression model. Table IV presents the results of this Hausman test.

[Insert Table IV here]

4.3 Correlation analysis

Table V shows the pairwise correlation amongst the included variables. From Table V, a negative correlation exists between PCs and external financing decisions (SDR and LDR), whereas a positive correlation exists between PCs and the internal financing decision (the retained earnings and reserves ratio (RET)). In addition, a positive correlation exists between PCs and cash holdings (CTA). At the same time, a negative correlation exists between cash holdings (CTA) and external financing decisions (SDR and LDR), whereas a positive relationship exists between the internal financing decision (RET) and cash holdings (CTA). Table V suggests that our proposed models have no multicollinearity. Finally, the correlation analysis coefficients indicate that the levels of correlation amongst all variables are somewhat low, and the correlations amongst all independent variables are less than 0.80. The standard economic models are unlikely to suffer from the multicollinearity problem (Qawqzeh et al., 2021; Queiri et al., 2021; Jabari and Muhamad, 2021).

[Insert Table V here]

4.4 Regression results

4.4.1 OLS results of models 1, 2, 3 and 4

Table VI shows the results from running five models. In these models, we tested the relationship among retained earnings and provisions ratio, TDR and PCs.

Table VI shows the following results. Firstly, a positive and statistically significant relationship exists between PCs and RET in model 1 (coefficient = 0.0268, sig = 0.0051 < 1%). Therefore, H1 is accepted: a positive association exists between PCs and RET. The result is consistent with the results of several studies (e.g. Jensen, 1986; Benjamin, 2016; Lin et al., 2018). These studies have found that politically connected firms retain higher profits rather than paying high dividends. Moreover, the presence of members of the royal family on the board of directors may provide immunisation to company management. Thus, managers prefer internally generated funds (retained earnings or contributions of current owners) over external financing (Cassar and Holmesb, 2003). The reason is that retained earnings are considered the first alternative to managers' sources of financing.

Secondly, a negative and statistically significant relationship exists between PCs and the decision to finance with debt, regardless of whether it is short- or long-term debt. The presence of members of the board of directors from the royal family is mostly in companies owned by the royal family or the government. This result is consistent with those of other studies (Feng et al., 2020) that have found that government ownership (a form of PCs) in China has a negative relationship with total debt. In addition, Ahemd and McMillan (2021) demonstrated that political connections negatively affect banks capital structural decisions in GCC. The results contradict the claim that politically connected firms tend to sustain higher debt due to government privilege and a lower chance of bankruptcy. We divided the total debt into short- and long-term debt to verify the previous result, and the results are as follows:

* A negative and statistically significant relationship exists between PCs and SDR in model 2 (coefficient = -0.0175, sig = 0.0185 < 5%). Therefore, H2a is accepted: PCs are associated with SDR. These results are consistent with those of (Feng et al., 2020) who found that government ownership (a form of PC) in China has a negative relationship with SDR.

* A negative and statistically significant relationship exists between PCs and LDR in model 3 (coefficient = -0.0218, sig = 0.0022 < 1%). Therefore, H2b is accepted: PCs are associated with LDR. These results are consistent with those of (Liu et al., 2011; Feng et al., 2020) who found that government ownership in China has a negative relationship with LDR.

Thirdly, a positive and statistically significant relationship exists between PCs and cash holding in models 4 (coefficient = 0.01246, sig = 0.0018 < 1%) and 5 (coefficient = 0.0140, sig = 0.017 < 5%). Therefore, H3 is accepted: a positive association exists between PCs and cash holding. These results are consistent with those of other studies (Boubakri et al., 2013; Saeed et al., 2014; Al-Dhamari and Ismail, 2015; Lin et al., 2018; Belghitar et al., 2019) that have found a positive relationship between PCs and cash holding. According to the agency's view of the politically connected companies, these companies are expected to retain more liquidity. However, these companies' cash holding is not to meet transaction costs, precautionary measures or future investment requirements as typical companies do, but rather out of private interests (Amara and Khlif, 2020; Opler et al., 1999) argued that opportunistic managers keep cash rather than pay dividends to shareholders because they tend to use cash to their advantage, such as empire building, greater rewards, job security and building political relationships.

Fourthly, a positive and statistically significant relationship exists between RET and cash holding in models 4 (coefficient = 0.04509, sig = 0.0001 < 1%) and 5 (coefficient = 0.05584, sig = 0.0008 < 1%). Therefore, H4 is accepted: a positive association exists between RET and cash holding. The result is consistent with that of (Boyle and Guthrie, 2003) who indicated the need for a high level of cash holding in companies to avoid dependence on high-cost external sources of financing and to benefit from internal sources of financing. As a result, companies have to hold more cash (Ferreira and Vilela, 2004) because they prefer internal rather than external sources of funding (Ozkan and Ozkan, 2004). In this context, cash holding can be justified by companies' need to finance their investments (Mikkelson and Partch, 2003) according to pecking order theory.

Fifth, a negative and statistically significant relationship exists between cash holding and the decision to finance with debt, regardless of whether it is short- or long-term debt. Companies need to maintain more liquidity to reduce the risks of external financing and take advantage of available investment opportunities. This finding is in line with the results of other studies (Ferreira and Vilela, 2004; Tiago and Caldeira, 2014; Ha and Tai, 2017) that have found a negative relationship between total debt and cash holding. We divided the total debt into short- and long-term debt to verify the previous result, and the results are as follows:

* A negative and statistically significant relationship exists between SDR and cash holding in models 4 (coefficient = -0.05619, sig = 0.002 < 1%) and 5 (coefficient = -0.07146, sig = 0.0009 < 1%). Therefore, H5a is accepted: a negative association exists between SDR and cash holding. This finding is consistent with the results of (Tiago and Caldeira, 2014; Ha and Tai, 2017.)

* A negative and statistically significant relationship exists between LDR and cash holding in models 4 (coefficient = -0.033884, sig = 0.0264 < 5%) and 5 (coefficient = -0.033335, sig = 0.0690 < 10%). Therefore, H5b is accepted: a negative association exists between LDR and cash holding. This finding is consistent with the results of (Ferreira and Vilela, 2004 ; Tiago and Caldeira, 2014; and Ha and Tai (2017).

[Insert Table VI here]

5. Additional tests and robustness check

We perform additional tests to check whether the previous results are robust in the face of alternative modelling specifications and to ensure that our results are free from potential endogeneity issues. The objective is to address the endogeneity problem, which is caused by the measurement errors, time-invariant endogenous variables and reverse causality (Yamani and Rakowski, 2019). We also re-estimate Eqs. (1)–(5) by applying the dynamic system generalised method of moments (GMM) estimation technique for robustness checks. The GMM has superior ability in addressing the potential endogeneity and serial correlation issues (Bond, 2002; Jabbouri and Almस्ताfa, 2020; Grassa et al., 2021). In general, dynamic endogeneity refers to the endogeneity that arises when the current values of explanatory variables are related to past values of the dependent (Yamani and Rakowski, 2019). Many variables can affect previous relationships, such as the ownership of the royal family, whether the executive director or the chairman of the board belongs to the royal family. Many variables can also affect the share of the distributions, whether the executive director is the chairman of the board of directors, the size of the auditing company, the size of the board of directors and the percentage of independent members in the board of directors, the logarithm of the company's market value and the age of the company. One point to be emphasised is that Table (VII) also reports the results of the Sargan and Hansen test of over identifying restrictions and the Arellano-Bond test for autocorrelation error. The Sargan test and Hansen test yield all p-values above 0.10, which means that a null hypothesis could not be rejected. Hence, overidentification restrictions are valid. The AR (1) tests indicate that the residuals in first differences are correlated as expectation, while the AR (2) tests give p-values above 0.10, which means that a null hypothesis of no second-order serial correlation could not be rejected. Therefore, the results extracted from GMM are reliable (Le,2015; Bhat et al.,2020).

[Insert Table VII here]

Table VII shows an agreement in the results between the OLS regression and GMM. A positive and statistically significant relationship exists between PCs and internal financing decisions (RET), whereas a negative and statistically significant relationship exists between PCs and external financing decisions (LDR and SDR). Also that is, a positive and statistically significant relationship exists between cash holdings and PCs and internal financing decision (RET), whereas a negative and statistically significant relationship exists between cash holdings and external financing decision (LDR and SDR)

6. Conclusions

PC is a dominant institutional characteristic in most countries, and they represent a key element in shaping the economic environment and the functioning of the capital market. In the GCC countries, one of the most common types of firms is the firms controlled or owned by the royal family. We apply the fixed effect model to examine the relationship amongst PCs, financing decisions and cash holdings based on a total of 1448 firm-year observations from six countries. We also apply the dynamic system-GMM technique as a robustness check to alleviate the endogeneity concern.

We found that PCs have a positive effect on cash holdings and internal financing through retained earnings. The justification for this is that companies with PCs prefer internal financing through retained earnings, and therefore, they keep cash to finance their investments. According to the agency's view of the politically connected companies, these companies are expected to retain more liquidity. However, these companies' cash holding is not to meet transaction costs, precautionary measures or to meet future investment requirements, as typical companies do, but rather out of private interests (Amara and Khlif, 2020; Opler et al.,1999) argued that opportunistic managers keep cash rather than pay dividends to shareholders because they tend to use cash to their advantage, such as empire building, greater rewards, job security and building political relationships. On the contrary, a negative relationship exists between PCs and the decision to finance debt (whether short- or long-term debt). We also found a negative relationship between the decision to finance with debt (whether short- or long-term debt) and cash holdings. The main contribution of this study is to obtain empirical evidence about the impact of the presence of members of the royal family in the board of directors of companies on financial decisions, such as financing with retained earnings and short- or long-term debt, and examining the impact of PCs and financial decisions on the cash holdings in GCC countries

Our finding is beneficial for corporate stakeholders to better understand the role of politically connected directors and particularly the presence of a royal family member in the board of directors linked with financing decisions on cash holdings in the GCC. Firstly, in terms of the regulatory authorities, the results of this study can help formulate regulations for appropriate corporate governance, including the role of royal family members in the board of directors. In the (GCC) stock markets, which are considered emerging markets with low protection for small investors, our findings recommend policymakers to develop more effective policies for listed firms to mandatorily provide information on the political positions of members of the board of

directors, managers and major shareholders/owners in companies. Secondly, investors and lenders will have a better understanding of the impact of PCs when making their investment decisions. Moreover, this study helps provide important information about the business environment and conditions. In investing in developing countries, such as GCC, investors and financial analysts must consider the existence of PCs for companies before making investment decisions and not rely on published narrative and financial disclosure alone.

Our study has some limitations. However, these limitations will certainly point to potential research directions. Firstly, the research was limited to the time period from 2009 to 2016 for a sample of 181 companies. Thus, future studies can extend our study by increasing the sample size and covering a longer period of time (i.e. before and after the COVID-19 pandemic). Secondly, the PCs were measured using a dummy variable coded as 1 for politically connected firms and 0 if otherwise. The PCs were limited to the presence of members of the royal family on the board of directors. Therefore, future research could measure PCs with alternative measures (e.g. the proportion of government ownership, the proportion of royal family ownership and the percentage of politicians in the board of directors). Thirdly, this research was limited to the use of linear regression analysis, and therefore, future research may study the same previous relationships using nonlinear regression or structural equation models. Fourthly, financial decisions were limited to internal financing with retained earnings and external financing with debt and cash holdings. Therefore, future research may study the impact of PCs on decisions to issue shares and the cost of financing with shares, including the impact of PCs on the issuance of bonds and the cost of financing with bonds.

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Table (I) Distribution of the sample companies selected from the GCC

The state	Saudi Arabia	Oman	UAE	Qatar	Kuwait	Bahrain	TOTAL
The number of firms with PCs	20	14	9	5	2	1	51
The number of firms that do not have PCs	49	50	14	8	4	5	130
Total number of Selected firms	69	64	23	13	6	6	181
Number of observations	552	512	184	104	48	48	1448

Table (II) Methods of measuring the various research variables

variables	symbol	Measurement	Source
Cash holdings	CTA	Cash and cash equivalents/(Total assets – cash and cash equivalents)	Guizani and Abdalkrim (2021)
	CASHTA	Cash holdings to total assets	Ferreira and Vilela (2004), Ha and Tai (2017), Jabbouri and Almustafa (2020)
Internal financing	Retained earnings ratio (RET)	(Retained earnings + provisions)/total assets	Zhang and Chen (2017), Thompson and Adasi (2021)
External debt financing	Short-term debt ratio (SDR)	short-term debt to total assets	Tiago and Caldeira (2014), Ha and Tai (2017)

	Long-term debt ratio (LDR)	Long-term debt to total assets	Ha and Tai (2017), Zhang and Chen (2017), Wans (2017)
Political connections	PC	Dummy variable coded as 1 for politically connected firms and 0 otherwise	Hashmi et al., (2018), AL Nasser (2020)
Firm size	size	The natural logarithm of total assets	Guizani and Abdalkrim (2021), Al Amosh and Khatib (2021a)
Net working capital	NWC	Current assets – current liabilities-cash and cash equivalents divided by total assets	Ranjee and Pathak (2019), Guizani and Abdalkrim (2021)
Firm profitability	ROA	Net income divided by total assets at the beginning of the year	Jabbouri and Almustafa (2020), Al Amosh and Khatib (2021b)
Cash flow from operations	CFO	Cash flow from operating activities divided by beginning total assets	Hashmi et al., (2018), Guizani and Abdalkrim (2021)
Market-to-book ratio	MTB	(The market value of equity /Total assets	Çam and Özer (2021)
Liquidity	LIQ	Current assets divided by current liabilities	Jabbouri and Almustafa, (2020)
Dividend per share	DPS	Cash dividends divided by number of shares outstanding	Boshnak (2021)
Inflation	INF	Annual inflation rate, Growth in Consumer Price Index (CPI).	Ezeani1 et al., (2021)
Economic growth	GDP	Growth in nominal Gross Domestic Product (GDP)	Ezeani1 et al., (2021)
Duality	DUA	A dummy variable that equals 1 if the CEO is also the chairperson, and 0 otherwise	Alzeban (2020), Jesuka and Peixoto (2022)
Earnings Per Share	EPS	net profit per share	Liu and Mehran (2015)

Table (III) Descriptive statistics

Variables	Mean	Median	Maximum	Minimum	Std. Dev	Skewness	Kurtosis
RET	0.1538	0.159	07185	-2.754	0.273	-1400	7.280
SDR	0.0799	0.046	0.645	0.000	-0.093	1.634	5.960
LDR	0.098503	0.051	0.645	0.000	0.1252	1.564	4.872

CTA	0.077	0.045	0.800	0.000	0.093	2.949	15.40
CFO	0.084	0.073	0.592	-0.385	0.091	0.482	5.232
SIZE	5.789	5.806	11.66	1.175	1.880	0.158	2.861
MTB	3.289	1.582	13.96	0.000	5.149	5.778	31.42
NWC	0.089	0.080	0.703	-0.299	0.123	0.452	3.435
PC	0.268	0.000	1.000	0.000	0.443	1.044	2.091
LIQ	2.091	1.549	21.28	0.0112	1.818	4.096	32.76
ROA	0.055	0.049	0.328	-0.370	0.075	-0.149	5.709
DPS	0.232	0.051	2.136	0.000	0.392	2.319	8.051
INF	0.025	0.026	0.058	-0.048	0.017	-0.471	4.696
GDP	0.040	0.044	0.195	-0.134	0.036	0.031	6.875
DUA	0.042	0.000	1.000	0.000	0.201	4.538	21.60
EPS	0.417	0.169	3.800	-1.736	0.702	1.765	6.889

Notes: See Table (II) for variables definitions

Table (IV) Hausman test results

Regression model	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	Result
1	64.469	12	0.0000	Null hypothesis is rejected. Hence, Fixed effects Model, FEM are the best
2	61.200	12	0.0000	
3	52.349	12	0.0000	
4	56.256	15	0.0000	
5	58.258	15	0.0000	

Table V: The correlation matrix of the research variables

	SDR	LDR	RET	CTA	PC	SIZE	ROA	MTB	LIQ	NWC	CFO	GDP	INF	DPS	EPS	DUA
SDR	1															
LDR	0.0089	1														
RET	-0.143	-0.11	1													
CTA	-0.300	-0.14	0.21	1												
PC	-0.103	-0.03	0.15	0.150	1											
SIZE	-0.078	0.32	0.24	-0.007	0.226	1										
ROA	-0.230	-0.199	0.57	0.22	0.09	0.03	1									
MTB	-0.151	-0.111	0.039	0.24	0.135	0.137	0.12	1								
LIQ	-0.345	-0.154	0.20	0.42	0.06	-0.119	0.177	0.26	1							
NWC	0.291	-0.13	0.002	-0.20	-0.06	-0.29	0.027	-0.063	0.138	1						

CFO	-0.209	-0.130	0.390	0.18	0.04	0.039	0.65	0.116	0.084	0.10	1						
GDP	0.054	0.039	0.022	0.065	0.046	-0.054	0.043	0.009	-0.052	0.027	0.008	1					
INF	-0.041	0.061	-0.086	-0.007	0.100	-0.007	0.082	0.181	0.101	0.022	0.035	-0.10	1				
DPS	-0.098	-0.086	0.348	0.079	0.231	0.199	0.449	0.241	0.038	0.051	0.33	0.007	0.013	1			
EPS	-0.173	-0.083	0.391	0.158	0.205	0.164	0.592	0.233	0.052	0.058	0.44	-0.02	0.064	0.72	1		
DUA	-0.012	0.032	0.034	0.008	0.038	0.105	0.342	0.015	0.052	-0.053	0.017	-0.18	0.015	0.086	0.110	1	

Notes: See Table (II) for variables definitions

Table (VI): Regression result of FEM

Variables	Model 1 (RET)	Model 2 (SDR)	Model 3 (LDR)	Model 4 (CTA)	Model 5 (CASHTA)
	Coefficient/ Sig	Coefficient/ Sig	Coefficient/ Sig	Coefficient/ Sig	Coefficient/ Sig
C	0.0563***	0.1551***	-0.0306**	0.0349***	0.0447***
SIZE	0.0101***	-0.0100***	0.0250***	0.0019*	0.0006
ROA	1.2246***	-0.2297***	-0.3920***	0.1034***	0.0944*
MTB	-0.0050***	-0.0001	-0.0033***	0.0002	-0.0003
LIQ	0.0173***	-0.0142***	-0.0023	0.0103***	0.0138***
NWC	-0.0080	0.1621***	-0.0258	-0.0970***	-0.1160***
CFO	0.1350**	-0.1840***	0.0329	0.0491*	0.0420
PC	0.02682**	-0.0175**	-0.0218***	0.0124***	0.0140**
GDP	-0.3462	0.0388	0.2679***	0.1119**	0.0094
INF	-1.6878	-0.1339	0.6230**	-0.2568**	-0.0525
DPS	0.0403***	0.0319***	-0.0212*	-0.0232***	-0.0241***
EPS	0.0057	-0.0049	0.0131*	0.0043	0.0086
DUA	0.0306	-0.0035	-0.0027	0.0017	0.0164
RET				0.0450***	0.0558***
SDR				-0.0561***	-0.0714***
LDR				-0.0338**	-0.0333*
R-squared	0.4142	0.3198	0.2725	0.44708	0.3734
Adjusted R-squared	0.4063	0.3012	0.26981	0.43545	0.36871
F-statistic	53.092	38.898	31.229	55.211	42.257
Prob(F-statistic)	0.000	0.000	0.000	0.0000	0.000

Notes: Table (VI) presents OLS Panel data (fixed effect model) regression estimations and The variables are as reported in *, **, *** Significant at 10, 5 and 1 percent levels, respectively. See Table (II) for variables definitions

Table VII the results of GMM

Variables	Model 1	Model 2	Model 3	Model 4	Model 5 (CASHTA)
	(RET)	(SDR)	(LDR)	(CTA)	
	Coefficient/ Sig	Coefficient/ Sig	Coefficient/ Sig	Coefficient/ Sig	Coefficient/ Sig
C	0.1387***	0.2944***	-0.2118***	0.3845***	-0.0013
SIZE	0.0101**	-0.0314***	0.0330***	-0.0355***	0.0018
ROA	3.9618***	0.3488	-0.4506	0.6577***	0.2870*
MTB	-0.0089***	0.0126***	-0.0103***	0.0191***	0.0035
LIQ	0.0292***	-0.0511***	0.0244**	-0.0488*	0.0495***
NWC	-0.0896	0.7810***	-0.2234	1.5375**	-1.2730***
CFO	-1.2488***	-0.2670***	-0.2141*	-0.3395*	0.3434***
PC	0.0522***	-0.0531*	-0.0471*	0.2245***	0.0951**
GDP	-0.7859*	-1.1349*	2.6703***	-0.5839	0.7625***
INF	-4.7677***	-0.9865**	2.3251***	-1.3982***	-0.9508***
DPS	0.7613***	0.0423	-0.0591*	-0.1224*	-0.2771***
EPS	-0.4909***	-0.0421	0.0657	-0.0508*	0.0047
DUA	0.0152	0.0869	-0.1406***	0.2173***	0.1620**
RET				0.2338***	0.2438***
SDR				-1.6393***	-0.8236**
LDR				-0.3769**	-0.3709***
AR (1) in first differences (p-value)	0.0025***	0.01334*	0.0091***	0.00114***	0.00918***
AR (2) in first differences (p-value)	0.3301	0.6123	0.2691	0.5012	0.5937
Hansen-J test (p-value)	0.3689	0.4951	0.4350	0.3925	0.3538
Sargan test (p-value)	0.6894	0.2943	0.3296	0.4960	0.2761

Notes: Table (VII) presents the results of re-estimating our models using the Dynamic System GMM approach. The variables are as reported in *, **, *** Significant at 10, 5 and 1 percent levels, respectively. See Table (II) for variables definitions.