The Role of Environmental, Social, and Governance Performance on Attracting Foreign Ownership: Evidence from Saudi Arabia

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Abstract: This research aims to examine whether corporate social responsibility (CSR) and corporate governance (CG) attract foreign investors as key indicators of a firm’s sustainability. By adopting both stakeholder theory and legitimacy theory, it is assumed that a firm could build trustworthiness and legitimacy with its stakeholders by enhancing its environmental, social, and governance (ESG) performance. Using a sample of 110 firms from the Saudi stock market from different industries, this study employs both OLS and System-GMM estimation to test the effect of both ESG performance and CG on foreign investment in Saudi Arabia. The findings indicate that ESG performance positively affects foreign investment. Additionally, it is found that the corporate governance score has a greater effect than social and environmental scores. These empirical findings suggest that companies in Saudi Arabia should adopt global schemes to improve ESG performance to maximize the share of foreign investment, thus boosting the country’s economy and increasing the level of competitive advantages and sustainability.

Keywords: corporate social responsibility; foreign investment; ESG performance; corporate governance; stakeholder theory; legitimacy theory

1. Introduction

It is widely known that corporate social responsibility (CSR) plays a vital role in enhancing corporate sustainability and improving reputation [1]. More recently, huge amounts of attention have been paid, especially in emerging markets, to how a firm discloses CSR practices in its financial reports in a way that impresses the firm’s stakeholders [2]. More importantly, it is a major interest of any firm to attract foreign investment, as this is a key indicator of enhanced competitive advantages amongst peer firms. Good CSR disclosure can also reflect good corporate governance practices, which may distinguish a firm from others. The fundamental concept of CSR is to enhance a firm’s concern of environmental, social, and even governance aspects, and these efforts are considered by top management departing from well-known financial actions motivated solely by achieving firm profitability [3]. In Saudi Arabia, a key developing economy in a region that has improved rapidly in the last five years, most large firms reference CSR in their annual reports. This is not only to adhere to corporate governance policies but also to satisfy the various needs of stakeholders including shareholders, investors, employees, and the wider community.

The rising interest in CSR in Saudi firms follows the introduction of the Saudi Vision 2030 in 2016, which pays significant attention to social responsibility and its practices in the local community. Additionally, the improvement in corporate governance in the same vision plays a role in motivating Saudi firms to start publishing their CSR and other initiatives that help different parties in the Saudi community. The CSR strategy was launched in 2020 and aimed at promoting corporate social responsibility, which is a part of the national transformation program in the Ministry of Human Resources and Social
Development. The strategy includes analyzing the reality of corporate social responsibility in the Kingdom and conducting a standard comparison of the international best practices in the field. Its vision was to establish a culture of social responsibility in all developing sectors to enhance corporate contributions to social responsibility programs, which have a vital impact on the development of the local society, environment, and whole economy. This strategy also aims to establish a social responsibility infrastructure by activating social responsibility capabilities represented by six pillars: partnerships and governance, laws and regulations, national planning, motivation and encouragement, awareness and capacity development, and monitoring and measurement.

The concentration on CSR in Saudi Arabia comes from its vision and reforms applied to various aspects of the economy to open it to the global economy and host foreign investment, which is believed to boost the local economy and sustainability [4]. Even though the institutionalization of CSR in Saudi firms is still growing, most firms have followed these orientations since 2016 and confirm that they are willing to enhance CSR practices and show them in their annual reports. However, it is difficult to predict the determinants of CSR disclosure in Saudi firms. Additionally, foreign investment rules are also being modified to allow more foreign equity to enter the Saudi stock market, either in the form of individual investors or via direct investment by large foreign corporations. Hence, the rise of foreign investment witnessed recently could be explained by the disclosure of CSR by Saudi firms, which researchers have not yet examined in this field.

However, prior research discusses the difficulties for foreign investors when deciding to invest in a host country [1,5]. This is mainly due to uncertainty and information asymmetry that could be increased in the case of foreign investment. Hence, corporations that put more emphasis on enhancing ESG performance could reduce the level of uncertainty and improve trustworthiness [6]. Accordingly, and based on the Stakeholder theory, a firm should facilitate all its stakeholders’ needs [7]. This can be achieved by improving the level of disclosure and increasing its accountability towards those stakeholders. As a result, these actions will also build a solid and trustworthy relationship between the host firm and foreign investors [8]. Legitimacy theory also provides a theoretical framework that could explain this relationship. That is, firms that improve their ESG performance in various ways following global CSR standards may seem more legitimate and trustworthy to foreign investors [9]. Improving corporate governance is another benchmark for foreign investors who wish to see that their host firm is adopting good corporate governance schemes that alleviate its legitimacy and trustworthiness.

This research aims to examine whether ESG performance and CG can attract foreign investment as key indicators of good performance and sustainability. This research contributes to the existing literature on CSR. Although the empirical literature on CSR is rapidly growing, it still provides inconsistent findings when explaining the rationale of the relationship between CSR and foreign investment. This may be justified by the presence of too many proxies that could affect these types of relationships. This research adopts two critical theories that may clarify the association between improving ESG performance as a tool of CSR and the magnitude of foreign investment. Furthermore, most prior literature is limited to foreign direct investment (FDI) and its impact on CSR [10–14]. However, regardless of the economic importance of FDI for corporations and countries, the literature neglects the importance of attracting individual foreign investors who can improve the governance practices of the stock market and increase liquidity [15]. This research aims to provide empirical findings that justify why ESG performance is important for foreign investors.

Given the nature of Saudi Arabia and the recent global focus on the significant reform of its economy, which is one of the fastest-growing economies in the region, this research was conducted on Saudi firms for two reasons. First, the notable reforms in CSR that have been witnessed amongst Saudi firms in the last five years could be crucial and informative if they are investigated alongside the growth in foreign investment. Second, the parallel improvement in corporate governance in Saudi Arabia can be linked to the
increase in foreign investment percentage, which jumped by 150% in 2021 compared to 2018. Taken together, theoretically and empirically, this research is expected to fill the gap in the literature on CSR, CG, and foreign investment, especially in emerging markets.

The rest of the study is organized as follows. The next section illustrates the theoretical and empirical literature on the relationship between CSR, CG, corporate performance, and foreign investment. This also includes a discussion of hypotheses development. Section 3 presents the sample and methodology, followed by regression results and a discussion in Section 4. The final section summarizes the research conclusions, implications, and limitations.

2. Literature Review and Hypotheses Development

2.1. Theoretical Background of CSR

The argument of corporate social responsibility for businesses by the well-known author Milton Friedman was originally conceived in 1970. It is argued that the only social responsibility for a firm is to maximize its profit, and that other objectives are incompatible with this objective [16]. Most neoclassic theorists support this thought by Friedman and his belief that this is what shareholders want from a business where they invest their money [17]. However, the modern economy has changed according to different business environments and various thoughts regarding the objective of CSR and what responsibilities organizations have in terms of their communities. Freeman [7] criticized Friedman’s belief by introducing the concept of stakeholder theory which advocated that there are other stakeholders, such as employees, suppliers, customers, government, and communities, who have different interests from those of shareholders; the theory emphasizes these stakeholders’ needs, which should receive more attention by firm decision makers. By the end of the twentieth century, the business environment had become more complex, and consumers were more demanding. Recourses also became more limited, creating more problems regarding the supply chain. Technological development created another dilemma in that a business’s stakeholders became aware of all the activities conducted by the business. All of these rapid changes drew attention to what Friedman advocated and what the business environment currently needs, in addition to what a business can do for society and the people living in it.

The limitation of the classical model and the development of business needs and environment in the 21st century encourage the debate of whether CSR is needed and, more importantly, what is demanded by stakeholders of corporations. This is associated with the concept of shared value creation introduced by Porter and Kramer [18], which is based on the idea of identifying and expanding the connections between societal and economic progress. They build on the theoretical background of CSR by addressing critical differences between corporate share value creation and CSR. While CSR is about performing good work, share value creation links societal and economic benefits to cost. Additionally, According to Porter and Kramer [18], the connection between corporations and society should be in the context of share value creation. The share value strategies concentrate on shifting from capitalism into a more sustainable social, environmental, and economic paradigm. Corporate philanthropy should be embedded in the strategic giving that helps society and simultaneously evolves corporate competitive advantage [19]. However, seeing CSR always as only the performance of good work is questioned by Morsing and Vallentin [20] and Falck and Heblich [21], who argued that there is a possibility that companies that are performing good work in the context of CSR are corrupt in their underlying structure, thus hiding weak performance.

CSR was defined originally by Bowen [22] as “the social obligation”. García-de-Madariaga and Rodriguez-de-Rivera-Cremades [17] defined CSR as “the set of obligations and lawful and ethical commitments with stakeholders, stemming from impacts of activities and operations of firms cause on social, labour, environmental and human rights fields”. The concept of CSR has evolved over time; Chandler [23] added to the theoretical concept of CSR by building on Porter and Kramer [18]’s perspective of value creation as one of the
strategic CSRs. He states that “the firm creates the most value when it focuses on what it does best, which is defined by its core operations”. Chandler [23] defined the strategic CRS as “the incorporation of a holistic CSR perspective within a firm’s strategic planning and core operations so that the firm is managed in the interests of a broad set of stakeholders to optimize value over the medium to long term” [23].

Furthermore, based on legitimacy theory, it can be said that corporations are required to pay attention to the internal and external expectations of stakeholders, which may not necessarily be profit-maximizing, but rather involve increasing self-regulation and legitimacy [9,24,25]. By doing this, corporations can maximize their profit and, more importantly, their value in the community by applying good CSR schemes and disclosing them in their annual reports. However, it is not easy to say that CSR will improve performance; this is because of the numerous intersectional relationships and indicators that can predict firm performance (e.g., corporate governance, market share, reputation, geographical indicators, and other indicators); thus, the empirical literature should be reviewed to paint a full picture of CSR and its effect on firm performance and consequently attract foreign investment.

Based on the above review of the key theoretical concepts that could provide a relative explanation of the relationship between CSR, CG, and foreign investment, it could be said that stakeholder theory provides a framework for how a corporation should satisfy the various needs of a group of stakeholders, including foreign investors [26]. This can be accomplished by improving corporate policies and disclosure criteria that reduce risk-taking, uncertainty, and information asymmetry. The theory highlights that corporations need to focus on targets other than profit-maximizing and engage in more social and environmental actions that improve the whole community. When doing so, foreign investors may trust and invest in these host firms. Legitimacy theory also explains this relationship from the other side. Foreign investors can build trustworthy relationships with corporations that engage in social actions within societal boundaries and norms [27].

2.2. Literature Review

Whether or not CSR positively affects firm value is examined in the literature. The stakeholder theory presented by Freeman [7] suggests that CSR can improve the well-being of all firm stakeholders and maximize the firm’s competitive advantages by building a trustworthy relationship with various stakeholders [28–30]. Several prior studies showed a positive impact of CSR on corporate financial performance (CFP) [8,31–41]. However, several studies found no evidence of a positive association between CSR and financial performance [42,43]. Additionally, some studies found a negative association in this relationship [44,45]. A few studies showed that the relationship between CSR and CFP is non-linear and may have a U-shaped relationship if the cost of CSR is considered and examined [46–48]. Similarly, Kabir and Thai (2021) found that foreign ownership, international orientation, gender diversity, and CEO education positively influence CSR.

The moderating role of corporate governance on CSR is also widely investigated in the literature [25,49–59]. Money and Schepers [50] showed evidence that UK companies shifted from the agency theory concept, which concentrates on shareholders’ expectations only, to the broader concept of stakeholders. They found an alignment between corporate governance and CSR programs. Similarly, Jamali et al. [60] provided evidence from qualitative approach outcomes that top management in Lebanon believes that corporate governance is a significant pillar of sustainable CSR. Huang [51] and Tibiletti et al. [59] also found that the presence of independent outside directors positively affects CSR performance. Esa and Gazali [53] investigated whether corporate governance affects the level of CSR disclosure in Malaysian government-linked companies, and they concluded that the board size has a positive impact on CSR disclosure. On the contrary, Worokinasih and Zaini [25] and Kirana and Prasetyo [57] found that CSR disclosure is negatively affected by corporate governance indicators in Indonesian samples. Oh et al. [61] concluded that managerial ownership has a negative impact on CSR. Another stream of the literature found no significant relationship between corporate governance and CSR. Orbaningsih and Sawitri [56] found no influence
of managerial ownership, foreign ownership, and company size on CSR disclosure, but they found a positive influence of institutional ownership on CSR disclosure, similar to what Harjoto and Jo [52] found. Yahaya and Apochi [58] concluded that board size and independence fail to show a significant impact on CSR in Nigerian companies.

Another aspect of the literature links the quality of CSR disclosure with foreign investment, either direct or indirect [62]. Most of these studies show that high-quality CSR disclosure is associated with firms that have a higher proportion of foreign ownership [41,56,63–65]. A few studies have shown that firms that are superior in their CSR performance are more likely to attract foreign investment [1,61,66]. Lee et al. [1] examined whether the CSR performance of the host firms can increase their foreign investments. By using a sample from the Korean stock market, they concluded that higher CSR performance is associated with higher foreign investment, meaning that improved CSR disclosure could attract foreign equity to the firm. In a similar vein, Chauhan and Kumar [66] examined the effect of disclosing non-financial data to foreign investors using a large sample of Indian firms. They concluded that foreign investors prefer to invest in firms that disclose CSR information.

2.3. Hypotheses Development

Based on the theoretical and empirical literature, socially responsible firms could be a target for foreign investors [61]. By adopting both stakeholder theory and legitimacy theory, it is assumed that a firm could build trustworthiness and legitimacy with its stakeholders by engaging in more environmental and social actions. Investors know what the host firm should do and, more importantly, what it should not do. Irresponsible actions that are taken by the host firm could negatively affect future decisions that are taken by investors. According to Panicker [67], foreign investors differ from domestic ones in three ways; first, foreign investors are likely to pay more attention to the sustainability and the survival of the host firm, especially if their investment is in the long-run time horizon. Firms participating in social actions and responding to their communities are believed to maintain sustainable development [65]. Second, foreign investors are more aware of environmental and social issues due to their experience in multiple foreign markets, which gives them a higher level of responsibility toward the social community [63]. Third, the problem of information asymmetry is rising more in the case of foreign investors since the separation of shareholders and management is active as one of the corporate governance concepts [65,68].

Based on the previous discussion, it is assumed that foreign investors demand more social and environmental engagement from their host firms to reduce the level of risk and uncertainty [1]. This engagement should also be declared clearly in the company’s reports. This is mainly to provide a transparent vision and positive impression for potential investors [69,70]. Furthermore, top management may be aware that foreign investors seek low-risk businesses and low information asymmetry when they decide to invest in a foreign country. Hence, top management may take more decisions with the aim of increasing ESG performance to influence investors and attract them to their companies. Taken together, it is assumed that improving ESG performance could positively affect the magnitude of foreign ownership over time. Accordingly, the main research hypothesis can be set as follows:

**Hypothesis 1:** ESG performance has a positive impact on foreign ownership.

CSR in Saudi firms is usually classified into three major categories: (I) social, (II) environmental, and (III) governance. The social scheme mainly includes donations, health and safety, human rights, employees, and community welfare. The environmental scheme includes emission reduction, product innovation, source consumption, recycling, and afforestation. The governance scheme includes governance applications that raise the sense of responsibility, accountability, fairness, and transparency [71]. These include governance indicators such as ownership structure, board composition, executive compensation, and level of disclosure in annual reports. It is assumed that a rational foreign investor may follow one of the three main indicators of ESG. Those investors may be more attracted
to social actions that are taken by the host firm. Similarly, it could be said that foreign investors are willing to see more environmental protection schemes from their host firm. Also, the importance of corporate governance is not less than the other two previous indicators. Hence, breaking the main hypothesis further into three sup-hypotheses may provide additional explanation of the relationship between foreign ownership and ESG performance. This study follows Ortas [72] in breaking down the ESG performance of these three groups. This is expected to provide precise results related to each proxy. It also tests which of the three groups has the highest effect on foreign ownership. This study breaks Hypothesis 1 further down into three sup-hypotheses:

**Hypothesis 1a:** The social score has a positive impact on foreign ownership.

**Hypothesis 1b:** The environmental score has a positive impact on foreign ownership.

**Hypothesis 1c:** The governance score has a positive impact on foreign ownership.

3. Sample and Methodology

The initial sample included 184 listed firms in the Saudi stock market (Tadawul). Due to the exclusion of firms that suffer from insufficient data either in foreign ownership or CSR score, the final sample covered 110 firms from different industries, including financial firms from 2017 to 2021, with around 550 firm-year observations. With respect to data sources, financial data, corporate governance data, and foreign ownership data were collected from the Saudi stock market (Tadawul), the sample was built using the data of Alregab [4], and we expanded the period to cover the latest years. Data for ESG performance were gathered from the CSRhub database, which has been ranked among the top five sustainability ratings in the world [73–75].

To test the research hypotheses, a regression analysis was employed for all models using both OLS and System-GMM estimation, and the study uses pooled OLS to identify the initial relationship between the dependent variable and explanatory variables. However, it is known that OLS may present incorrect results, especially in the types of relationships that may show endogeneity [76]. Hence, the use of the System-GMM estimator was mainly for accommodating the expected endogeneity in regression models by employing instruments and lagged variables. The main model was tested based on the following formula [1]:

\[ FO_{it} = \beta_0 + \beta_1 FO_{it-1} + \beta_2 CSR_{it-1} + \beta_2 GOVERNANCE_{it} + \gamma_2 CONTROL_{it} + \varepsilon_{it} \]

where:
- \( FO_{it} \): Foreign ownership of firm \( i \) for year \( t \);
- \( FO_{it-1} \): The lag of FO for one period of time;
- \( CSR_{it-1} \): The lag of corporate social responsibility score of firm \( i \) for year \( t \);
- \( GOVERNANCE_{it} \): governance variables, including ownership structure (OS) of firm \( i \) for year \( t \), board independence (BI) of firm \( i \) for year \( t \), and executive pay (EP) of firm \( i \) for year \( t \);
- \( CONTROL_{it} \): The logarithm of return on equity (LogROE), firm age (AGE), firm size (Ln SIZE), and leverage (LEV).

The CSR variable is broken further into three variables to be tested individually, as shown in the hypotheses. The first is social CSR (Soc CSR). The second is environmental CSR (Env CSR). The third is governance CSR (Gov CSR). Additionally, the logarithm of some variables was applied because of the skewness of the variable. The definitions of all variables are presented in Table 1.
Table 1. Variable definition and measurement.

| Variable | Definition |
|----------|------------|
| FO       | Foreign ownership is measured by the percentage of individual foreign ownership to total ownership [1,77]. |
| ESG      | The corporate social responsibility score (overall) is measured by the ESG score [78,79]. |
| Soc CSR  | Social CSR is the score for companies’ activities that are socially related, such as activities that serve employees and the community [72]. |
| Env CSR  | Environmental CSR is the score for environmental actions that are disclosed by companies [72]. |
| Gov CSR  | Governance CSR is the score for corporate governance benchmarks that companies apply according to global standards [72]. |
| CONCENT  | Concentration is measured by the percentage of largest owners to total owners [4]. |
| BoardInd | Board independence is measured by the percentage of independent directors to the total number of directors [80]. |
| LnEP     | The natural logarithm of executive pay is measured by the total compensation of the top executives [4,81]. |
| logROE   | The logarithm of return of equity is measured by the net income before extra-ordinary items divided by the book value of common equity [2]. |
| LnSIZE   | The natural logarithm of firm size is measured by the total assets [4]. |
| AGE      | Firm age is measured by the total years of a firm since establishment [82,83]. |
| LEV      | Leverage is measured by the ratio of total debt to total assets [2]. |

4. Results and Discussion

4.1. Descriptive Statistics

Table 2 presents descriptive statistics for all variables. The average percentage of total shares owned by foreign investors in Saudi firms is 8%, while the maximum percentage that can be owned by foreigners in Saudi Arabia is 49%. The mean of the total score of CSR is 40%. This score is still lower than for Saudi Arabia’s peers in developed countries, which show a score above 100% (Gamerschlag et al. 2011). Social, environmental, and governance CSR show a similar mean, which ranges from 36 to 39%, with a higher social score and a lower environmental score. The ownership structure shows a mean of 30%, which reflects the percentage of concentration in Saudi firms. Noticeably, some Saudi firms still suffer from significant concentrations, reaching 85% owned by the largest shareholders. However, this is not a negative sign in some circumstances; there are key firms that are owned by the Saudi Public Investment Fund (PIF). On average, board independence is around 52%, with the minimum for the least-independent boards at 12% and the maximum for fully independent boards is 79%. The average total executive pay in the sample is 11 million. The return on equity for the average firm in the sample is 7%, and the average total assets are 25 billion. Finally, firm leverage is 46% on average.

Table 2. Descriptive statistics.

| Variable | N  | Mean | SD  | Min  | Max  |
|----------|----|------|-----|------|------|
| FO       | 550| 0.080| 0.10| 0.22 | 0.66 |
| CSR      | 545| 0.40 | 0.33| 0.21 | 0.64 |
| Soc CSR  | 527| 0.39 | 0.25| 0.13 | 0.67 |
| Env CSR  | 515| 0.36 | 0.19| 0.17 | 0.70 |
| Gov CSR  | 532| 0.38 | 0.30| 0.12 | 0.79 |
| CONCENT  | 550| 0.30 | 0.16| 0.001| 0.49 |
| BoardInd | 550| 0.52 | 0.15| 0.12 | 0.79 |
| LnEP     | 510| 14.61| 1.035| 9.31 | 19.01|
| logROE   | 550| 0.07 | 0.12| −0.92| 1.13 |
| LnSIZE   | 550| 21.77| 1.934| 16.76| 26.84|
| AGE      | 550| 28.13| 14.15| 5    | 67   |
| LEV      | 550| 0.46 | 0.25| 0.12 | 0.86 |

The definition of all variables is presented in Appendix A Table A1.
4.2. Pearson Correlation Test

Table 3 shows a Pearson correlation test of study variables. It can be seen that foreign ownership is positively correlated with CSR variables, board independence, ROE, and firm size, and negatively correlated with firm leverage. Additionally, the correlation is high between CSR variables, which is expected since they are sub-score variables of the main CSR score. To account for the multicollinearity problem, this study applied separate models for each regression test. CSR is also positively correlated with board independence, ROE, and firm size. This may indicate that large firms, which show good performance and good governance, tend to be involved in more CSR activities in a prestigious manner. The correlation among independent variables is acceptable since it is below 50%, according to Bryman and Cramer (2001), where the correlation between independent variables can be a serious problem if it exceeds 80%.

Table 3. Correlation matrix.

|      | FO  | CSR | Soc CSR | Env CSR | Gov CSR | CONCENT | BoardInd | LnEP | logROE | LnSIZE | AGE | LEV |
|------|-----|-----|---------|---------|---------|---------|----------|------|--------|--------|-----|-----|
| (1)  | 1   | 0.42* | 0.33* | 0.35* | 0.41* | 0.09* | 0.29* | 0.15 | 0.56* | 0.62 | 0.02 | -0.22* |
| (2)  |     | 1   | 0.40* | 0.76* | 0.69* | 0.05 | 0.11* | 0.01 | 0.12 | 0.50 | 0.24 | -0.10 |
| (3)  |     |     | 0.89* | 1     | 0.76* | 0.17 | 0.89 | 0.19 | 0.24 | 0.76 | 0.26 | -0.09 |
| (4)  |     |     |       | 0.66* | 1     | -0.11* | 0.66 | 0.43 | 0.44* | 0.16 | 0.43 | 0.05 |
| (5)  |     |     |       |       | 1     | 0.16 | 1    | 0.16 | 0.11 | 0.16 | 0.02 | 0.10 |
| (6)  |     |     |       |       |       | 1    | 1    | 1    | 0.16 | 1    | 0.46 | 0.18 |
| (7)  |     |     |       |       |       |      |      |      |      |      |      | 0.02 |

Pearson correlation coefficients. * Statistical significance at the 5% level.

4.3. Regression Results

Table 4 presents the OLS results of regressing the direct effect of all CSR variables on FO. The direct effect of the total score of CSR and the sub-score of social, environmental, and governance responsibility are shown in Models (1)–(4). The results show that the regression coefficients of all CSR variables are positive and statistically significant. This indicates that a firm’s CSR score positively affects foreign ownership. The effect of governance variables is shown in Models (5)–(8). It is found that concentration (CONCENT) and board independence (BoardIN) have a positive impact on FO, and it is statistically significant. Additionally, firm size and ROE show a positive and significant impact on FO in all regression models.

Table 4. Direct effect of CSR on FO: pooled OLS regression.

| Dependent Variable | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
|--------------------|-----|-----|-----|-----|-----|-----|-----|-----|
| CSR                | 0.35** | (0.02) | &nbsp; | &nbsp; | 0.48* | (0.02) | &nbsp; | &nbsp; |
| SOCIAL             | 0.60** | (0.39) |     | &nbsp; | 0.53* | (0.32) | &nbsp; | &nbsp; |
| ENVIRON            |     |     | 0.19** | (0.22) |     | 0.36* | (0.23) | &nbsp; |
| GOV                |     |     |     | &nbsp; | 0.46** | (3.46) | &nbsp; | 0.04** | (1.97) |
| CONCENT            |     |     |     |     |     |     | 0.43* | (0.01) | 1.07* | (0.01) | 0.36* | (0.01) | 0.18** | (3.93) |
Table 4. Cont.

| Dependent Variable | FO | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
|--------------------|----|-----|-----|-----|-----|-----|-----|-----|-----|
| BoardIN            |    | 1.08 * | 3.04 * | 1.64 * | 1.64 * | 0.65 * |     |     |     |
|                    |    | (1.97) | (1.61) | (1.08) | (1.06) |       |     |     |     |
| LnEP               |    | 0.39 | 1.38 | 0.94 | 14.82 |       |     |     |     |
|                    |    | (0.74) | (0.57) | (0.38) | (7.97) |       |     |     |     |
| LogROE             |    | 0.93 ** | 0.06 ** | 0.16 ** | 0.91 ** | 0.29 ** | 0.59 * | 0.01 * | 0.36 ** |
|                    |    | (1.97) | (1.61) | (0.93) | (2.02) | (1.97) | (1.63) | (0.05) |     |
| LnSIZE             |    | 0.18 * | 0.93 ** | 0.53 ** | 0.93 * | 0.76 *** | 0.92 * | 0.95 * | 0.68 * |
|                    |    | (5.51) | (7.11) | (5.73) | (6.20) | (5.10) | (5.43) | (4.74) | (3.93) |
| AGE                |    | 0.99 | 0.95 | 0.93 | 0.19 | 2.64 * | 0.51 * | 1.12 * | 0.65 * |
|                    |    | (1.01) | (2.02) | (2.03) | (3.27) | (1.48) | (2.37) | (4.36) | (5.06) |
| LEV                |    | −0.60 | −6.24 | −5.07 | −4.63 | −4.89 | −0.44 | 1.07 | 14.82 |
|                    |    | (−4.10) | (−5.10) | (−2.21) | (−2.48) | (−2.20) | (−0.37) | (−0.33) | (0.97) |
| Intercept          |    | 0.58 ** | 0.17 ** | 0.25 ** | 0.72 ** | 0.31 ** | 0.49 * | 0.11 * | 0.33 ** |
|                    |    | (1.45) | (1.54) | (1.73) | (0.45) | (1.02) | (1.73) | (1.48) | (0.42) |
| N                  |    | 523 | 542 | 515 | 534 | 456 | 486 | 475 | 446 |
| Adj. R-squared     |    | 0.26 | 0.39 | 0.26 | 0.25 | 0.23 | 0.36 | 0.26 | 0.26 |
| Year DUMMY         |    | YES | YES | YES | YES | YES | YES | YES | YES |
| Industry DUMMY     |    | YES | YES | YES | YES | YES | YES | YES | YES |

The table shows pooled OLS regression results of the direct effect of CSR on FO. *t statistics of regression coefficients are shown in parentheses. Model: \( FO_t = \beta_0 + \beta_1 \text{CSR}_t + \beta_2 \text{GOVERNANCE}_t + \gamma Z + \varepsilon_t \). *, **, *** Significance at the 10%, 5%, and 1% level. The definition of all variables is presented in Appendix A Table A1.

Table 5 presents SYS-GMM estimation for the relationship between CSR score and FO in conjunction with corporate governance variables. The use of SYS-GMM is mainly for solving endogeneity, which is expected to appear in these types of relationships. The lag of dependent and explanatory variables is employed in Table 4. The results show a positive and significant coefficient of all CSR variables. This indicates that the CSR score affects the magnitude of FO. Additionally, social, environmental, and governance scores can also attract FO to the firm. Furthermore, governance variables are mostly positive and significant, except for executive pay. This is expected since Saudi firms are still weak in their compensation packages and their role in governance. The control variables show some positive coefficients; ROE and firm size positively and significantly impact FO. These results support all of the research hypotheses that ESG performance positively affects foreign investment.

Table 5. System-GMM estimation.

| Dependent Variable | FO | (1) | (2) | (3) | (4) |
|--------------------|----|-----|-----|-----|-----|
| \( FO_{t-1} \)     |    | 0.55 *** | 0.58 *** | 0.52 *** | 0.17 *** |
|                    |    | (0.08) | (0.05) | (0.02) | (0.03) |
| \( \text{CSR}_{t-1} \) |    | 0.43 * |     |     |     |
|                    |    | (0.73) |     |     |     |
| \( \text{SOCIAL}_{t-1} \) |    | 0.49 * |     |     |     |
|                    |    | (0.19) |     |     |     |
| \( \text{ENVIRON}_{t-1} \) |    |       |     |     |     |
|                    |    |     |     | 0.39 * |     |
|                    |    |     |     | (0.72) |     |
| \( \text{GOV}_{t-1} \) |    |       |     |     | 0.66 ** |
|                    |    |     |     |     | (3.36) |
Table 5. Cont.

| Dependent Variable | (1)  | (2)  | (3)  | (4)  |
|--------------------|------|------|------|------|
|                   | 0.13 * | 1.41 * | 0.46 * | 0.28 ** |
|                   | (0.04) | (0.21) | (0.31) | (0.53) |
| CONCENT            | 1.15 * | 0.03 * | 1.84 * | 0.75 * |
|                   | (1.97) | (1.21) | (2.08) | (1.26) |
| BoardIN            | 0.46   | 1.73   | 0.48   | 0.52   |
|                   | (0.14) | (0.17) | (0.08) | (0.17) |
| LnEP               | 0.43 **| 0.56 **| 0.66 **| 0.17 **|
|                   | (1.37) | (1.63) | (1.45) | (0.63) |
| LogROE             | 0.38 * | 0.33 **| 0.43 **| 0.73 * |
|                   | (2.41) | (4.31) | (4.53) | (4.30) |
| LnSIZE             | 0.59   | 0.34   | 0.76   | 0.62   |
|                   | (0.07) | (0.08) | (0.06) | (0.57) |
| AGE                | −0.40  | −2.34  | −4.17  | −2.63  |
|                   | (−0.34)| (−0.16)| (−0.43)| (−0.58)|
| LEV                | 0.68 **| 0.97 **| 0.95 **| 0.89 **|
|                   | (4.75) | (4.14) | (3.63) | (3.85) |
| Intercept          | 489    | 475    | 500    | 469    |
|                   | 110    | 110    | 110    | 110    |
| Number of id       | YES   | YES   | YES   | YES   |
| Year FE            | YES   | YES   | YES   | YES   |
| Industry Dummy     | YES   | YES   | YES   | YES   |
| Number of instruments | 45  | 73    | 43    | 39    |
| Hansen Test P      | 0.209 | 0.284 | 0.328 | 0.254 |
| AR(1)              | 0.000 | 0.000 | 0.000 | 0.000 |
| AR(2)              | 0.281 | 0.414 | 0.346 | 0.168 |

The table shows system GMM estimation results for the effect of CSR on FO. t statistics of regression coefficients are shown in parentheses. Model: $FO_{it} = \beta_0 + \beta_1FO_{it-1} + \beta_2CSR_{it-1} + \beta_3GOVERNANCE_{it} + \gamma_2CONTROL_{it} + \epsilon_{it}$. *, **, *** Significance at the 10 %, 5% and 1% level. The definition of all variables is presented in Appendix A Table A1.

4.4. Discussion

This study explores the effect of CSR scores and governance on attracting foreign equity in Saudi-listed firms. Pooled OLS and System-GMM are employed to regress this relationship. OLS results initially confirm the positive association between the three main variables tested. The relationship between CSR and FO is tested once with governance variables and once without them to show the dual effect of both indicators that can attract foreign ownership to the firm [77]. That is, firms with high CSR and good corporate governance can attract more foreign equity. However, McWilliams et al. [76] noted that empirical research in CSR and other variables may suffer from endogeneity. In other words, the relationship could be explained the other way around; companies with a percentage of foreign ownership may seek to present better CSR actions and improve their governance practices. Therefore, this study mainly employs a model that solves for endogeneity and other statistical errors, such as omitted variable bias and heteroskedasticity, presenting robust and reliable results [84,85]. Although the model allows for many lag periods, it is preferred to use one lag period to avoid generating too many instruments, especially with a relatively small number of observations.

Findings from System-GMM estimation support the positive association that is approved by the OLS model. The use of lagged variables for the total score of CSR confirms that improving CSR actions could subsequently attract more foreign equity to the firm. Additionally, lagged variables for social, environmental and governance scores also reveal that each score has an important influence on foreign investors. Findings also show that the governance score has a higher significant effect on foreign ownership. This confirms
the results presented in the OLS model that indicate that good corporate governance may represent trustworthy signs that foreign investors need to see in the host or potential firm. This is consistent with the findings of Oh et al. [61] and Jul et al. [1]. The results are robust and verified by the Arellano–Bond test, which confirms the absence of second-order autocorrelation. Additionally, the Hansen test is suitable for overidentifying restrictions. These findings confirm the dual effect of CSR and CG on FO. The results also show that foreign investment positively correlates with ownership concentration and board independence. This is consistent with the findings of Alregab [4]. This could be explained by the fact that foreign investors prefer large firms owned by large shareholders, usually institutional shareholders, reflecting more stable risk-taking and a strong position in the market.

5. Conclusions

Based on theories of CSR, this study aims to investigate the effect of ESG performance on foreign investors in conjunction with corporate governance indicators. It is argued that firms with more social and environmental action disclosure enjoy better performance and sustainability. Additionally, corporate governance is one of the corporate social responsibility pillars that could improve a firm’s performance and attract more foreign investment. Given that the existing literature does not provide consistent findings—especially in terms of CSR and foreign investment association, as well as emerging markets where investor protection is not well-regulated—this study provides new evidence from Saudi Arabia, which is one of the leading economies in the region and which has witnessed considerable reform in recent years. By undertaking an empirical examination of a sample of 110 firms from Saudi Arabia, this study analyses ESG performance as a total and breaks it down further to include three sub-scores according to the three main indicators of CSR: social, environmental, and governance. This study employs two tests to regress the effect of ESG performance and corporate governance on foreign ownership. Pooled OLS is used to present the initial relationship. Additionally, System-GMM is employed to test this relationship and solve for the expected endogeneity that could appear in these types of regression analyses.

The findings indicate that, in general, the ESG score can predict foreign investment; this includes all CSR variables. That is, on the one hand, superior ESG performance is noted by foreign investors who need to see trustworthy signals that help them to decide whether to invest or not. On the other hand, firms are required to pay more attention to their ESG performance and to satisfy their current or potential investors. This is supported by both stakeholder theory and legitimacy theory. Additionally, the governance score shows the highest positive association in terms of its significance level, indicating that corporate governance practices are more important for foreign investors. These results suggest that firms that show good governance scores may attract extra foreign equity. The findings also reveal that foreign investment positively correlates with ownership concentration and board independence. Additionally, the size of the firm and its profit are positively associated with the magnitude of foreign investors. This may indicate that large firms that show high profitability tend to pay more attention to CSR and CG, thus attracting foreign investors who trust these large corporations.

Research findings have several implications that could be considered by corporations, policymakers, and researchers in this field. First, in countries similar to Saudi Arabia (e.g., the Gulf area, the Middle East and North Africa, MENA), where CSR is still growing and improving, further policies and regulations are needed to follow the global schemes. Second, the consistency of CSR standards and disclosure is considered inevitable at this stage, especially in these emerging economies. Third, firms must concentrate on other non-financial activities, which are a priority in the new economy.

This research has several limitations that could inspire future research. First, this research is limited to one country. Further research could be conducted in the Gulf area and MENA region. Second, research data is relatively restricted by the availability of information for each firm in the sample. Expanding the dataset may provide more robust...
findings. Third, it is recommended to include additional proxy variables to the regression model testing these overlapping relationships. Finally, a comparative study between countries in the MENA region could provide additional information.

**Funding:** This research received no external funding.

**Institutional Review Board Statement:** Not applicable.

**Informed Consent Statement:** Not applicable.

**Data Availability Statement:** Data is generated during the study from annual reports available in Home (saudiexchange.sa) also ESG scores has been purchased from Big Data Corporate and Investment ESG Solutions | Consensus ESG Scores (csrhub.com).

**Conflicts of Interest:** The authors declare no conflict of interest.

### Appendix A

**Table A1.** Variable definition.

| Variable | Definition |
|----------|------------|
| FO       | Foreign ownership is measured by the percentage of foreign ownership to total ownership. |
| CSR      | Corporate social responsibility score (overall) |
| Soc CSR  | Social CSR is the score for a company’s activities that are socially related, such as activities that serve the employees and community. |
| Env CSR  | Environmental CSR is the score for environmental actions that are disclosed by companies. |
| Gov CSR  | Governance CSR is the score for corporate governance benchmarks that are applied by companies according to global standards. |
| CONCENT  | Concentration is measured by the percentage of largest owners to total owners |
| BoardInd | Board independence is measured by the percentage of independent directors to the total number of directors |
| LnEP     | The natural logarithm of executive pay is measured by the total compensation of top executives. |
| logROE   | The logarithm of return of equity is measured by net income before extra-ordinary items divided by book value of common equity. |
| LnSIZE   | The natural logarithm of firm size is measured by total assets. |
| AGE      | Firm age is measured by the total years of a firm since its establishment. |
| LEV      | Leverage is measured by the ratio of total debt to total assets. |

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