

Corporate Governance In The GCC:

What Has Been Done & What Remains



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■ By Dr Nasser Saidi

“The scope of corporate governance improvements and reform should not be limited to public-listed companies. Given the dominant financial intermediation role of banks in our region – representing over 60 percent of the financial structure in the MENA region – effective bank corporate governance is fundamental to establishing sound financial systems.”

“We need to level the playing field with the private sector, reinforce the State Owned Enterprises (SOEs) ownership function, try to delineate and avoid the mixing of political or social policy and business decisions, improve transparency, empower SOE boards and improve their accountability.”

“Having issued codes, the next challenge for the region’s regulators is how to support effective implementation of corporate governance in listed companies, especially in the areas of transparency and disclosure, board practices and risk management. The danger here, as is the case elsewhere in the world, is that corporate governance becomes a box-ticking exercise, where the principles and values of good corporate governance are not internalised by the companies and their boards.”

Corporate governance is a relatively new concept in the Gulf Cooperation Council (GCC) countries. Indeed it is only in the last 10 years that an Arabic word

“The region’s investors, particularly the sovereign wealth funds, should play an important role in driving the corporate governance reform in the region. The first step for the investors should be to incorporate corporate governance criteria in their investment decision process. Although many asset managers in the region acknowledge the importance of corporate governance for sustainable and lower return volatility, governance factors are not formally integrated in the investment process.”

“The ESG Index is being used to raise awareness among the region’s sovereign wealth funds and institutional investors on the impact good corporate governance can have on the bottom line and the Index has outperformed the market benchmark by a significant margin.”

“Our region is still overlooked by global investors despite its natural resource wealth, positive demographics and promising growth prospects. This marginalisation has much to do with a perceived lack of good corporate governance – we are not providing investors with the investor protection, transparency and disclosure they require.”

for ‘corporate governance’, *hawkamah*, has emerged. Despite its infancy in the region, corporate governance has been making significant headway. The region is on the

right path, but significant challenges remain, especially in the areas of transparency and disclosure, board practices and risk management, whether in the realm of listed companies, banks or state-owned enterprises. The GCC countries must recognise the importance of building on this momentum for corporate governance to truly take root in the region. This article sets out the recent developments in corporate governance in the region and describes current Hawkamah Institute For Corporate Governance (henceforth Hawkamah) initiatives to address the next steps for governance reform.

The Institute is a regional not-for-profit organisation dedicated to the advancement of good corporate governance in the Middle East and North Africa. It has been at the forefront of corporate governance debates through increasing public awareness, advocacy, conducting studies on the state of governance in the Middle East, identifying gaps, outlining areas for reform, providing training, advice & technical assistance, and providing advisory services to companies & regulators to bridge the corporate governance gap.

Corporate Governance Codes In The GCC

Hawkamah's research indicates that there have been significant improvements in corporate governance in the GCC region in just a few short years. Although implementation is still patchy, the concept and principles of corporate governance are now well accepted. Regulators and companies have taken substantial steps, albeit from a low base, to improve their practices. Almost all GCC countries now have corporate governance codes or guidelines in place for publicly listed companies. Oman has been ahead of the curve with the Omani Capital Market Authority announcing corporate governance standards for listed companies as early as 2002. While Kuwait remains the only GCC country without a corporate governance code, it has taken a significant step to monitor and regulate capital market activities by issuing a law establishing a Capital Markets Authority in 2011.

Conventional & Shariah-compliant Banks & FIs

But the scope of corporate governance improvements and reform should not be limited to public-listed companies. Given the dominant financial intermediation role of banks in our region – representing over 60 percent of the financial structure in the

MENA region – effective bank corporate governance is fundamental to establishing sound financial systems. This merits targeted supervisory monitoring and guidance.

Hawkamah also urges banks to incorporate corporate governance criteria into their investment and lending criteria in order to more effectively manage portfolio and credit risks, as called for by the Basel supervisory guidelines. In a market where most companies are non-listed, family-owned enterprises, banks as well as the private equity industry can play a central role in instilling a culture of good corporate governance in the region, which is so vital for private sector development. Building on the success of the 2009 Hawkamah-OECD Policy Brief on corporate



governance of banks in the Middle East, Hawkamah issued a Policy Brief Corporate Governance of Islamic Banks and Financial Institutions earlier this year in partnership with experts in the area of corporate governance in Islamic finance, Islamic finance standard setting bodies, and Islamic financial institutions from across the MENA region. The Policy Brief, which is addressed to policy makers, Islamic banking regulators, banking associations and Islamic banks and financial institutions, highlights the improvements required in the corporate governance frameworks and practices of Islamic Banks and Financial Institutions in MENA. It takes into consideration international practices

and standards developed by various Islamic finance standard setting bodies and in the light of the global financial crisis and its lessons for the banking and financial industry.

Recent Initiatives: Non-public-listed Companies

The year 2011 also saw two important initiatives outside the realm of public-listed companies. Both of these were Dubai specific, but other GCC markets could benefit from learning from the approach taken in Dubai.

The first has been the development of Corporate Governance Guidelines for Small and Medium-sized Enterprises (SMEs) in Dubai. The guidance was developed by Hawkamah and issued by the Dubai SME, an agency of the Department of Economic Development, Government of Dubai. The guidelines are aimed at supporting the growth of SMEs in Dubai by addressing their governance challenges. These are based on nine voluntary principles, nine pillars, that SMEs could implement to show a commitment to strong corporate governance and help convince banks or outside investors to provide more financing and lower the cost of capital.

The second important initiative relates to the drafting of a corporate governance code for the real estate sector in Dubai. The code is being developed by Hawkamah and issued by the Real Estate Regulatory Authority, which recognises that improving and strengthening corporate governance practices is one of the main pre-requisites to protecting property rights, gain and maintain investors', markets', home owners', tenants' and their associations' and other stakeholders' confidence in the real estate sector.

The Next Steps Corporate governance in public-listed companies

Having issued codes, the next challenge for the region's regulators is how to support effective implementation of corporate governance in listed companies, especially in the areas of transparency and disclosure, board practices and risk management. The danger here, as is the case elsewhere in the world, is that corporate governance becomes a box-ticking exercise, where the principles and values of good corporate governance are not internalised by the companies and their boards.

Corporate governance in SOEs

The region's regulators will need to address

corporate governance standards in SOEs which are a major and pervasive part of the economic system. Improving the corporate governance of SOEs will lead to mutually reinforcing multiple rewards of significant efficiency gains, improvement in the quality of public services, increased foreign investment and ultimately improved growth prospects. In many instances, better performing SOEs can have positive fiscal implications, insofar as government budgets are all too often called to the rescue of large SOEs. We have seen this particularly happen during the financial crisis of 2008-09. We need to level the playing field with the private sector, reinforce the SOEs ownership function, try to delineate and avoid the mixing of political or social policy and business decisions, improve transparency, empower SOE boards and improve their accountability. The imperative for this become more pronounced following the “Arab Spring”, not only in countries such as Tunisia and Egypt, but across the MENA.

Regional investors and corporate governance

Corporate governance reform is often investor driven in the more developed markets, but in the GCC the burden of corporate governance improvements falls on the regulators. Much of this stems from a combination of facts such as the ownership structures of GCC companies (mainly family or state-owned), the ready availability of liquidity and financing from regional banks, and the relatively underdeveloped capital markets. But the region’s investors, particularly the sovereign wealth funds, should play an important role in driving the corporate governance reform in the region. The first step for the investors should be to incorporate corporate governance criteria in their investment decision process. Although many asset managers in the region acknowledge the importance of corporate governance for sustainable and lower return volatility, governance factors are not formally integrated in the investment process. Part of this is due to unavailability of data and indicators, lack of know-how, lack of governance specialists within investment houses, and because it is a difficult task to assign a numerical figure to governance criteria.

To address this gap, Hawkamah, in partnership with Standard & Poor’s and the International Finance Corporation, has created the first-ever Environmental, Social and Governance (ESG) Index for the MENA. It ranks and tracks the transparency and disclosure of regional listed companies on

ESG issues. The constituents of this Index are derived from the stock exchanges of 11 Arab countries. The purpose of this Index is to identify the MENA companies that go the extra mile in their governance practices.

The Index is being used to raise awareness among the region’s sovereign wealth funds and institutional investors on the impact good corporate governance can have on the bottom line and the Index has outperformed the market benchmark by a significant margin. One of the region’s sovereign wealth funds has invested in the index and hopefully others will follow.

Encouraging the sovereign wealth funds to adopt a more active role in promoting good corporate governance would not only be a welcome step for the development of the GCC capital markets, but also across the world in the markets and companies they invest in.

Although the need for corporate governance reform has been readily acknowledged in the GCC countries for many years, that acknowledgement has not always been translated into action. This has started to change drastically, but more needs to be done. Our region is still overlooked by global investors despite its natural resource wealth, positive demographics and promising growth prospects. This marginalisation has



much to do with a perceived lack of good corporate governance – we are not providing investors with the investor protection, transparency and disclosure they require.

In formulating adequate responses to the issues I have been describing and be prepared to address future crises, much will be required from the region’s policymakers and regulators. Regulations can be very blunt instruments and, therefore, they need to be carefully formulated. In other words, regulators need to embrace good governance themselves – they need to have clear roles, mandates and lines of accountability, and staffed with competent personnel. Above all, they need to be effective, transparent and predictable. ■

The ESG Index Has Out-performed The Market By A Significant Margin



The white line indicates the performance of the ESG index, whereas the orange line represents the market performance.