THE HAWKAMAH JOURNAL

Dr. Helmut Maucher
An Interview with the Honorary Chairman of Nestlé
pages 06-09

Reflections on Gulf Corporate Governance
In-depth look at how the Gulf views Corporate Governance
pages 33-42

The Importance of Subsidiary Governance
Four perspectives on on the latest regional trend
pages 10-23
Reflections on Gulf Corporate Governance

Reflections on Gulf Corporate Governance

‘There is a growing recognition that the world is complex, and cultural diversity creates a need to deal with people on their own terms. In earlier times, many decision makers, embracing neoclassical principles, believed that economic reactions are universal and rational. ...Today, however, the ability of culture to trigger unique responses is being recognised ...’

Across the world there is great diversity in corporate governance arrangements, with their respective strengths and weaknesses. At best they are tailored responses to local circumstances designed and evolved to ensure that generally accepted corporate governance principles are applied. While the principles have wide acceptance, the means to apply these principles vary according to local culture, laws and regulations. At worst, in some parts of the world, corporate governance is so light touch that it is largely or partially ineffective.

In this article we examine some of the characteristics of boards of quoted companies in the Gulf region in comparison with elsewhere, attempting to identify their strengths and weaknesses, and having regard to local circumstances.

Composition of Boards

A significant difference of approach is between countries that rely on unitary boards, usually comprising non-executive as well as executive directors, and those with two-tier board structures. One example of the latter is the German supervisory board above the management board where the supervisory board comprises at least twenty non-executive members including worker representatives on the principle of ‘co-determination.’ In other countries where there is no requirement for two-tier boards, they may be optional.

If a company has a single, unitary board, the CEO is nevertheless likely to make use of an executive committee (EXCO) to assist in running the business, resulting informally in an arrangement which resembles a two-tier structure in some respects. This may be an important part of the CEO’s approach to managing the business.

In many companies across the world with unitary boards, the CEO uses the EXCO prior to each board meeting to ensure that the executive is ready for the board meeting and that all of the executive board members ‘sing from the same hymn sheet’ at the board meeting. The

justification for the latter is that boards may not welcome a top executive team with divergent views on important matters. On the other hand, each executive director has a responsibility to exercise independent judgement and to be frank with the board – which a sensible board should expect and welcome.

There is considerable variation within unitary board arrangements. In the UK there is often an approximate balance between executive and independent board members: the UK Corporate Governance Code\(^2\) stipulates that at least half the board (excluding the chairman in the count) should be independent directors and that there should also be a significant number of executive directors on the board. In the US the traditional practice that the chairman of the unitary board will also be the CEO is diminishing in frequency so that it now applies only to a minority of Fortune 500 companies. Where it still applies, the great power of the dual role CEO-Chairman is attempted to be counter-balanced by the rest of the board, or most of it, being independent directors. Where this dual role applies it can certainly result in strong leadership, which may be useful temporarily at times of crisis, but the concept is flawed as the chairman's role is, \textit{inter alia}, to run the board and the CEO's role is to run the business. If the CEO is also the chairman of the board, the board is hampered in its oversight of the CEO as the board cannot rely on the chairman's leadership for this.

The principle to achieve is to avoid excessive power at the top of the company: hence, the guidance is often that the roles of chairman and CEO should usually be separated, and that the chairman should be independent when appointed as chairman.

The preponderance of non-executive directors on the boards of companies in the Gulf region means that the region largely avoids a particular challenge which would apply if board membership were more balanced between executive and non-executive members. This is the challenge of an executive being able to transition successfully from being solely a competent executive to also being an effective board member. Every director, executive or non-executive, is expected to participate in board decision making in ways which are in the best interests of the company as a whole. This may not be the same as the best interests of the function an executive director heads. Furthermore, executive directors being expected to exercise independent judgement in the boardroom may require them to dissent from the wishes of the CEO. The region largely circumvents this challenge by having few executives on their boards.

To compensate for the relative absence of executive board members, the practice is widespread in the region for senior executives who are not board members to be in attendance at board meetings – either generally or for specific agenda items or presentations. Not having the status of being directors of the company, these executives in attendance at board meetings are even more likely to be ‘under the thumb’ of the CEO. Not being board members, they do not have the same legal responsibilities that directors have - to exercise independent judgement and to act in the best interests of the company.

\textbf{Executive remuneration}

The small extent to which executives belong to Gulf boards has facilitated keeping executive rewards in check in comparison with the Western world. This is unlikely to be as much a tribute to the effectiveness of Gulf board remuneration committees\(^3\), as to do with the lesser influence of executives at board level. The corporate governance principle is that nobody should participate in the determination of their own rewards. Agency theory tells us that management are the agents of the owners, but that management are determined to maximise their own rewards. In the Gulf, the reward packages given to executives are generous but well under control. So it is not unusual to find that the remuneration committee of a Gulf board meets perhaps just twice a year – once to set executive targets, and secondly to decide upon the performance-related rewards. This contrasts to the multiple meetings of a typical remuneration committee in the West, valiantly but unsuccessfully endeavouring to keep under control excessive executive demands. The bargaining position of top Gulf executives, especially the majority who are from overseas, is not as strong as elsewhere. Perverse incentives are largely avoided. Deferred bonuses and claw-back arrangements to avoid excessive risk-taking are practised in the Gulf, at least as much as in the Western world.

\textbf{Related parties}

Different classes of shares are widely allowed across the world but indulged in to a varying extent from one country to another. The origin of different classes of shares is often in the founding family’s reluctance to cede control of the company when the first proportion of its equity is floated. So, for instance, the family holds the ‘A’ shares (which constitute a small proportion of the total issued share capital) but has floated most or all of the ‘B’ shares: major decisions may require majority votes of both classes of shareholder. It is argued that this structure reduces the likelihood that a stronger management team can bid to take over from an incumbent, second rate management team: this protection from predatory takeover may not be in the best interests of most of the shareholders, the staff, suppliers, customers and other parties. Since such a share structure protects the company from predatory takeover bids, it allows the board to be less short-termist.


\textsuperscript{3}Certainly, in the Western world, remuneration committees have been unsuccessful at containing executive remuneration.
Conversely, it is argued that it should be a matter of ‘one share, one vote’ – that is, an investor taking an equal risk should have equal participation in the company. On the other hand, those who acquired ‘B’ shares with fewer rights presumably did so with their eyes open.

Whether or not a share structure with different classes is resorted to, the initial public float of a family business is often not accompanied by sufficient realisation that the company is in future to be run for all the shareholders, not just for the family, with greater transparency and with greater commitment to corporate governance principles. Those who controlled the company when it was private may continue to engineer the appointments of chairman and ‘independent’ directors following the initial public offering – with, therefore, a question mark over how independent those directors are.

Possibly the greatest corporate governance strength of Gulf quoted companies is the presence of large shareholders prepared to take a long-term view and to stand behind their investments in difficult times. Even without different classes of shares with their own voting rights, vulnerability to often highly leveraged takeovers is therefore reduced. However, the risks of running a Gulf public company as if it were the private property of a few are similar to the risks which apply to old family businesses, which we discussed above.

The ownership of Gulf quoted companies is relatively closely held. Typically a few shareholders control a significant proportion of the equity. This usually carries rights to nominate one or more to be members of the board. It is not unusual for at least half the board to be members nominated by fewer than half a dozen shareholders. Widely expressed across the region is the fear that the rights of minority shareholders in quoted companies may not be sufficiently safeguarded by boards comprising perhaps a majority of directors nominated by the large shareholders. Of course, those minority shareholders know what they are buying into when they acquire their shareholdings, and in some respects they benefit from the support of the institutional and other large shareholders.

There is the additional issue that the relatively low proportion of equity that is ‘free float’ makes the market for shares less liquid, potentially leading to greater share price volatility as fewer and small deals may move the share price significantly. A less liquid market is less attractive to investors, resulting in higher costs of capital and lower market capitalisation than would otherwise be the case.

In other countries of the world, institutional and other large investors are usually less keen to place their nominees on the boards of companies they are invested in. It risks placing them in the position of being insiders unable at times to deal in the shares they own. It also risks an investor becoming a shadow director with the responsibilities similar to those of a director appointed formally. It places the nominee director in a conflicted position as the nominee’s duty to act in the best interests of the company on whose board he or she sits, may rest uneasily with the natural desire to feedback significant, perhaps price-sensitive, information to the nominator. It may impede the institutional investor from dissenting objectively from board policy since that policy will have been formulated by a board that includes one or more of the institutional investor’s nominees.

**Director independence**

In the Gulf the distinction is made between non-executive directors who are independent and those who are not. Those regarded by the board as being independent are, in accordance with global best practice, disclosed as such within the annual reports of Gulf public companies.

The concept of director independence is important. While each director, executive or non-executive, should exercise independent judgement when participating in board decisions, there is a category of director specifically categorised as ‘independent’. No executive director fits into this category, and not all non-executive directors may do so. It is widely held that a non-executive director who can be regarded as independent should not be a major shareholder, nor represent a significant shareholder. He or she should not have been an employee of the company in the recent past nor have close family ties with it, nor be associated with any parties who have material business relationships with the company, nor have cross-directorships or significant links with other directors through involvement in other companies or bodies.

Apart from receiving a fee for being a non-executive director (which may include supplements for attendance, and for committee chairmanship and attendance) independent directors are not beneficiaries of performance-related reward schemes or of pension schemes. The fundamental reason is that the board needs a significant proportion of its members who can be relied upon to view these schemes impartially.

Independence is not just a matter of these and other specific criteria: it is also to do with whether the director has the personal qualities of character and judgement to be relied upon to be independent.

The appearance to stakeholders of a director’s independence is as important as the decision the board has come to about the director’s independence.

**Reflections on Gulf Corporate Governance**

*Article by Professor Andrew Chambers*

\*\*A ‘shadow director’ being a person (or a corporate entity) whose instructions a board customarily follows."
The minimum acceptable proportion of independent directors on boards in the region is less than elsewhere and the independence tests are not so rigorous. For instance, certain regional banks classify as ‘independent’ directors some who have been nominated to the board by major shareholders.

Whereas elsewhere best practice would suggest that chairmen of boards should be independent when appointed to that position, this is very frequently not the case in the region due to the common association of new chairmen with leading shareholders or with other connected parties.

Best practice elsewhere is that only non-executive directors who pass stringent independence tests should be members of board audit, risk and remuneration committees. This restriction is not always followed in the region although executive membership of these committees is readily avoided, not least due to the small number of executives with board positions.

The relative weaknesses of independence arrangements in the region can perhaps be defended on several grounds. First, since it is unusual for more than one member of the board to be an executive, the overwhelming weight of non-executive directors on boards facilitates the exercise of board judgement that is at least independent of the executive interest, if not independent of related parties. The need for independent members on boards is in part to ensure that boards have a capability of a perspective which is independent of the executive and a greater potential to challenge the executive effectively.

**The role of the Chairman**

Likewise, the rationale for the chairman to be independent when appointed as chairman is in large measure to avoid excessive alignment of the chairman of the board with the executive - which might be likely had the chairman previously been a senior executive of the company. In the Gulf this is unlikely to have been the case. The chairman needs to be the chairman of the whole board, endeavouring to avoid alignment with any faction on the board, and indeed reducing the risk that factions develop.

Although the Gulf very effectively avoids excessive chairman alignment with the executive, there is often a built-in likelihood of an alignment bias towards the nominee directors.

While a less than objective relationship between the chairman and the CEO should always be avoided, a hallmark of a healthy company is a good, constructive relationship between these two. In view of the board structure in the region, there is a risk that the CEO may be positioned, in the eyes of the board, as an outsider rather than as an equal member of the board team. This may be counter-balanced by a board’s awareness of the extreme importance of the CEO to a board otherwise bereft of executive membership.

**Effectiveness of Boards**

There are reasons to be concerned about the competence and effectiveness of some boards in the region, although there are also some relative strengths in this regard.

The practice of large shareholders nominating directors, means that the majority owners have effective ‘reserve powers’ to safeguard their investment. In contrast, in highly liquid capital markets where ownership is widely held, the capacity of shareholders (who, after all, are the owners) to influence their boards has been noted as often being only very marginal, slow, indecisive and inadequate. In determining the composition of boards in the region, it would appear that undue emphasis is placed on ensuring these ‘reserve powers’ are in place, to the detriment of board effectiveness in other respects. Board succession planning does not always extend to ensuring that nominee directors bring to the board the qualities the board needs to oversee the executive effectively. Board nomination committees in the region may have little influence upon whom a large shareholder nominates.

It must be emphasised that it is not necessary, and may be sub-optimal for a nominee to be connected to the nominating party as an employee or otherwise: the primary driver for choosing a nominee director should be the needs of the company and the board’s nomination committee should be the prime mover in this. Succession planning for the board should ensure that collectively the board is able to challenge and support the executive across the key functional areas of the business. Succession planning should extend to influencing the choice of nominee directors.

While attendance at board meetings and board committees is usually good in the region, participation at board meetings is often inadequate with many directors lacking the experience or confidence to contribute, and showing excessive deference to the chairman of the board. Clearly a board should have sufficient respect for its chairman to enable the chairman to discharge his/her responsibilities well on behalf of the board and the company. But a board chairman is only *primus inter pares* (first amongst equals) In UK law, for instance, a board need not have a chairman, or may change its chairman for each board meeting. In UK law the chairman has no distinctive responsibilities beyond those of being a director, and it is the board itself that determines who shall be the chairman. Of course, if the shareholders seriously dissent from the board’s choice, the shareholders may vote that person off the board. Quality of dialogue at board meetings may be poor.

---

5 This best practice elsewhere is often not followed. For instance HSBC made Stephen, now Lord, Green their Group Chairman in 2006, having previously been their Group CEO; in 2010 he was succeeded to the chairmanship by Douglas Flint who until then had been HSBC’s Group Finance Director.
Effectiveness of directors

There is good disclosure of directors’ other interests in most published annual reports of listed companies in the region. This rightly allows us to observe that many directors on boards in the region appear to be over-extended, and this seems to be a particularly acute problem with respect to nominee directors. Including preparation time, site visits and board committee memberships, a time commitment of between thirty and thirty-six days a year for a non-executive director is unlikely to overstate the real need. If a company is in difficulty, is facing a takeover bid, is on the acquisition trail, is embarked upon a strategic restructuring or is grappling with a crisis, the time commitment may be significantly greater temporarily.

The time commitment of a non-executive chairman varies greatly, is most unlikely to be less than sixty days a year and may be as much as four days a week.

Someone with a full-time executive role elsewhere would be unlikely to be able to cope properly with more than one or two non-executive directorships. Someone with a plural professional life could handle up to five non-executive directorships if he or she had no other calls upon their working time. Board chairmen should have fewer other demands on their time and should certainly not have an executive position elsewhere.

Generally, but not without exception, annual reports of quoted companies disclose membership and attendance at board and board committee meetings. The reported, good attendance levels which apply in the region may be related to the common practice of paying directors’ fees in part according to meetings attended. This is equitable and may be a successful policy, but it risks directors wrongly considering they are not responsible except for matters dealt with at meetings they attended. It is not a common approach in the West where, on the other hand, supplements to the basic director fee may be paid for board committee membership and for board committee chairmanship. Other companies in the west pay no supplements for board committee chairmanship and membership, arguing that these additional responsibilities tend to be evenly spread across their independent directors over time.

Letters of appointment for directors should set out the anticipated time commitment and the skills and other qualities that the directors is expected to bring to the board. Those approached to take on director roles should be clear that they will have the time and will be able, through competence and in other ways, to serve the board as the board anticipates.

Roles of Boards

It is striking that many boards of companies in the region become heavily involved in executive matters, even though their membership is largely non-executive. Some UAE banks have EXCO committees of the board comprising largely or exclusively non-executive board members. In some cases the EXCO even includes board members indicated in the annual report as being independent. Participating in executive decisions is inimical to being an independent director.

There are examples of boards of UAE banks having risk committees of the board that may meet between 20 and 50 times a year: clearly these risk committees are making executive-type credit and other decisions, going far beyond the roles of a board risk committee to oversee the formulation of risk policy and processes, and to oversee their application by the executive on behalf of the board.

The conventional corporate governance model across the world is as follows:

- The members (shareholders) own the company;
- The chairman runs the board;
- The board runs the CEO;
- The CEO runs the business.

A sensible board sets the direction, provides the requisite resources and oversees that the CEO is implementing the direction the board has set. A sensible board does not ‘tread on the toes’ of the CEO as he or she runs the business. For instance, it should be possible for a bank’s board, perhaps assisted by the board risk committee, to agree lending policy and risk criteria and to oversee that the policy has been discharged at executive level.

Executive decision making, in line with the company’s policy framework, should be a matter for the executive; if it is not, then one or more of the following probably apply:

- There is an avoidable lack of clarity on policy;
- Policy is clear but the board frequently requires that the policy be overridden (perhaps in the interests of related parties);
- The board, although nominally non-executive, has assumed executive responsibilities;
- A low level of executive membership of the board makes it more likely that non-executive board members will be tempted to assume quasi-executive responsibilities.

Meetings of Boards

The implicit notion that the board serves the purpose of being a ‘reserve power’ (so that arrangements are already in place should drastic remedial action be needed on behalf of the majority shareholders) is sometimes further borne...
out by an undue infrequency of board meetings. A board that meets infrequently is unlikely to be much more than a ‘reserve power’. Formulation and adoption of policies and effective oversight of the executive will not be done effectively by an absentee board. For instance, one leading regional bank’s board in 2012 met just four times, with a gap of almost 120 days between two adjacent board meetings. Notwithstanding that committees of the board also met, such infrequency puts in doubt that the board is able to discharge all of its responsibilities effectively, which include:

- Setting the direction of the business and determining overall policies;
- Determining and providing the resources needed to implement the direction set;
- Overseeing that the executive is running the business so as to implement the direction the board has set;
- Instigating remedial actions as and when needed.

It is hard to imagine that a board can be effective if it meets less than about ten times a year, perhaps more. The board should be the body in the company that makes the most difference.

Committees of Boards

In the financial sector across the Gulf, risk committees of the board are already generally established. While financial institutions historically have had risk committees these have in the past usually only been at an executive level – such as credit risk committees. The establishment of risk committees of boards has been a response to an awareness that boards on the whole did not understand the risks that their companies (banks and insurance companies in particular) were running at the time of the global financial crisis. So guidance has been developed that boards should establish risk committees comprising wholly or largely of independent directors.

Now it is widely accepted general practice that listed company boards should have at least four committees – audit, remuneration, nominations and risk. In the Gulf’s financial sector all these committees are generally in place, though frequently two or three may be combined which is not ideal. In particular, the audit committee will lose some of its necessary independence if it is combined with another board committee.

In comparison with the West, it is likely that the oversight of risk by risk committees of Gulf bank boards must be at last as effective as in the West, since Gulf banks’ exposure to exotic financial instruments is more modest than in the US and UK. An opposing view is that the common practice in the Gulf for board risk committees to make lending decisions threatens an inadequate focus on risk policy, risk appetite and oversight of the executive. Furthermore, a risk committee cannot effectively oversee executive-type decisions that the risk committee itself has made.

Diversity of Boards

A contemporary issue of some importance is that of board diversity. It is much broader than gender diversity: age, nationality, background and skills are likely to be other relevant diversity hallmarks.
A non-diverse board may find it harder to 'think out of the box' and be more likely to succumb to 'group think' and staying within its 'comfort zone'.

Boards should consider the likely benefits of diversity but avoid creating a more diverse board if this would compromise board effectiveness. It is the business case rather than the politically correct, social policy case that should be the driver of increased board diversity – as it should be with respect to the composition of the board generally. The experience of Norway, which has achieved their statutory proportion of 40% female directors on their large company boards, does not suggest that mandatory quotas are an unmitigated good: it has resulted in relatively few women holding an excessive number of board positions.

Without quotas, the UK has achieved only about 17% female participation on large quoted company boards, with a greater proportion of women holding non-executive compared to executive directorships. Bearing in mind the higher proportion of executive directors on UK boards than on Gulf boards, to be comparable with the UK's very modest level of achievement, female board participation in the Gulf would now be between 25% and 30% of total board membership. Many Gulf companies, including banks, have one woman on the board, few have more. With typical board size of twelve or so, the percentage of women on Gulf boards cannot be more than 10% currently.

There is a need to move beyond the 'token woman' member of the board. It is difficult for one woman to make the distinctive contribution that women can make when she is a lone voice on the board. It becomes likely she will tend to emulate the macho culture so often found in all-male boards.

A degree of international diversity on Gulf boards is often achieved through the frequent overseas status of the CEO who is generally a member of the board, and international diversity is high at executive levels below the CEO. Nominees directors, especially those who are CEOs of the nominating parties, sometimes also enhance the international element to Gulf boards.

Age diversity appears to be at least as great with Western companies – probably more so as there are many young, nominated directors, often with family links to the nominating party.

An issue of importance for financial institutions across the world is the depth of financial experience of board members. In particular it is generally considered important for the chairman of a bank's board to have significant executive banking experience, in addition to leadership experience. Even despite the general restriction of chairman appointments to nationals, Gulf banks usually succeed in appointing board chairmen with significant financial and leadership experience.

### Sustainability

Gulf companies, even those such as banks that are not in more obvious exploitative sectors, are now taking sustainability seriously. Not so long ago, they tended to interpret their corporate social responsibility obligations only as a matter of making charitable donations and reporting that they had done so. Now they have a much broader understanding of their obligations especially to their local community, extending to issues relating to exploitation, pollution, global warming, staffing and social obligations. Though without any data as evidence, it appears that published sustainability reports, usually separate from the main annual reports, are now as widespread and as detailed as in the West.

Sustainability should entail concern right across the supply chain. For instance, a bank, using a scorecard approach to assist in making lending decisions, might consider assessing a potential borrower's sustainability credentials as one of a number of factors which contribute to the credit decision. The concern that this might disadvantage the bank in a competitive environment, may be counterbalanced if it is the case that sustainably responsible companies are better run. This approach would allow both the bank and the client to publicise their sustainability commitment and achievement.

### Evaluation of Boards

Board evaluation is being introduced in the region. Its maturity varies. Sometimes it is undertaken or facilitated by an external party in accordance with best practice. For instance, in the UK the performance of the board should be assessed at least annually; and at least once in every three years, this assessment should be externally facilitated. Some companies, but not all, include an assessment of the performance of the board chairman, and the chairmen of the board committees.

Rarely do board evaluations in the region extend to assessing the performance of individual directors. Elsewhere where this is done, it is usually overseen by the chairman of the board: its introduction has been sensitive but has been subsequently welcomed by those it impacts. This should be regarded as an important area to be addressed in the region. Directors find it helpful to learn about their strengths and weaknesses, and how they are perceived by their peers. Of course, this process flags up areas where improvement is needed. Usually how to achieve the needed improvement will be self-evident, and self-knowledge is an important and effective prerequisite for achieving enhanced performance.

---

7The UK Walker Report (2009) said: 'The chairman of a [bank or other financial industry] board should bring a combination of relevant financial industry experience and a track record of successful leadership capability in a significant board position.'
Companies should expect that individual director evaluation will often indicate needed personal development programmes tailored for individual directors. The best companies in the region already invest in board development programmes, though they report poor attendance levels at these programmes, and they are rarely tailored to the needs of individual directors.

We consider there is great merit in designing personal development programmes for individual directors, even to the extent of providing one-to-one expert mentoring of individual directors. This would be an important part of a concerted effort to ‘raise the bar’ in terms of the minimum competence and commitment needed from directors. Individual director ‘buy-in’ to a tailored personal development programme is likely to be higher than for a programme targeted only at the company’s needs, but will be beneficial for both.

In the region, rarely is the board evaluation 360° with directors assessing the performance of their co-directors, and with senior management below the board contributing to the board assessment process. To the extent that shareholders participate in the evaluation, it is usually only indirectly via the nominee directors, so that the voices of other shareholders are not heard.

Audit

Professor Mackenzie, an eminent economist at Manchester University UK, coined these immortal words as far back as 1966 in his Foreword to a book on auditing in governments by E.L. Normanton based on the latter’s MPhil thesis which Mackenzie had supervised: 8

‘Without audit, no accountability; without accountability, no control; and if there is no control, where is the seat of power? … … great issues often come to light only because of scrupulous verification of detail.’

Effective audit has been regarded as an essential element of corporate governance and, indeed, as price to pay for limited liability.

It is not surprising, in view of its importance, that auditing has been under the spotlight in the wake of the global financial crisis. An issue is whether the oligopoly of the ‘Big 4’ is impacting negatively on audit price and/or quality, whether there is sufficient choice of auditor and whether there are excessive barriers to entry into this elite by mid-tier audit firms. Both the European Commission and the UK’s Competition Commission have the matter under review. A number of measures are being proposed. One is to outlaw restrictive covenants under which, for instance, a lender is able to insist that the borrower’s accounts are audited by a ‘Big 4’ firm. Others are mandatory tendering of audit services and/or mandatory rotation of the audit firm.

In the West the ‘Big 4’ and also companies have been lobbying furiously against mandatory tendering or rotation of auditors, citing alleged excessive costs associated with these measures. The comparative success of the MENA region in avoiding lengthy retention of the same audit firm, calls to question the resistance to mandatory audit firm tendering and rotation in the West.

In Oman, an external auditor can only audit the same bank for a maximum of four years, and in Qatar for five years. Similar requirements are in place in Algeria, Egypt, Tunisia, Saudi Arabia and elsewhere in the region, but in the UAE there is no such requirement. 9

An excessively lengthy relationship of an audit firm with a particular audit client is subject to the same criticism as a lengthy term of office of an independent director on a board: ultimately complacency and a lack of professional scepticism are likely to creep in: the auditor (as with the independent director) is likely to have been party to so many judgements in the past that it becomes difficult or impossible to view things objectively. To some extent the audit profession, following auditing standards, has tried to surmount this difficulty by periodically rotating the audit engagement partner.

Hawkamah and the OECD carried out a survey on the governance practices of banks in the MENA region which found that 78% of the surveyed banks had internal policies on the rotation of the external auditors according to specific terms. 10

Conclusion

The focus of this article has been on the corporate governance of quoted companies in the Gulf region. Markets exist by the grace of investors. Investor confidence depends upon country factors (such as the banking system, property rights, pressure on corruption, taxation), capital market factors (such as market regulation, market liquidity, accounting standards) and corporate factors (such as much of what we have discussed in this article). The region has on the whole carefully adapted and applied what are generally regarded as corporate governance best practices to the extent that this has been feasible in view of the distinctive culture of the region. That distinctiveness has resulted in some elements of corporate governance that are stronger than elsewhere and others that are not so. Many but not all of these have been explored in this article.