



**HAWKAMAH**  
THE INSTITUTE FOR CORPORATE GOVERNANCE

**Corporate Governance  
in the Middle East: Key Issues and  
Reforms**

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# Overview

- Growth and Governance in Middle East
- Impact of Good Corporate Governance in Emerging Markets
- Challenges to Implementing Corporate Governance
- Hawkamah Institute for Corporate Governance
- IIF/Hawkamah Survey
- Reforms for good Corporate Governance

# Middle East: Sustaining Growth

- Region is experiencing above trend growth and improved macroeconomic environment
- Economic reforms, liberalization, diversification and state divestment and privatization are generating attractive prospects across many sectors.
- Growing private sector investment (FDI, portfolio) across MENA countries.
- Sizeable infrastructure developments around the region with an estimated value of projects planned or under development in GCC & Iran in excess of USD 1.4 trillion.
- Greater regional and international economic integration: WTO, RTAs, FTAs, GCC Monetary Union in 2010, lower trade barriers, Greater Arab FTA
- Central challenge is to use oil wealth and demographic dividend to create economic and financial incentives for sustained growth.

**But key to sustaining growth is addressing governance challenges.**

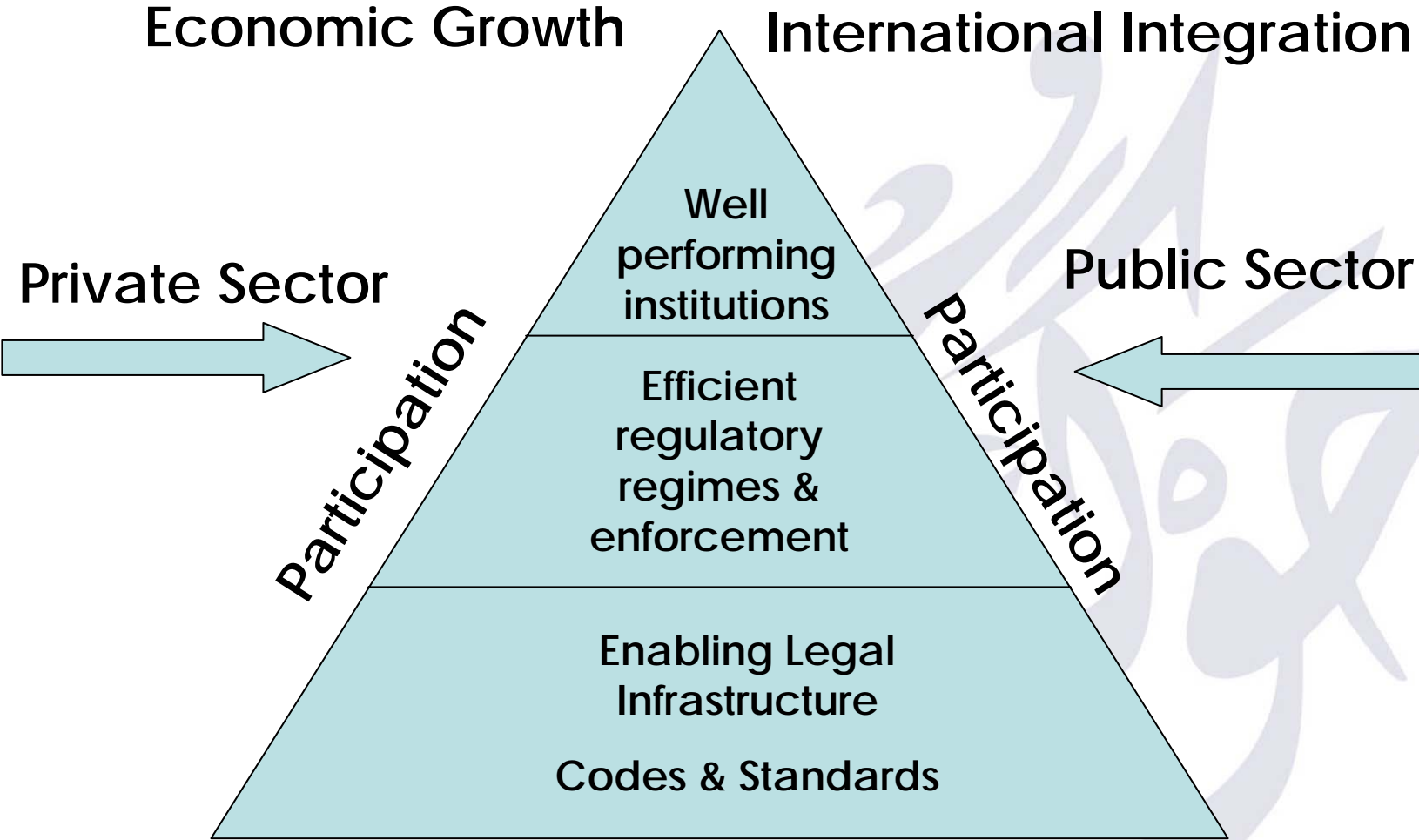
# MENA Governance Issues

- Substantial natural resource wealth has not resulted in prosperity or economic growth
  - The region is 'wealthy' in natural resources, but poor in economic performance
- Governance issues along with wars, violence and insecurity have been retarding factors
- WB states: *"At the root of MENA's growth gap is its governance gap. Indeed, simulations find that if MENA had matched the average quality of administration in the public sector for a group of good-performing Southeast Asian countries (Indonesia, Malaysia, the Philippines, Singapore, and Thailand), its growth rates would have been higher by about one percentage point a year."*

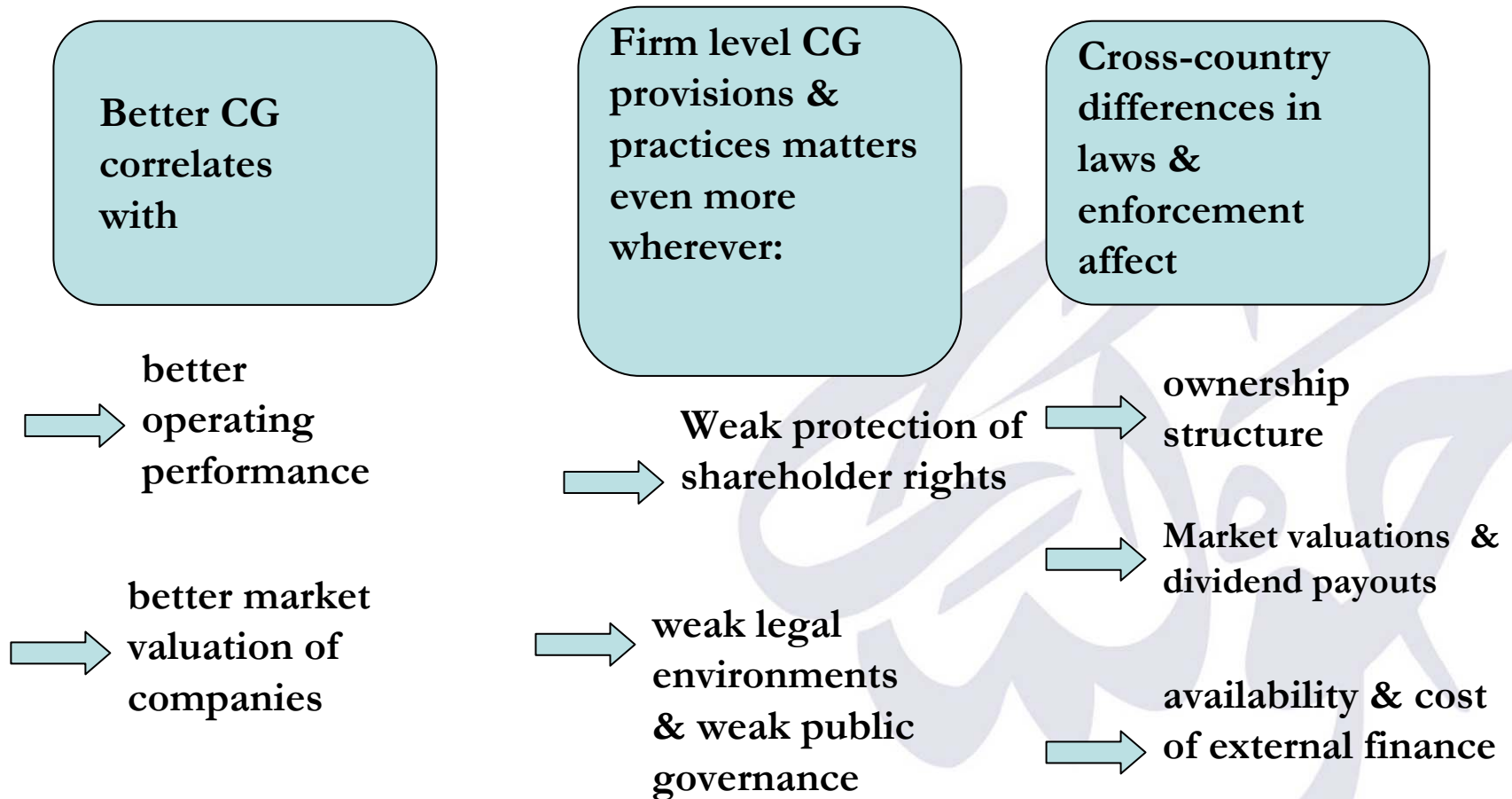
# “Good Governance”

- Well performing institutions, enabling legal infrastructure, regulatory regimes and enforcement, “good governance” are major contributors to economic growth & prosperity and democracy
- Public Governance matters for effective CG:
  - **Control of corruption**
  - **Regulatory quality**
  - **Rule of law**
  - **Government effectiveness**
- “Good governance” is required by both the public sector and the private sector in the MENA
- There is a Governance ‘gap’ in the region

*Governance is integral element of sustainable economic growth & development: it is an imperative*



# Corporate Governance : Performance in Emerging Markets





# Why CG matters – Macro side

- Poor Corporate Governance means inefficient use of capital by firms - the misallocation of available savings
- Higher over-all cost of capital, lower investment, resulting in slower growth
- Poor Corporate Governance identified as an important contributor to systemic risk, financial instability and crisis (US, EU, Asia, Russia, Latin America)
- Countries with strong shareholder rights and investor protection tend to have larger capital markets, companies with less debt and perform better during periods of crisis



# Why CG Matters for Companies

- Good CG at the firm and the country level results in higher company valuations, better access to finance & higher credit ratings
- Efficient Operation / Profitability
- Access to finance & increased variety of financing instruments
- More competitive market for mergers & acquisitions
- Institutional investors consistently express preferences for companies with good governance.

# Impact of Good Governance & Transparency

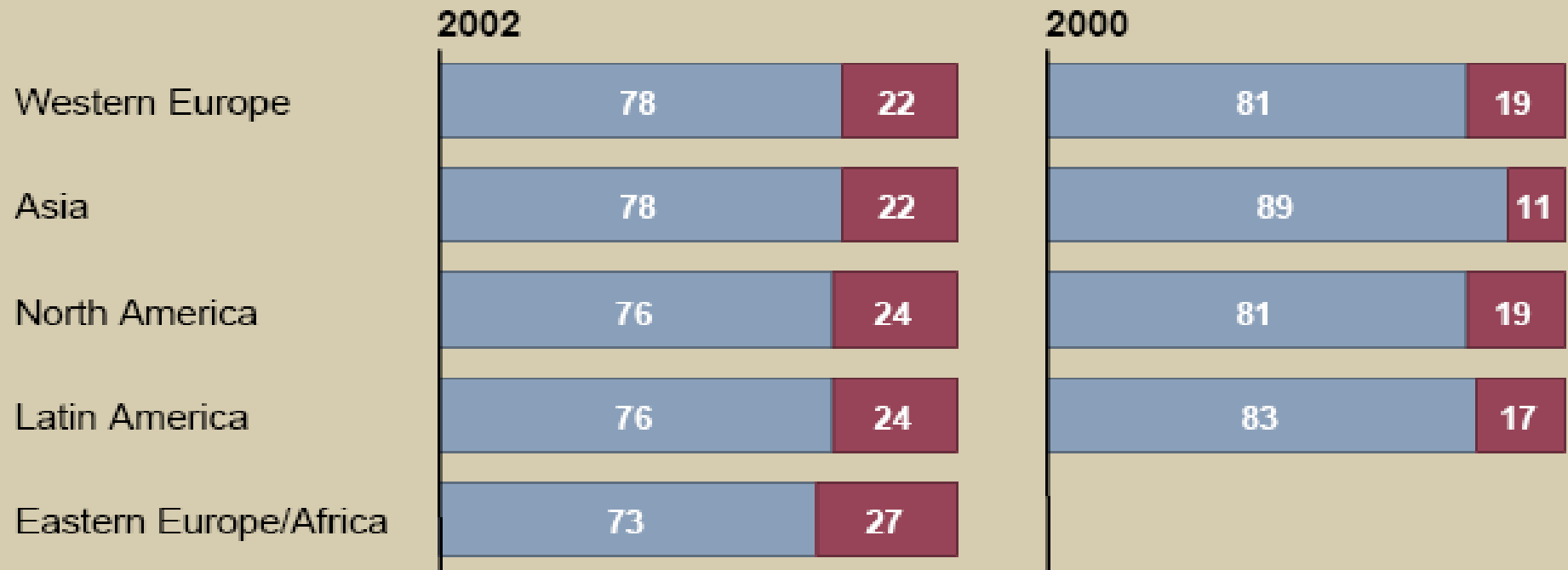
- Recent survey of 4,411 firms in 29 countries looked at relationship between foreign investment and corporate governance
- Survey showed that foreign investors invest less in less governed companies
- Investors look at country level disclosures and governance practices AND firm level improvements in governance or information flows in making investment decisions.

[Source: Leuz, Lins, Warnock, "Do Foreigners Invest Less in Poorly Governed Firms?" 2005]

# A significant majority of investors say they are willing to pay a premium for a well-governed company\*

Percentage of investors

Yes  
No

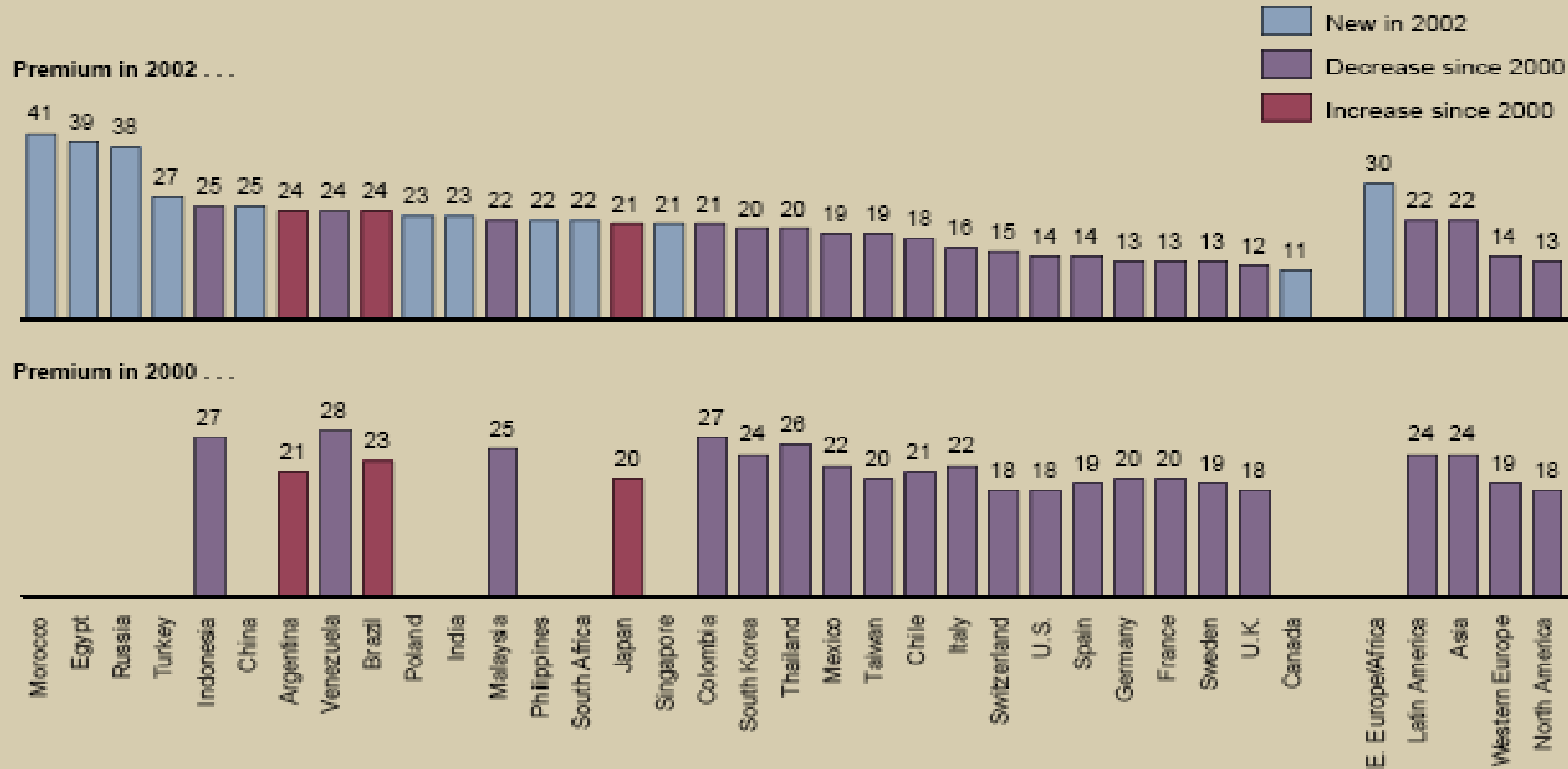


\* Refer to Exhibit 11 for full survey question

Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002

# The premium investors would pay for a well-governed company varies by country and region\*

Average premiums of those investors willing to pay premium



\* Refer to Exhibit 11 for full survey question

Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002

# Corporate Governance Codes

- CG Codes and Principles have been developed for major sectors of modern economies
  - Listed Companies (OECD, WB)
  - Banks and financial institutions (BIS)
  - Insurance Companies (IAIS)
  - Investment managers (IOSCO, Hermes)
  - Family enterprises (Cadbury, King)
  - State Enterprises (OECD)
  - Shari'a compliant finance & institutions (IFSB)
- Need to adapt to national legal and institutional conditions

# OECD Corporate Governance Principles

1. Ensuring the basis for effective Corporate Governance framework
2. The rights of the shareholders and key ownership functions
3. The equitable treatment of shareholders
4. The role of stakeholders in CG
5. Disclosure and transparency
6. The responsibility of the board

# OECD CG Principles (2004)

- Stronger role of shareholders: institutional investors
- Conflicts of interest and self dealing
- Abuse of related companies
- The role of stakeholders including creditors
- Executive and director remuneration
- Financial market integrity: audit and accounting
- Transparency; also intermediaries
- Ensuring the basis for an effective corporate governance framework: effective enforcement



# What Good Corporate Governance should do

- Align interest between shareholders and board of directors/management
- Promote accountability throughout the company
- Win and retain confidence of investors and other stakeholders
- Ensure fair treatment of minority shareholders
- Enhance transparency & disclosure within the company and to the outside world
- Ensure responsiveness to stakeholder concerns, consistent with long-term shareholder value creation

# Hawkamah was created to support corporate sector reform.

**MISSION:** Assist the countries and companies of the region to develop and implement sound and globally well integrated corporate governance frameworks.

**VISION:** Drive institution building, corporate sector reform, good governance, and sustainable economic development and growth in the region.

# What we do:

- Provide technical assistance on regulatory and firm levels to develop the optimal corporate governance environment
- Conduct CG assessments and prepare CG improvement plans
- Provide advisory services
- Conduct consultations with various stakeholders
- Develop and implement training programs: Board Development Programme, Board Secretary Programme
- Serve as a knowledge centre and clearinghouse for corporate governance best practices from the region and beyond.
- Monitor & Report on the state of corporate governance

# We Serve ...

- Government Ministries and Agencies
- Central Banks and Regulatory Agencies
- Banks and Financial Institutions
- Listed Companies, Capital Market Authorities, Stock Exchanges
- Family Owned Enterprises
- State Owned Enterprises
- Private sector institutions
- Media
- Academics

# IIF-Hawkamah GCC CG Survey

- Hawkamah Institute for Corporate Governance partnered with the Institute for International Finance to assess the corporate governance environment of the GCC countries, from an investors perspective.
- GCC Task Force met with close to 100 regulators, Central Bank officials, accountants, auditors, investment firms in all 6 GCC countries.
- Analysis of the corporate governance environment focused on:
  - Minority shareholder rights
  - Structure and responsibilities of Board of Directors
  - Accounting and auditing
  - Transparency of ownership and control
  - Regulatory environment

**Table 5: Comparison of Corporate Governance Frameworks in the GCC with IIF Guidelines**  
(on scale of 1-5 with 5 being fully compliant)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
<b>Minority Shareholder Protection</b>	2.0	4.0	3.0	2.5	3.5	2.5
<i>Voting Rights</i>	1.5	3.5	3.5	2.5	2.0	3.5
<i>Firm/Capital Structure</i>	1.5	4.5	1.0	2.0	5.0	2.0
<i>Shareholder Meetings/Other Rights</i>	3.0	3.5	3.5	3.0	3.0	2.5
<b>Structure and Responsibilities of the Board of Directors</b>	2.0	1.5	3.5	1.5	2.0	1.5
<i>Board Structure</i>	1.0	1.5	3.5	1.5	1.0	1.0
<i>Disclosure</i>	4.0	3.5	5.0	1.5	4.0	3.5
<i>Others</i>	1.0	0.5	2.5	0.5	2.5	0.0

# Comparison of CG frameworks in the GCC Countries with IIF Guidelines (on scale of 1-5 with 5 being fully compliant)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
<b>Accounting and Auditing</b>	2.0	2.5	4.0	2.0	2.5	2.0
<i>Standards</i>	3.0	3.5	3.5	3.0	3.5	2.5
<i>Audit Committee</i>	0.5	0.0	5.0	0.0	0.0	0.0
<b>Transparency of Ownership and Control</b>	2.5	3.5	3.5	1.0	4.5	2.5
<b>Regulatory Environment</b>	2.0	2.0	4.5	2.5	2.5	2.0
<b>OVERALL ASSESSMENT</b>	<b>2.0</b>	<b>3.0</b>	<b>3.5</b>	<b>2.0</b>	<b>3.0</b>	<b>2.0</b>



# Takeaway of IIF-Hawkamah Survey

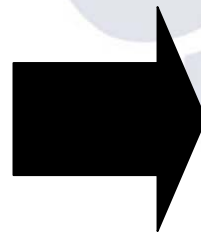
- Excess Liquidity in the GCC Region
  - ✓ Too much money chasing too few stocks
  - ✓ High valuations due to lack of sophisticated investor and poor equity culture
  - ✓ This creates high volatility in stock markets
- Easy access to capital provides little incentive for change at company level
- Efforts being made by authorities to improve overall corporate governance frameworks but some initiatives lack strategic focus and political will
- Banking sector in general has better corporate governance due to Basel II compliance

# Regulators

- GCC regulators seem to be professional but there are weaknesses that impact quality of regulatory environment
  - ✓ Political pressures
  - ✓ Lack of independence
  - ✓ Availability of skilled and professional staff
  - ✓ Weak underlying corporate laws

Existing regulatory structure in most GCC countries

- ✓ Regulator reports to Ministry of Commerce or Finance
- ✓ In some countries stock exchange also performs regulatory functions



Preferred regulatory structure

- ✓ Regulator independent from government ministry and stock exchange

# Stock Exchanges in the GCC

- Are at various stages of evolution although in general stock exchange play the role of both market maker and regulator, which creates conflicts
- Vary in size (market capitalization) and product offering
- Need to share a common technology platform, which could lead to integration of equity markets

Integration of GCC equity markets will make the region more competitive and help increase equity flows

# Individual and Group rankings of GCC Equity Markets

Rank	Country	Market Cap. (in Millions) as on Nov 11, 2006
1	Hong Kong	1,794,358
2	Russia	942,462
3	Korea	795,071
4	India	769,404
5	China	703,979
6	Brazil	643,549
7	South Africa	345,978
<b>8</b>	<b>Saudi Arabia</b>	<b>345,254</b>
9	Mexico	340,145
10	Malaysia	214,357
11	Turkey	159,355
12	Chile	157,668
13	Thailand	143,866
<b>14</b>	<b>UAE</b>	<b>143,344</b>
15	Poland	137,888
<b>16</b>	<b>Kuwait</b>	<b>130,756</b>
17	Israel	125,889
18	Indonesia	122,799
19	Egypt	75,906
20	Philippines	60,035
<b>21</b>	<b>Qatar</b>	<b>59,897</b>
22	Pakistan	47,370
23	Argentina	47,053
24	Colombia	46,754
25	Czech Republic	45,737
26	Peru	43,385
27	Hungary	37,812
<b>28</b>	<b>Bahrain</b>	<b>34,524</b>
29	Jordan	29,338
<b>30</b>	<b>Oman</b>	<b>12,548</b>
31	Venezuela	10,209
32	Bulgaria	7,592

- Only Saudi Arabia's equity market is in the top ten emerging market stock exchanges
- However, if combined, GCC equity markets would rank fifth after Hong Kong, Russia, Korea and India
- Integration is a key to stabilizing and growing the regions equity markets

# Planned GCC Corporate Governance Reforms

Bahrain	<ul style="list-style-type: none"> <li>The Ministry of Commerce in Bahrain has drafted a new Commercial Companies Law and a new code of corporate governance that will be enforced in the near term.</li> </ul>
Kuwait	<ul style="list-style-type: none"> <li>A new Capital Market Law will incorporate corporate governance-related requirements for companies.</li> </ul>
Oman	<ul style="list-style-type: none"> <li>The Capital Market Authority plans to reassess current corporate governance requirements in fall 2006.</li> <li>Authorities are considering privatization of Muscat Securities Market.</li> </ul>
Qatar	<ul style="list-style-type: none"> <li>Doha Securities Market will introduce a code of corporate governance by end 2006.</li> <li>Authorities are strengthening regulator's surveillance and enforcement of stock exchange and companies; they also created an independent regulator in 2005.</li> </ul>
Saudi Arabia	<ul style="list-style-type: none"> <li>The Capital Market Authority issued a draft code of corporate governance for public comment. It hopes to finalize and implement the code by end 2006.</li> </ul>
UAE	<ul style="list-style-type: none"> <li>The Emirates' Securities and Commodities Authority, the regulator for UAE, is currently drafting a code of corporate governance for listed companies.</li> <li>Abu Dhabi Securities Market recently issued corporate governance guidelines for listed companies for market feedback.</li> <li>Dubai Financial Market has drafted corporate governance guidelines for listed companies, which should become enforceable by fall 2006.</li> <li>The Ministry of Economy has drafted a new company law which includes corporate governance principles.</li> </ul>

# Improving performance: Recommended GCC CG Reform Measures (1)

- ✓ Develop a strong regulatory structure by clearly separating and defining the roles of the regulator and the stock exchange
- ✓ Increase effectiveness of regulators by making them fully independent of government
- ✓ Issue meaningful corporate governance codes and require mandatory compliance
- ✓ Build institutional capacity and strengthen surveillance and enforcement mechanisms to ensure compliance
- ✓ Strengthen the underlying corporate governance infrastructure by updating laws and creating specialized courts to deal with financial cases



# Improving performance: Recommended GCC CG Reform Measures (2)

- ✓ Promote training programs for directors of listed companies
- ✓ Promote investor education and enhance public awareness of good corporate governance principles and practices
- ✓ Introduce corporate governance best practices for state-owned and family-owned companies
- ✓ Grant foreign investors full access to equity markets and promote shareholder activism by foreign and domestic institutional investors and the media
- ✓ Create a regional level corporate governance task force to promote convergence and harmonization of laws and codes among GCC countries



# **Corporate Governance in the Middle East: Key Issues and Reforms**

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