

# **Corporate Governance in the UAE: Promoting Investment, Efficiency & International Integration**

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**'Let's Meet in Ras Al-Khaimah'**

**May 28-29 2005**

# AGENDA

- **What is CG**
- **Why does CG matter?**
- **What to do about it?**
- **What can UAE and RAK do?**
- **Proposals & recommendations**

# What is CG?

- Corporate governance refers to the set of rules and incentives by which the management of a company is directed and controlled so as to maximize the profitability and LT value of the firm for shareholders, while taking into account the interests of other stakeholders
- "Corporate Governance is the **system** by which **business** corporations are **directed & controlled**. The Corporate Governance structure specifies the distribution of **rights & responsibilities** among different **participants** in the corporation, such as, the board, managers, shareholders. [...] OECD 1999.
- ***CG applicable to Listed, Family-owned, SMEs and SOEs***

# 'New Institutional Economics' & "Good Governance"

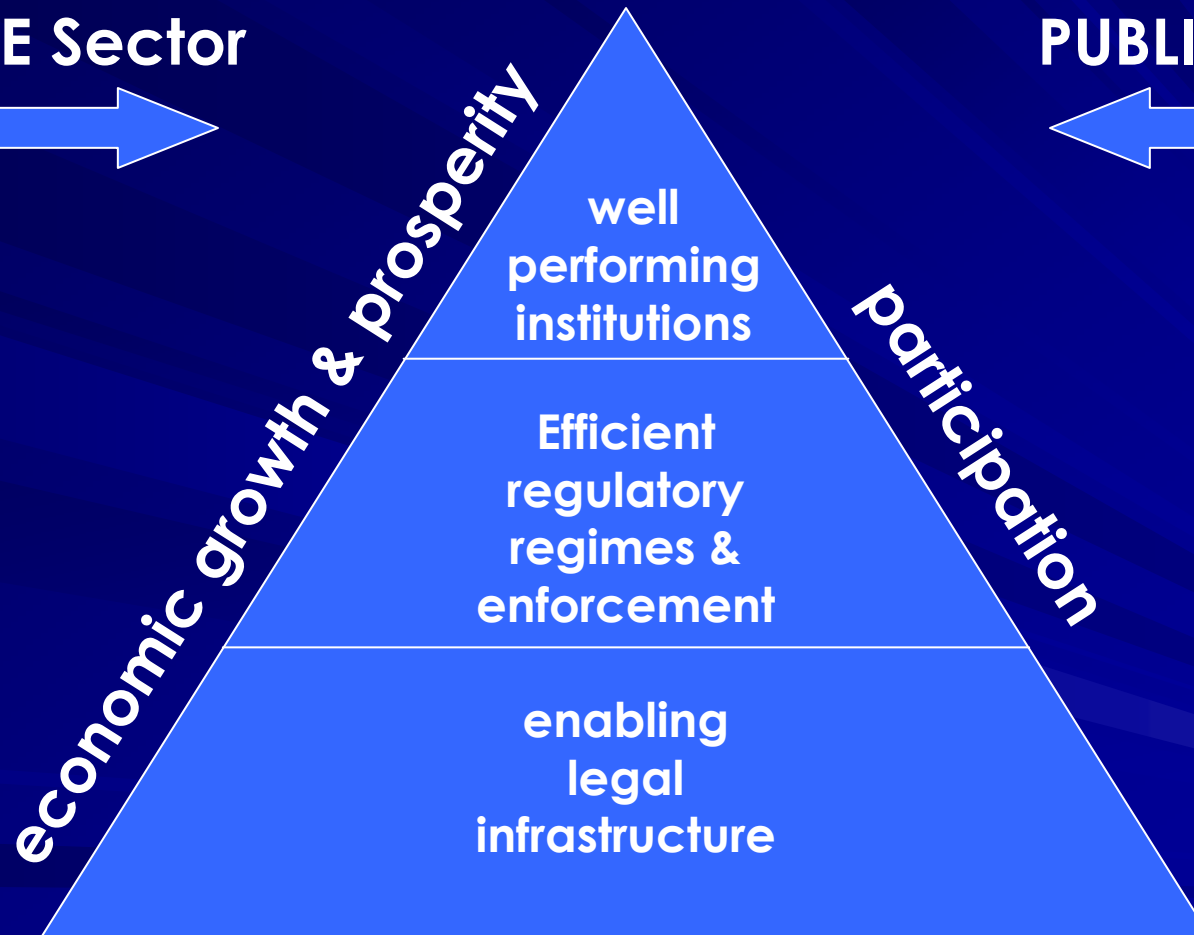
- Empirical evidence suggests that well performing institutions, enabling legal infrastructure, efficient regulatory regimes and enforcement; i.e. "good governance" are major contributors to economic growth & prosperity and democracy
- "Good governance" is required by both government and business in UAE

# CG & New Institutional Economics

**PRIVATE Sector**



**PUBLIC Sector**



**International Integration**

# Corporate Governance : Performance in Emerging Markets

Better CG  
correlates  
with

→ better  
operating  
performance

→ better market  
valuation of  
companies

Firm level CG  
provisions &  
practices  
matters even  
more wherever

→ weak  
shareholder  
rights

→ weak legal  
environments  
& weak  
public  
governance

Cross-country  
differences in  
laws &  
enforcement  
affect

→ ownership  
structure

→ dividend  
payouts

→ availability &  
cost of external  
finance

→ market  
valuations

# Impact of good governance

- At the country level, 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
- At a company level, companies with good governance tend to have higher values in the market & higher credit ratings
- Institutional investors consistently express preferences for companies with good governance.

[Sources: WB, OECD, CIPE]

# 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 financial instability and crisis (Asia, Russia, Latin America)



# Why CG Matters for Companies

- Good CG at the firm and the country level results in higher company valuations and higher credit ratings
- Efficient Operation / Profitability
- Access to finance & increased variety of financing instruments
- More competitive market for mergers & acquisitions

# Impact of good governance

- One study showed that the more active and independent a Board of directors is, the better the company performs.
- Various studies have concluded there is a 'governance premium' for companies which conform with local standards of best practice on corporate governance.

[Sources: WB, OECD, CIPE]

# Corporate Governance Principles (OECD)

- 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**

# 1. Minority shareholder protection

## **1. Protect the rights of minority shareholders:**

1. Right to vote on important matters
2. Right to buyback shares
3. Right to formally present an issue to the board of directors

## **2. Treat foreign shareholders equally with domestic shareholders: non-discrimination principle**

## 2. Responsibilities of the Board of Directors

- A majority of board members should be independent from management
- Boards should establish subcommittees to monitor & control
- All material information should be publicly disclosed – Transparency
- Develop an investor relations program that fully informs all shareholders of corporate activities

# 3. Accounting and auditing

- Firms should conform to accounting and auditing practices and standards i.e. comply with IAS (IFS)
- Audit committee should have a majority of independent directors, who should be able to read and understand fundamental financial statements
- All communications between the committee and external auditors should be without the company management present

# 4. Transparency of Ownership and Control

- Who controls a company?
- Who has significant ownership?
- Firms should disclose accurate, adequate, and timely information so as to allow investors to make informed decisions about acquisitions, ownership obligations and rights, and the sales of shares

# 5. Regulatory Environment

- Credible and transparent regulatory environment
- Regulatory environment must not be perceived to be under control or influence of any particular interest group
- Regulators should be independent



# Conclusions

- Empirically, strong investor protection is associated with more effective corporate governance which leads to: valuable and broad financial markets; wider ownership of shares; higher returns for shareholders & lower cost of credit for borrowers, higher valuation of firms, lower exchange rate depreciation & stock market declines after crises, etc..
- **Implications:**
  - Laws, Regulations and Enforcement underlie investment decisions!
  - Corporations in poor investor protection environments have to work harder to raise capital and need to be more creative.
  - Corporate Governance reform has large payoffs for firms, investors and countries.
- The UAE and RAK should put CG on the policy agenda to promote investment, growth and job creation.

[Sources: WB, OECD, CIPE]

# CG Focus

## Family Owned Enterprises (FOEs)

- Majority of U.A.E & MENA businesses & corporations are SMEs & family-owned
- Deal with 'dualistic' nature of MENA economies : SOEs and FOEs
- Develop relevant *incentive-compatible mechanisms for compliance*
- Reduce compliance costs
- Provide incentives for adoption & implementation

# Whether family-run firms are listed or privately held, to succeed, their owners must access capital, diversify wealth and manage succession

## Challenges for Family-Business Owners

### Challenge

### Issues

**Access Capital**

- Finance growth
- Balance debt/equity

**Diversify wealth**

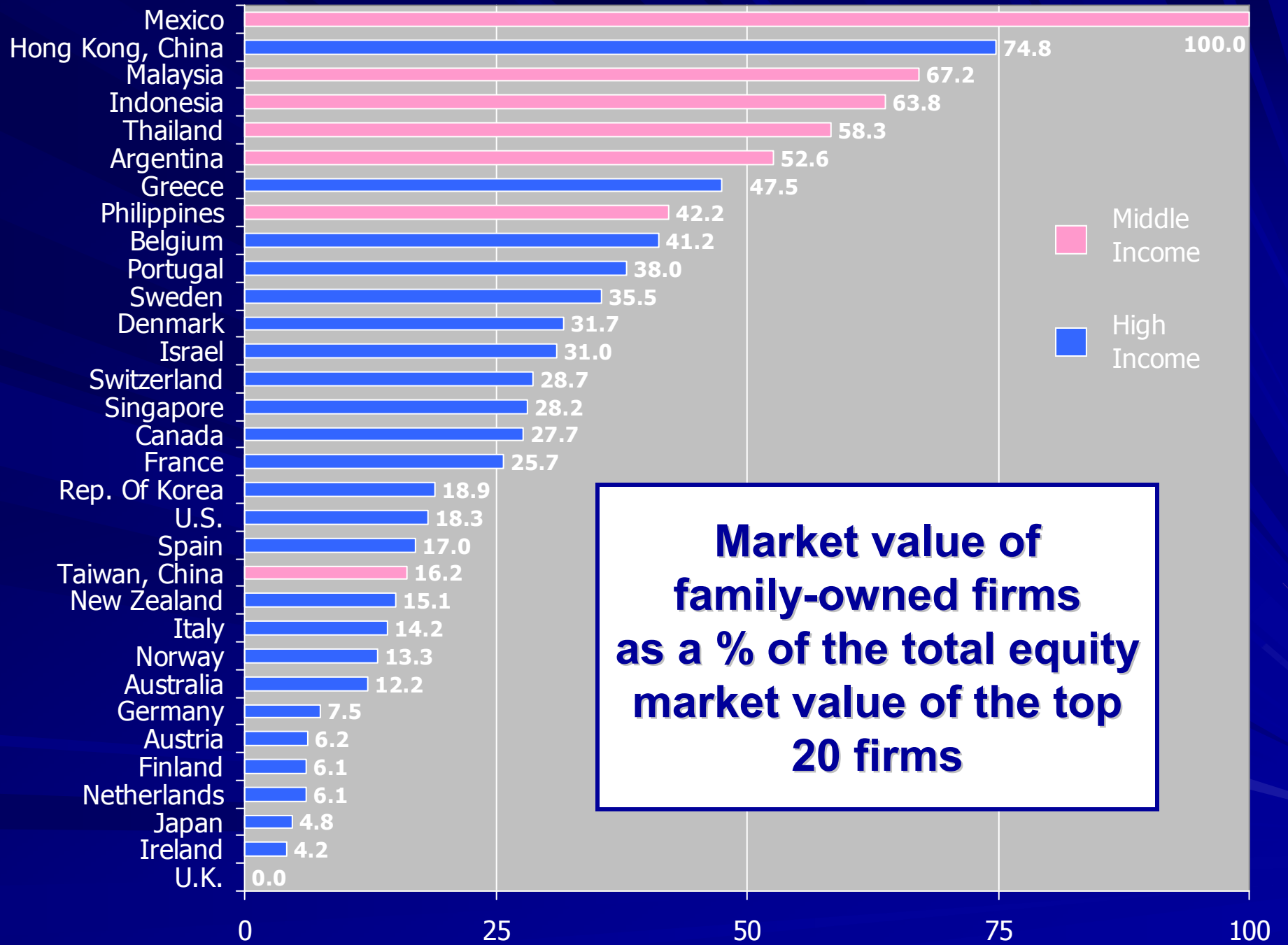
- Manage risk
- Provide liquidity

**Manage succession**

- Appoint competent directors/managers
- Adjust shareholdings pursuant to inter-generational hand-over
- Finance share transfers
- Balance jobs/compensation for family employees with returns to family shareholders

• These challenges and issues exist for all closely controlled firms

Source: OECD Analysis



# UAE CG Action Plan I

- *Put CG programme high on policy agenda*
- *Set-up a National Task Force for CG*
- *Undertake a CG survey & assessment*
- *Seek to apply the 12 Key Standards for Sound Financial Systems*
- *Adopt OECD CG Principles for listed companies*
- *Develop Code for FOFs*
- *Develop guidelines for SOEs*

# Guidelines for transparency and corporate governance in UAE

Proposal of a Draft Code of Corporate Governance comprising:

1. Minority shareholder protection
2. Responsibilities of the Board of Directors
3. Accounting and auditing
4. Transparency of Ownership and Control
5. Regulatory Environment

# UAE CG Action Plan II

- Strengthen the accounting and auditing professions and *ensure wide adoption of International Accounting and Auditing Standards* as the basis for disclosure and dissemination of information.
- *Governance is for both the public and private sector enterprises.*
- Establish strategy & change policies to reduce Cost of Doing Business (see WB indicators)

# UAE CG Action Plan III

- *The development of the Capital Markets should be a policy priority creating exits for FOEs and for privatisation of SOEs*
- *Focus on banking and financial sectors for adoption, implementation and enforcement of CG principles*
- *Develop & modernise legal infrastructure to Protect Shareholders & Creditors and to force timely disclosure of accurate information:*
  - *Company law*
  - *Bankruptcy law*
  - *Securities law*
  - *Mergers & Acquisitions law*
- *Build institutions:*
  - *Set-up an Institute of Directors*
  - *Set-up a Companies House*
  - *Establish Centralized Credit Reporting*



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***Thank you!***

**Q & A**