

Effective Bank Corporate Governance For the MENA Countries: Ownership, Control, Disclosure & Financial Markets

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Corporate Governance in the MENA Region
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Dr. Nasser Saidi*

**Executive Director Hawkamah Institute for CG,
DIFC*

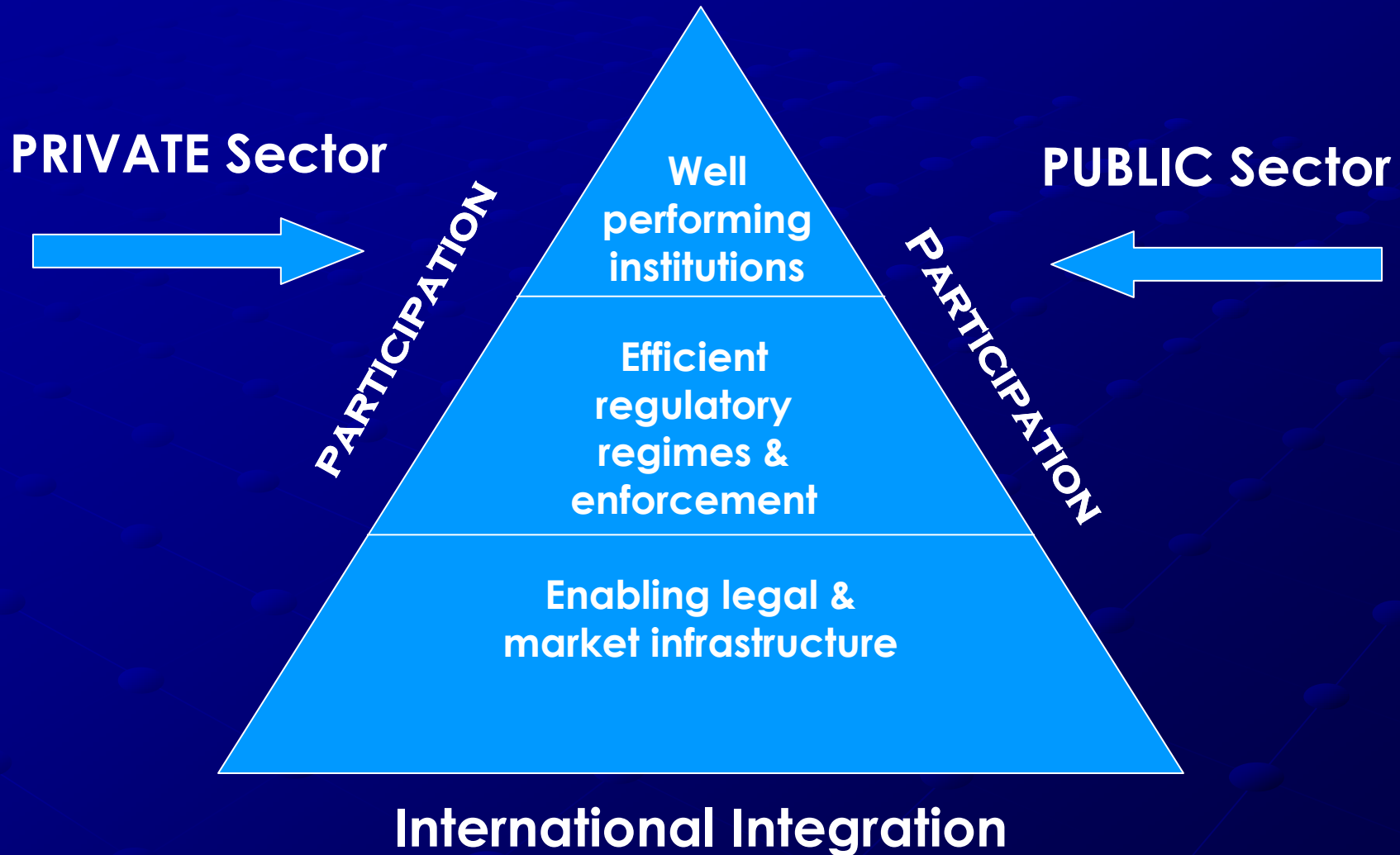
**Co-Chair OECD MENA WG on CG*

Agenda

- Legal Origins, Institutions & Corporate Governance
- Patterns of Ownership & Control
- Transparency & Disclosure
- The Imperative of Financial Market Development
- Some Priorities for the Way Forward

CG integral element of sustainable economic development & growth

Economic Growth & Prosperity



MENA countries differ in:

- Financial Market development
- Openness and International Integration
- Legal origins: Common Law vs. French Civil Code
- 3 Dimensions of Governance linked to CG:
 - Rule of Law & Judicial enforcement
 - Regulatory Quality
 - Control of Corruption

Table 2. Middle East and North Africa Countries: Financial Development Index, 2002/03 1/
(Based on Qualitative and Quantitative Data) Scale: 0-10 2/

	Financial Development Index	Banking Sector	Non-Bank Financial Sector	Regulation - Supervision	Monetary Sector & Policy	Financial Openness	Institutional Environment
Bahrain	7.66	7.28	5.00	9.33	7.77	8.00	8.89
Lebanon	6.97	8.74	3.33	7.67	8.25	7.00	5.22
Jordan	6.93	7.06	6.33	8.67	6.50	8.00	5.44
Kuwait	6.80	7.36	5.00	8.00	6.62	8.00	5.89
United Arab Emirates	6.60	7.89	5.00	6.67	5.98	8.00	5.89
Saudi Arabia	6.37	7.83	3.33	8.00	6.42	8.00	4.22
Oman	6.13	7.10	5.00	8.33	4.19	8.00	4.78
Qatar	5.68	6.81	0.67	6.67	5.66	8.00	6.33
Pakistan	5.60	4.19	6.33	7.67	7.37	4.00	3.89
Tunisia	5.57	7.70	4.67	5.33	4.46	5.00	5.00
Morocco	5.54	5.62	4.67	7.33	6.84	4.00	3.78
Egypt, Arab Rep.	5.45	5.99	6.33	5.33	5.57	6.00	3.22
Sudan	4.84	6.29	0.67	3.67	6.19	7.00	4.54
Yemen, Rep.	3.87	4.15	0.67	3.33	5.00	9.00	2.22
Djibouti	3.79	3.85	1.33	5.00	4.40	7.00	2.00
Mauritania	3.45	3.76	0.67	3.00	3.94	5.00	4.50
Algeria	3.23	2.55	3.00	3.46	4.36	4.00	2.33
Iran, Islamic Rep.	2.33	1.87	3.33	3.33	0.51	4.00	2.42
Syrian Arab Republic	1.13	1.92	0.67	0.00	0.90	0.00	2.42
Libya	0.99	1.35	0.67	2.00	0.50	0.00	1.00
Average	4.95	5.46	3.33	5.64	5.07	5.90	4.20

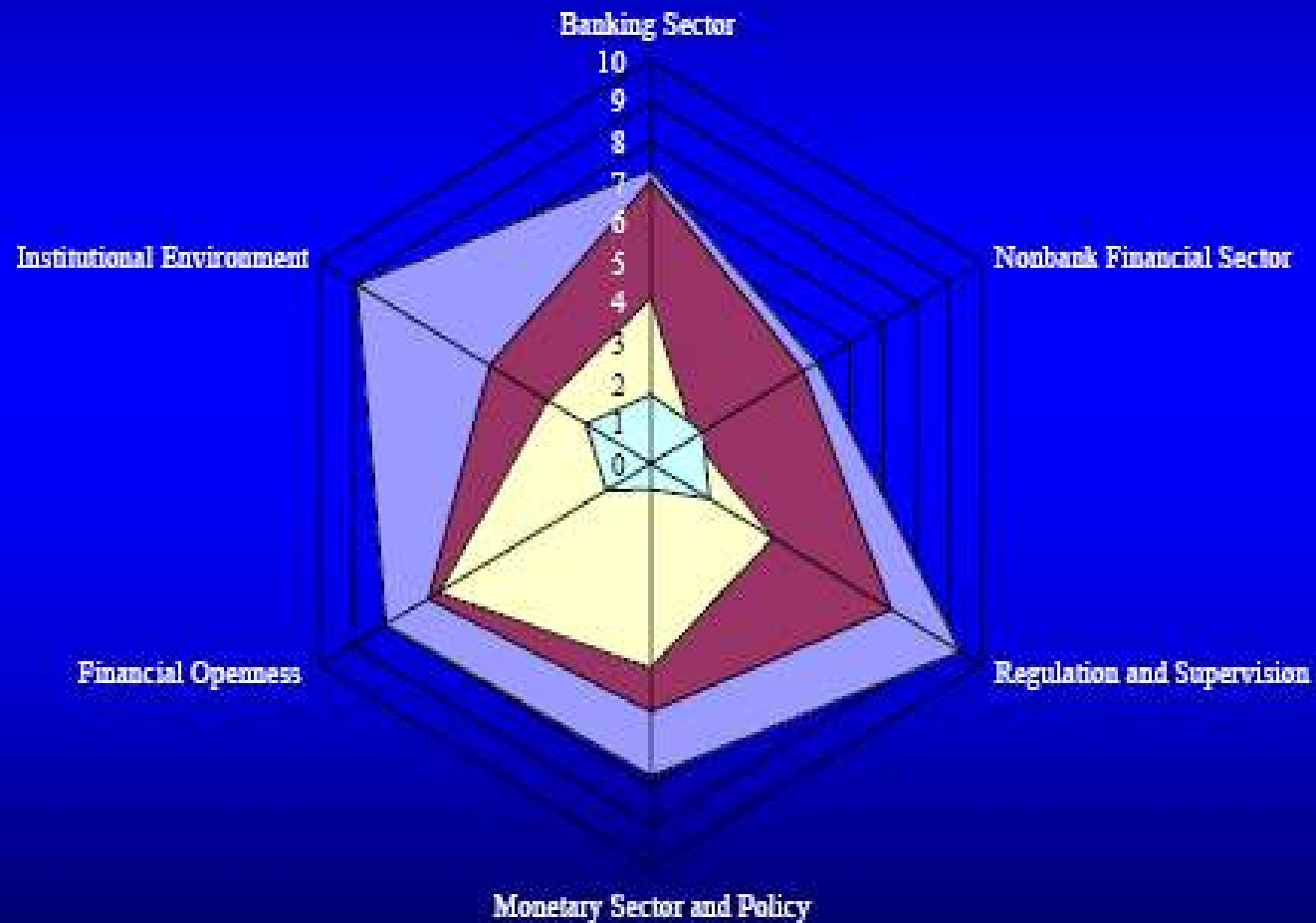
Source: IMF staff calculation

1/ 05 Mar 2006 objective" weighted index.

N Saidi Effective Bank CG in MENA

2/ Scale: Very Low=below 2.5, Low=2.51-5.0, Medium=5.1-6.0, High=6.0-7.5, Very High=above 7.5.

MENA: Comprehensive Index of Financial Development—Comparing Very High, High, Medium, Low, and Very Low Development Countries, 2002/03 (Scale 0-10)



- Average for Very High Financial Development
- Average for Medium-High Financial Development
- Average for Low Financial Development
- Average for Very Low Financial Development

Selected Banking Sector Indicators

	Public Banks *	Concentration **
Egypt	53	55
Iran	100	70
Kuwait	70	55
Lebanon	5	90
Libya	97	97
Morocco	41	50
Pakistan	54	49
Saudi Arabia	45	30

Source: IMF and S&P.

* Public banks' assets as a percent of total banking system's assets

** Top 3 banks' assets in percent of total banking system's assets.

Legal origins: Measures of Investor Protection (La Porta, 2002)

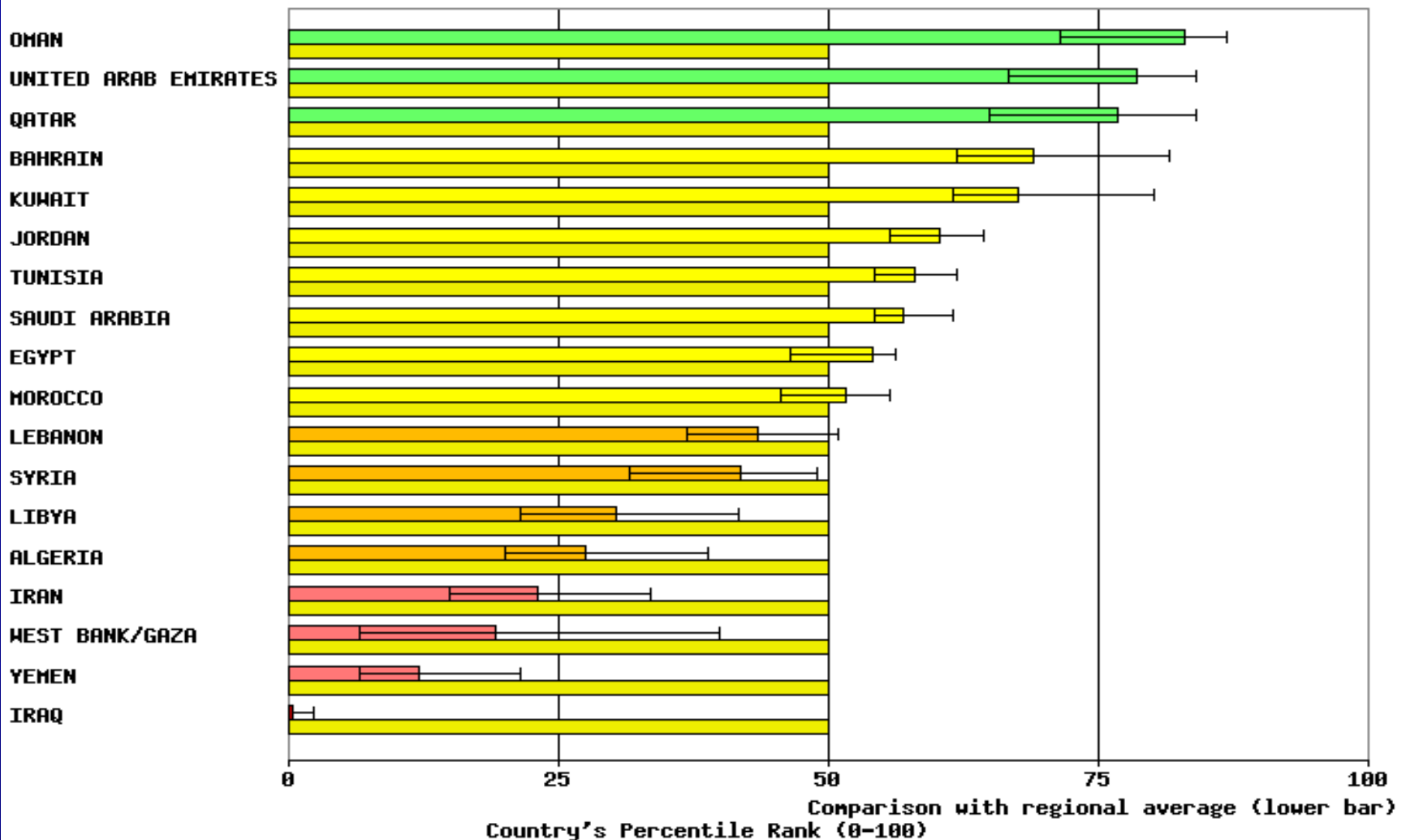
	Shareholder Rights (0-6)	Creditor Rights (0-4)	Efficiency of the Judiciary (0-10)	Accounting Standards (0-100)
Common Law	4.00	3.11	8.15	69.62
French Civil Law	2.33	1.58	6.56	51.17
German Civil Law	2.33	2.33	8.54	62.67
Scandinavian Civil Law	3.00	2.00	10.00	74.00
World (49 countries)	3.00	2.30	7.67	60.93

CG & Investor Protection: Performance in Emerging Markets

- Better CG highly correlated with better operating performance and market valuation
- Cross-country differences in laws & enforcement affect ownership structure, dividend payouts, availability & cost of external finance and market valuations
- Firm level CG provisions & practices matter even *more* in countries with weak shareholder rights and weak legal environments

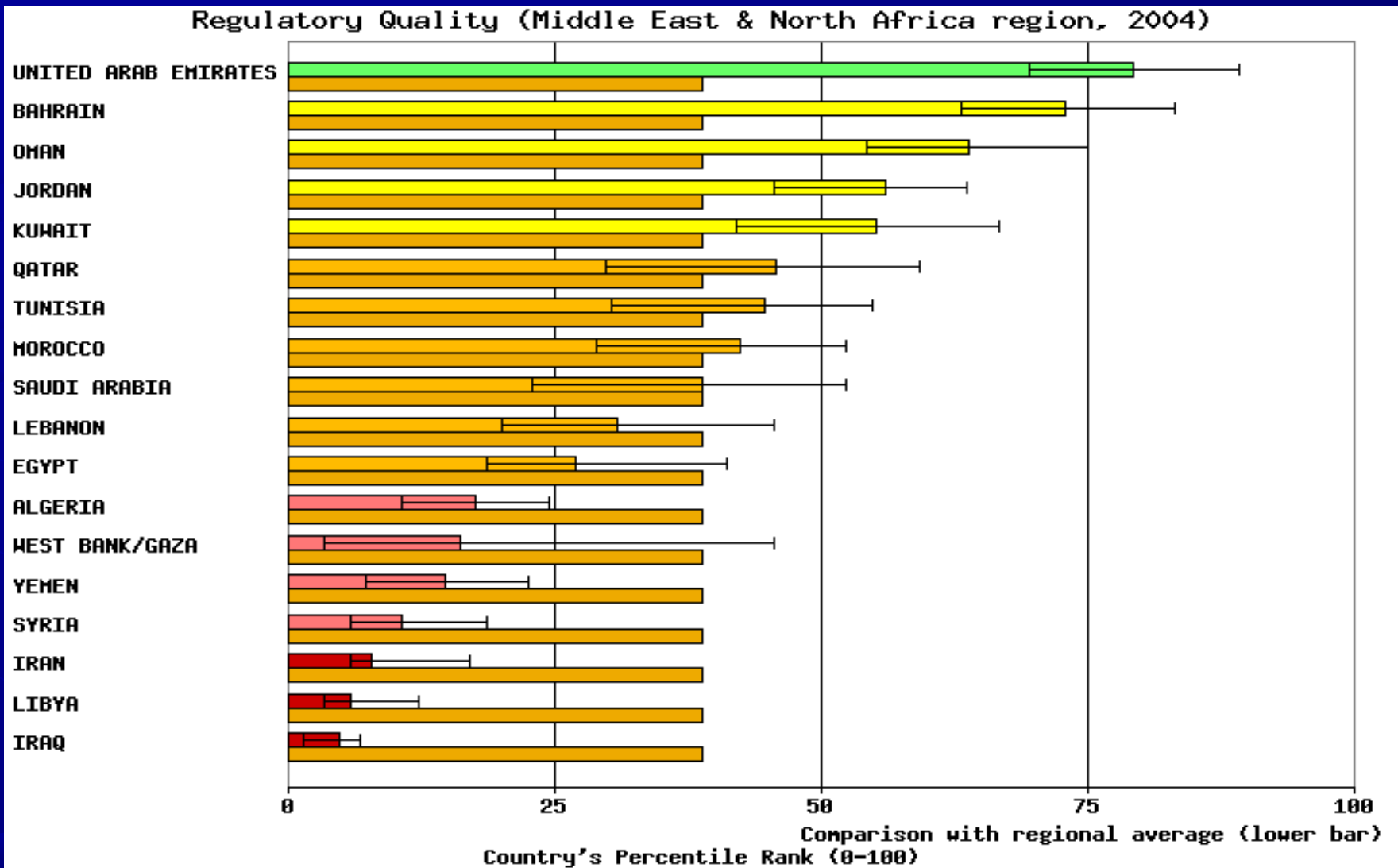
Governance: Rule of Law, MENA 2004

Rule of Law (Middle East & North Africa region, 2004)



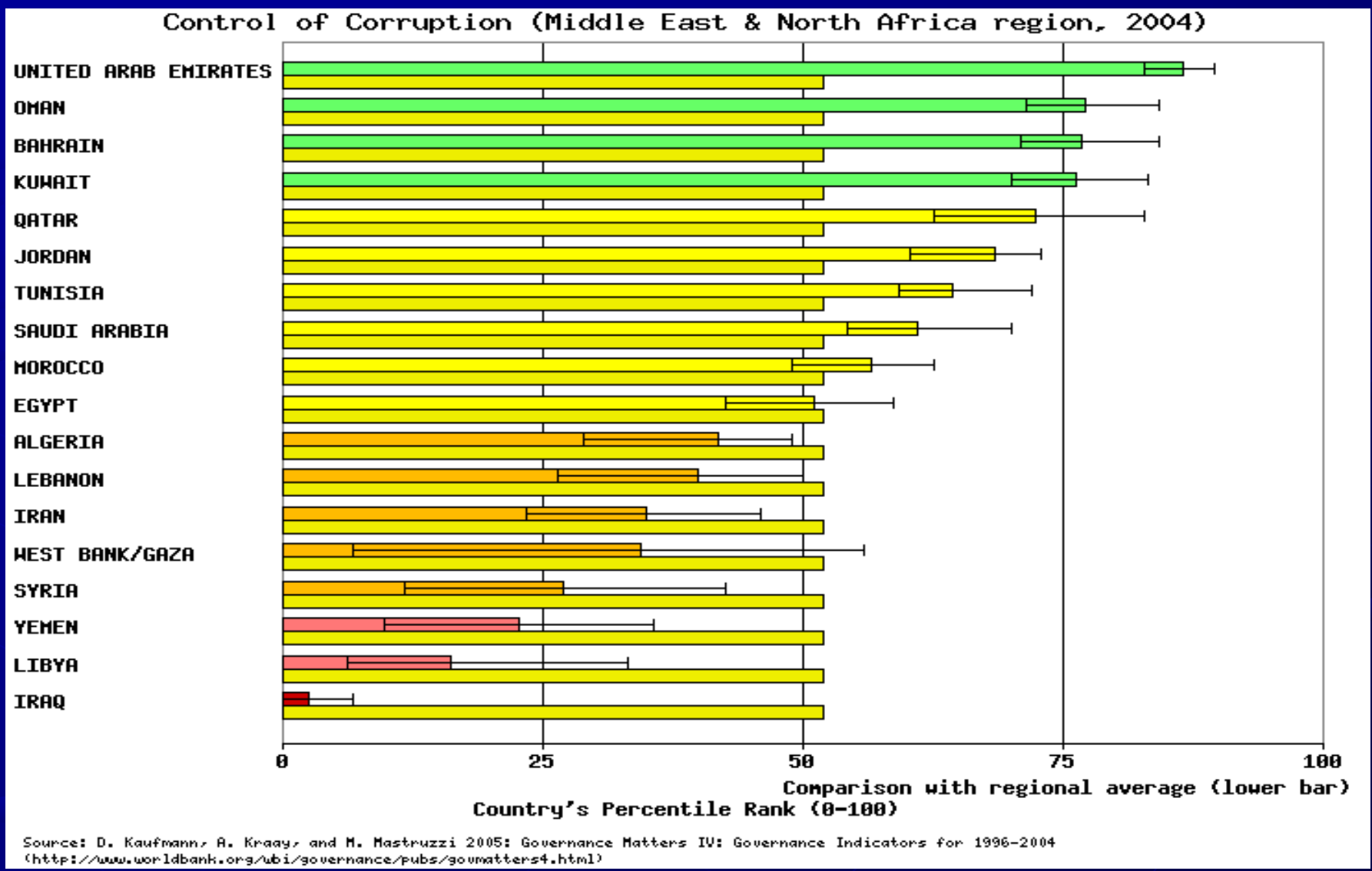
Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2005: Governance Matters IV: Governance Indicators for 1996-2004 (<http://www.worldbank.org/ubi/governance/pubs/goumatters4.html>)

Governance: Regulatory Quality, MENA 2004



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2005: Governance Matters IV: Governance Indicators for 1996-2004 (<http://www.worldbank.org/wbi/governance/pubs/govmatters4.html>)

Governance: Control of Corruption MENA 2004



Main Observations and Trends: I

- MENA FS less developed than other regions at similar level of economic development
- No surprises in country rankings
- FS are bank dominated systems
- Colonial past and its economic history are major institutional factors explaining bank dominance of FS as well as the choice of exchange rate regime in the MENA countries
- FS liberalization & Reform, Privatization process yielded limited change: no 'popular capitalism'
- 'Roaring 1990s' lost decade for MENA: did not lead to financial market development

Main Observations and Trends: II

- MENA FS have limited integration with international capital markets
- Government ownership and intervention in the banking and financial sector have been a major contributor to its lack of development and by implication lack of contribution to economic growth
- Region's relatively good performance in bank regulation and supervision largely attributable:
 - Implementation of international standards, in particular the Basel Core Principles
 - Banking supervision appointments have tended to be non-political, technical and professional

Bank CG in MENA important due to

- Banks' dominant position in financial & payment systems
- Banks dominate both credit and investment process for economy and for majority of firms
- Government ownership and concentration of ownership of banks
- Prudential regulation & supervision is sometimes weak
- Disclosure and reporting requirements inadequate: differences in accounting & auditing standards
- Government deposit guarantee policies leading to greater risk taking by banks
- Limited degree of external competition
- Liberalization & opening-up is providing greater latitude to banks

CG Focus: Family Owned Enterprises (FOEs)

- **Majority of MENA banks & corporations are FOEs & SOEs**
- **Deal with 'dualistic' nature of MENA economies : SOEs and FOEs**
- **Provide incentives for adoption & implementation**
- **Develop relevant *incentive-compatible mechanisms for compliance***

Issues Facing Family Banks

- Succession: who will succeed?
- Preservation of Wealth: sustainability
- Wealth Risk minimization
- Separation of ownership and management: agency problems
- Separation: allows specialization in mobilizing capital (shareholders/creditors) and efficient resource use (management)
- Large v/s minority shareholders

Family-run firms, listed or privately held, must access capital, diversify wealth and manage succession, to succeed and survive

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

Transparency & Disclosure

- Differences in approach and culture between developed & emerging markets: shame (“aiib”) vs. guilt
- Incentives to reveal, disclose true performance
- Role of taxation systems
- Systematic introduction of international accounting & auditing standards

Lebanon CG Survey of CEOs 2004*

- Impediments of Legal System & Judiciary
- Impediments to & Cost of Doing Business
- Corruption
- Perception of Legal System
- Bureaucracy & State Intervention
- Lobbying
- Auditing
- Shareholders, Boards & Management
- Banking

**Source: N Saidi, CG in Lebanon: A Survey, 2004*

CG Reform in Lebanon; CEO Respondents stressed as 'Very Important':

- Enforcing laws, rules, and procedures: 82.8%
- Stress on Independent judiciary: 75.8%
- Stress on Tax and financial disclosure: 76.6%
- Stress on Monitoring bodies to ensure compliance: 68.8%
- Stress on Accounting standards: 67.2%
- Stress on Financial market regulation: 57.8%
- Stress on Boardroom politicization: 47.7%
- Stress on Privatization of state owned enterprises: 28.9%

MENA CG Priorities I

- **Development of the Capital Markets should be a policy priority enabling exit strategies for FOEs (including bank-FOEs) and privatisation of SOEs**
- **Balanced development of financial intermediation channels: banks, debt and capital markets**
- **CG reform of State Owned Enterprises**
- **Develop & modernize 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 Companies Houses'**
 - **Establish Centralized Credit Reporting**

MENA CG Priorities II

- Good CG in banks should precede divestiture or privatization
- Gradual liberalization and opening-up preceded by improved prudential regulation & supervision
- Improve financial disclosure and transparency; adopt IFRS
- Effecting 'CG culture' change will take time
- Hawkamah CG Institute to promote CG reform and good CG practices

MENA CG Priorities III

- Focus on banking and financial sectors for adoption, implementation and enforcement of CG principles. Banking system should spearhead CG reform
- Central banks & bank supervisory authorities should introduce CG principles in banks & financial institutions as mandatory:
 - Effective monitoring
 - Effective enforcement
 - Integral part of external audit
- Establish ‘cascading CG” approach: guidelines for CG for corporate clients of banks and financial system as part of risk mitigation strategy
- Good CG in banks:
 - Complementary to Basel II requirements
 - Improves CG in corporate sector
 - Banks benefit from better CG in markets

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Thank you