

Good Governance: Core Principles for Family Businesses in LEBANON & MENA



Dr. Nasser Saidi



Core Principles for Good Governance

- n Evidence from economic growth and financial crises
- n Role & importance of good governance
- n Evidence on Governance in MENA
- n Proposals and recommendations for Lebanon & MENA countries
- n Proposed Action Plan



'New Institutional Economics' & "Good Governance"

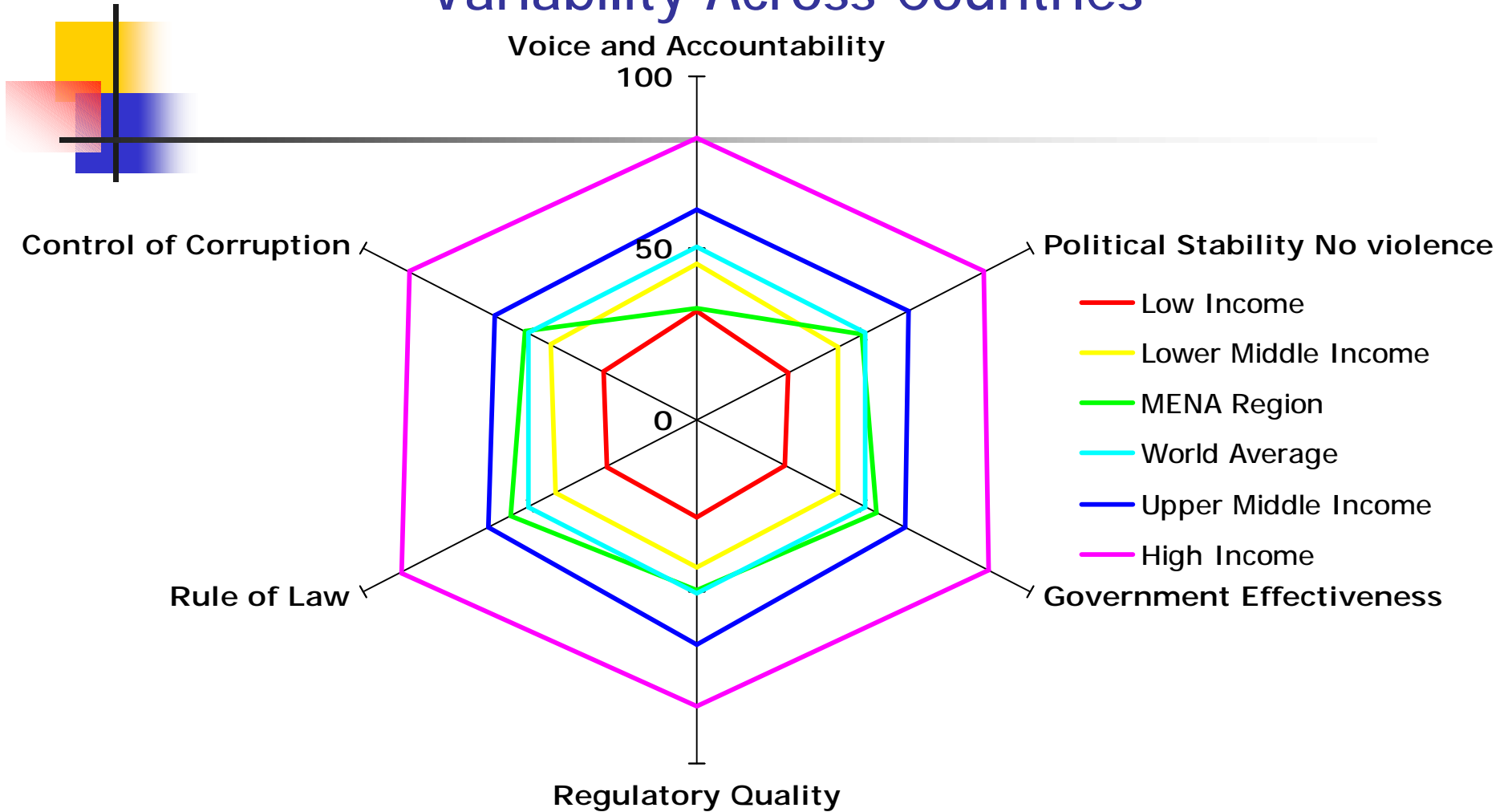
- n Empirical evidence suggests that well performing institutions, enabling legal infrastructure, regulatory regimes and enforcement, "good governance" are major contributors to economic growth & prosperity and democracy
- n "Good governance" is required by both government and business in MENA & Lebanon
- n Good CG essential in MENA & Lebanon to compensate for *weak overall (i.e. public) governance*

Dimensions of Good Governance (Source: World Bank)

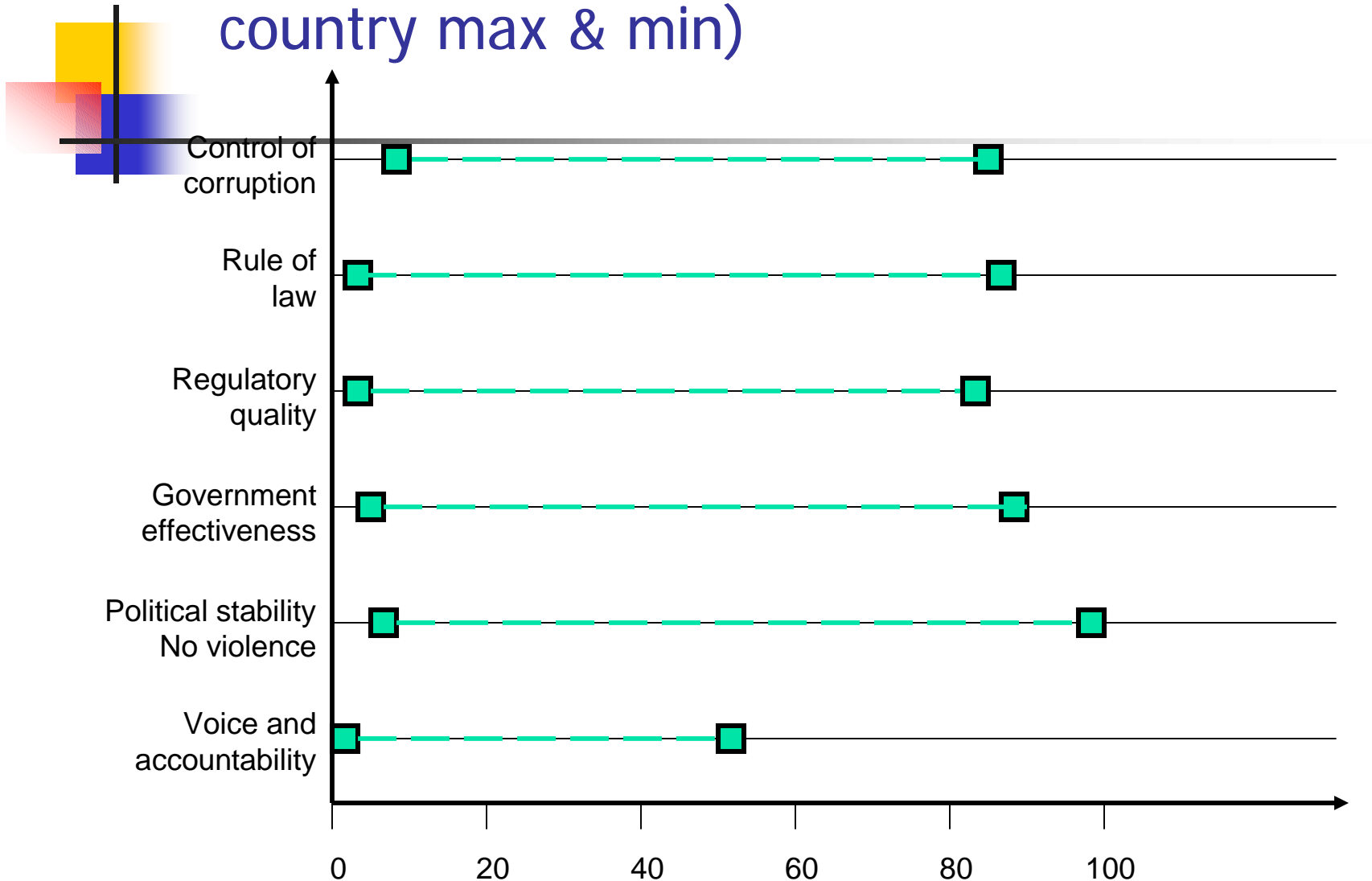
- n Voice and accountability
- n Political stability; No violence or conflict
- n Government effectiveness
- n Regulatory quality
- n Rule of law
- n Control of corruption



MENA Governance: Below Average; High Variability Across Countries



MENA Governance: Below Average; High Variability Across Countries (© indicates country max & min)



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Good Governance in MENA: Focus on SMEs & Family Businesses

- n Majority of business & corporations in MENA are SMEs & family-owned
 - n Lebanon: >85% of industrial companies have less than 10 employees
- n Deal with 'dualistic' nature of MENA economies: SOE's dominate many economies
- n Need to develop relevant *incentive-compatible mechanisms for compliance with CGG principles*
- n Need to reduce compliance costs
- n Provide incentives for adoption & implementation of CG Principles



Core Principles for Good Governance in Family Businesses in Lebanon & MENA

- n Change attitudes towards value of effective, transparent & accountable corporate governance: role of media, Parliaments, SRO's, business organizations & associations
- n Develop & adopt core principles for family businesses and SMEs
- n Amend laws to:
 - n Increase protection of minority shareholders
 - n Separate management from ownership
 - n Reform Law on Bankruptcy & Insolvency
 - n Develop Securities Law



Family business & Governance

The patriarch of an established successful family-owned business died and went to Heaven. At the gates to heaven, the patriarch asked God when there would be a family-owned business that was governed efficiently and in compliance with the rules on corporate governance.

God thought for a moment and then replied, "not in my lifetime".



CG & Investor Protection: Performance in Emerging Markets

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

http://www1.worldbank.org/finance/assets/images/Litan_Pomerleano_Sundararajan--finsec_gov-ch01.pdf (See WB Institute papers)



Issues Facing Family Business

- n Succession: who will succeed? How to ensure survival and continuity?
- n Separation of ownership and management: trade-off
- n Separation: allows specialization in mobilizing capital (shareholders/creditors) and efficient resource use (management)
- n Large v/s minority shareholders



Alternative Patterns of Separation of Ownership & Management

n Anglo-Saxon:

- n Founder/entrepreneur
- n Professional manager
- n Exit: sell-out

n European:

- n Founder/entrepreneur
- n Heirs + professional management
- n Retain ownership

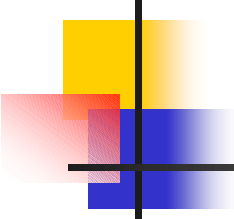
n Asian/EM:

- n Heirs
- n Maintain ownership



CG of banks: prominent example of family business in Lebanon

- n Liquidity and solvency problems
- n Opaqueness of banks:
 - n Difficulty in monitoring & evaluating bank managers; likeliness for family members to exploiting the private benefits of control
- n Abilities of bank managers to shift into higher risk activities
- n Money Laundering activities
- n Crowding out effect, less market competition



Regulatory environment is imperative: comply with international standards, including BIS

- n Conditions for establishing banks
- n Internal audit by banks
- n Law on illicit enrichment
- n Law on the issuance of and trading in bank shares, the issuance of bank bonds, and the ownership of real estate by banks
- n Anti-money laundering Law
- n Legal or supervisory limitations on connected lending
- n Minority shareholders protection



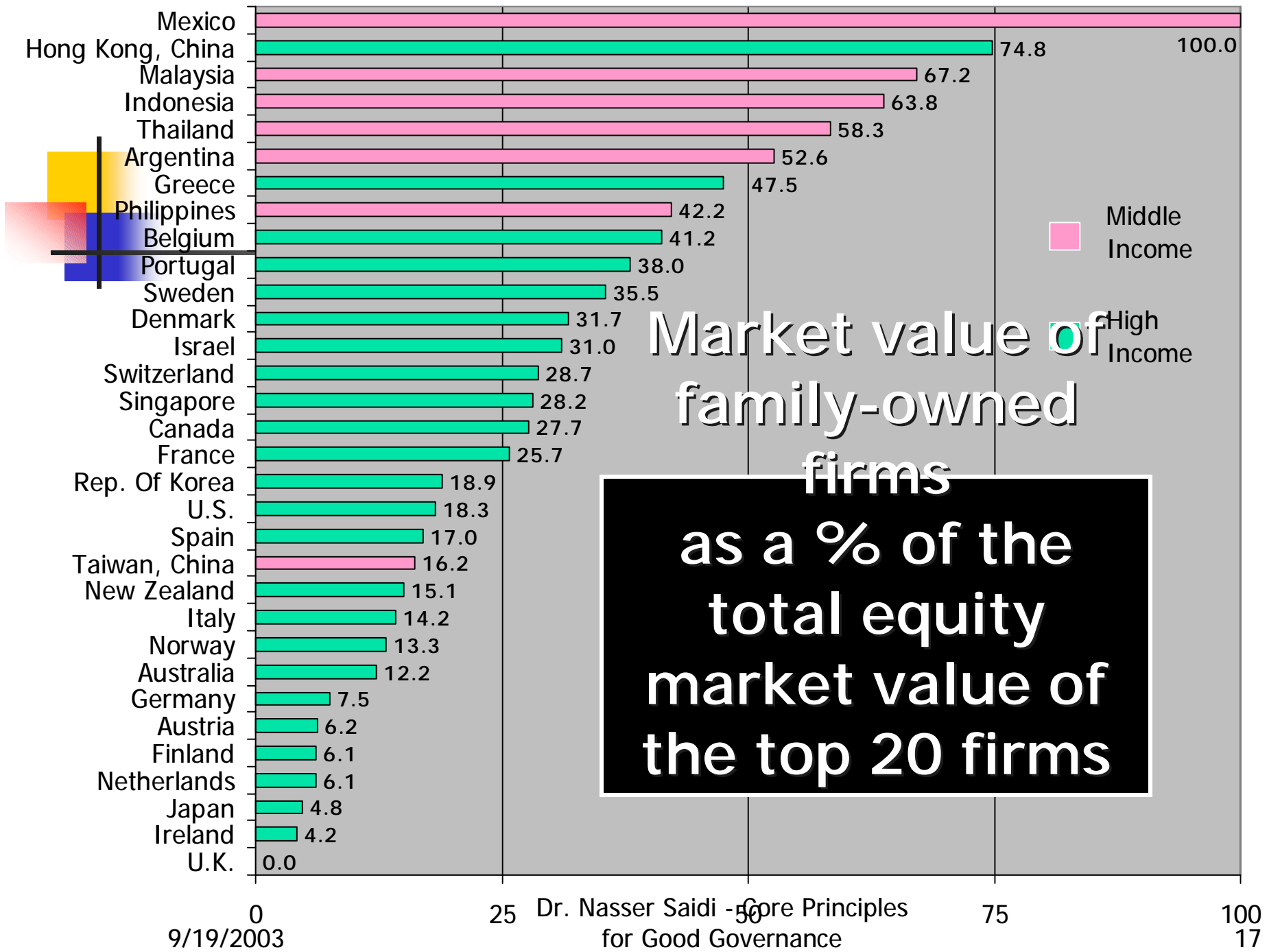
Bank CGG matters

- n Bank corporate governance is a prelude to CG for family businesses in Lebanon
- n Provide a quantity and a quality of banking services to accommodate overall economic development and minimize the threat of serious systemic crisis
- n Role of the government: laws & regulations
- n Improving the information environment
- n Attract foreign investors



Families and Finance in Lebanon & MENA

- n Families/entrepreneurs should actively promote development of financial markets:
 - n Reduce risk through diversification and divestment of family assets
 - n Exit strategy: solution to successor problem and equity in family inheritance
- n Capital Markets Development should be a priority for MENA countries





OECD: Principles of Good Corporate Governance

1. Shareholder rights
2. Equitable treatment of shareholders
3. Role of shareholders
4. Disclosure and transparency
5. Responsibilities of the board



Financial Stability & Soundness Standards

- n **Macroeconomic Policy and Data Transparency**
- n **Institutional and Market Infrastructure**
- n **Financial Regulation and Supervision**

Macroeconomic Policy and Data Transparency

- n Monetary and Financial Policy Transparency
 - n Code of Good Practices on Transparency in Monetary and Financial Policies IMF
- n Fiscal Transparency
 - n Code of Good Practices in Fiscal Transparency IMF
- n Data Dissemination
 - n General Data Dissemination System IMF
- n Data Compilation



Institutional and Market Infrastructure

- n Insolvency & bankruptcy World Bank

- n Corporate Governance
 - n Principles of Corporate Governance OECD
- n Accounting
 - n International Accounting Standards (IAS)
- n Auditing
 - n International Standards on Auditing (ISA)
- n Payment and Settlement
 - n Core Principles for Systemically Important Payment Systems BIS
 - Recommendations for Securities Settlement Systems CPSS/IOSCO
- n Market Integrity
 - n Forty Recommendations + 8 Special Recommendations Against Terrorist Financing of the FATF
- n Market Functioning

Financial Regulation and Supervision



Banking Supervision

- n Core Principles for Effective Banking Supervision BCBS

n Securities Regulation

- n Objectives and Principles of Securities Regulation IOSCO

n Insurance Regulation

- n Insurance Core Principles IAIS

n Financial Conglomerate Supervision



Lebanon's Compliance with Financial Soundness Standards

- n *Monetary and financial policy transparency/ Code of Good Practices on Transparency in Monetary and Financial Policies*, with the issuing body being the IMF.
 - n Lebanon has achieved substantial progress in this area
- n *Fiscal policy transparency/Code of Good Practices in Fiscal Transparency*; the issuing body is the IMF.
 - n Lebanon is seeking to implement the Code
- n *Data dissemination/ Special Data Dissemination Standard (SDDS)/General Data Dissemination System (GDDS)*, IMF
 - n Lebanon has now entered the GDDS and the Central Bank, with assistance from international institutions (IMF, World Bank) is establishing the Lebanese Statistics Portal (LebStat), which will provide a statistics gateway, a single-access point to available economic, social, financial and real sector data



Lebanon's Compliance with Financial Soundness Standards

n *Insolvency and Bankruptcy Procedures*

- n* The World Bank is assisting the Lebanese government in drafting modern insolvency and bankruptcy laws. Principles of bankruptcy are essential for the viability of corporate governance.
- n* *Principles of Corporate Governance*
 - n* The standard defined by the OECD awaits formal adoption in Lebanon by relevant institutions such as Chambers of Commerce, business & professional associations
- n* *Accounting*—International Accounting Standards, issued by the IASB
 - n* Lebanon recognizes the IAS, but there is no mandatory implementation by business or effective enforcement.
- n* *Auditing*—International Standards on Auditing, issued by the IFAC
 - n* Lebanon recognizes the ISA, but there is no compliance mechanism for the auditing and related professions.

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Lebanon's Compliance with Financial Soundness Standards

- n *Payment and Settlement*— Core Principles for Systemically Important Payment Systems and the Recommendations for Securities Settlement Systems, issued respectively by the BIS-CPSS and the BIS-IOSCO
 - n Lebanon has, with the assistance of the IMF, modernized its payments media and systems, bringing them into compliance with BIS Core Principles and related recommendations
- n *Market integrity*—40 Recommendations of the Financial Action Task Force (FATF) and 8 Special Recommendations Against Terrorist Financing, issued by the FATF.
 - n Lebanon has issued and enforces a modern Anti-Money Laundering Law (No. 318, April, 2001)



Lebanon's Compliance with Financial Soundness Standards

Banking supervision

- n Lebanon is at the forefront among emerging economies in the application of the Core Principles for Effective Banking Supervision issued by the BIS and related measures, such as the creation credit and audit committees, general audit, and independent surveillance reporting that are directly accountable to the board of directors. It has a well-managed, professional and independent Banking Control Commission.



Lebanon's Compliance with Financial Soundness Standards

- n *Securities regulation*—the standard is the implementation of the Objectives and Principles of Securities Regulation, issued by the IOSCO.
 - n Lebanon cannot effectively enforce principles and regulations in this key area, until the government establishes an independent capital market authority with the relevant mandate
- n *Insurance supervision*— Insurance Core Principles (ICP), issued by the IAIS
 - n An independent Insurance Control Commission has been established as a result of passage of a Law (in 1999) leading to extensive reform of the insurance industry in Lebanon. However, policy measures have yet to be taken to implement the ICP.



Recommendations & Proposals I

- n Change attitudes: highlight high value of effective, transparent & accountable public & corporate governance
- n CG practices matter more in Lebanon due to weak overall governance, protection of minority shareholder rights, legal & judicial systems
- n Standardize Accounting and Auditing Practices



Recommendations & Proposals II

- n Families/Entrepreneurs should contribute to development & well-functioning of financial markets
- n Reforms:
 - n Amend Laws to protect investors and minority shareholders
 - n Introduce separation between Board and Management
 - n Modernize & Reform Insolvency & Bankruptcy Law
 - n Introduce a comprehensive Capital Markets Law
- n Appoint a Commission to develop set of Core Principles for Good Corporate Governance



Guidelines for transparency and corporate governance in Lebanon

Proposal of a Draft Code of Corporate Governance (base on Cadbury report) :

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



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

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



3. Accounting and auditing

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



4. Transparency of Ownership and Control

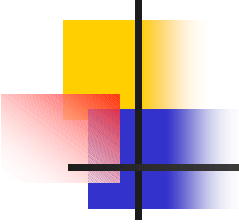
- n Who controls a company?
- n Who has significant ownership?
- n Firms should disclose accurate, adequate, and timely information so as to allow investors to make informed decisions about acquisitions, ownership obligations and rights, and the sales of shares
- è Establish 'Companies House' that would centralize information on companies



5. Regulatory Environment

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

Good Governance Strategy for MENA countries [1]

- 
- n Adopt and monitor progress in implementing 12 Financial Soundness Codes & Standards
 - n Adopt Cadbury Report principles for SMEs and FOEs; Adopt OECD CG for listed companies
 - n Right to Know & Right to Tell: seek to enact a 'Freedom of Information Act'
 - n Use banking & financial sector to enforce CG



Good Governance Strategy for MENA countries [2]

- n **Develop Central Credit Organizations** to report on sources and uses of credit (bank, non-bank & supplier credit): more and improved credit information leads to lower borrowing costs, improves access to credit, develops credit rating system, improves 'good standing', encourages investment and facilitates access to export markets
- \ **Rewards good governance**



Regional CG Cooperation: elements of an Action Plan [1]

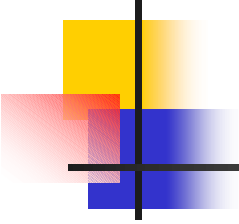
- n *Regional* dialogue on CG is important: expand participating countries & organizations
- n Build on the substantial economic, financial, banking and other reforms undertaken by some countries: reinforce reform agenda
- n Prepare for Paris meeting:
 - n Representation of the voice of the region
 - n Process should be demand driven
 - n Attract & involve other stakeholders: investors, media



Regional CG Cooperation: elements of an Action Plan [2]

- n Set-up and develop an Institute of Directors
- n Focus on Developing the capital markets
- n Establish a CG-Working Group for the MENA region: objective is to improve investment climate for the region
- n Establish a website for CG for the countries of the region to enhance networking potential and disseminate information
- n Adopt the Financial Soundness Standards as a framework for action on Public and Corporate Governance for the region

Good Governance Strategy for MENA countries [3]

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- n Set-up national 'Companies House' to implement centralized financial reporting and disclosure of corporate actions
 - n Encourage set-up of local rating agencies to ease compliance with Basel II standards
 - n Set-up Working Group on MENA CG
 - n Develop incentives for disclosure and CG:
 - n Set-up national websites of good CG companies
 - n OECD-WB to set-up a gateway that would provide a Network for good CG complying companies



Thank you

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