From Family to Public Governance: Lessons from the Arab Spring

Key note speech on occasion of the inauguration of Rami Fouad Makhzoumi Chair of Corporate Governance, American University of Beirut, Olayan School of Business

31 October, 2011

Dr Nasser Saidi[1]

Excellences, the Makhzoumi Family, Ladies and Gentlemen,

It is a distinct privilege and honour for me to be with you today at this inauguration of the Rami Fouad Makhzoumi Chair of Corporate Governance within the AUB's Olayan School of Business. The Chair will stand in testimony to Rami Makhzoumi's commitment to and practice of the principles of good corporate governance, which he advocated as a matter of personal conviction.

Corporate governance is starting to take root in the region, but key challenges remain. It is imperative that we build upon this momentum of governance reform and the establishment of the Rami Fouad Makhzoumi Chair of Corporate Governance within the American University of Beirut is an important step in supporting the governance movement in the region.

This is important for two reasons: First, the need for building institutions. The Hawkamah Institute for Corporate Governance has persistently advocated the need to build institutions in the region - institutions of the region, for the region. Only institutions and the establishment of the rule of law -not one-man shows and autocracies- provide the continuity which is essential for sustainable, long-term economic, political, cultural & social development.

Second, there is a shortage of corporate governance research in the region. Quality data & research are required to guide policymaking and advance private sector understanding of key implementation gaps and possible measures to bridge them. Today and tomorrow in Dubai, Hawkamah is hosting its 6th Annual Regional Corporate Conference, on "Arab Spring & Governance: Words to

---

[1] Executive Director, Hawkamah Institute for Corporate Governance, Mudara Institute of Directors, and Chief Economist, Dubai International Financial Centre.

Action". We will be calling for setting up a regional research platform for academics, research institutions and practitioners. We welcome the engagement of the Rami F Makhzoumi Chair and AUB in this initiative.

The state of corporate governance in MENA

It is only in the last ten years that an Arabic word for corporate governance, *Hawkamah*, has emerged. We forged it out of three words: Government ('houkouma'), to rule ('hikm') and wisdom ('hikmat') and adopted it for the name of our institute.

The main principles of corporate governance are well described by the OECD definition: *"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance."*

In the initial years, Hawkamah's calls for corporate governance reform were very much like voices in the desert. A benchmark survey Hawkamah undertook with the IFC in 2007 found that only 3% of listed companies and banks in the MENA followed good corporate governance practices, with none complying with international best practices.

Much has changed since then: the concept and principles of corporate governance are now well accepted, but the focus should now be implementation. Official codes and guidelines for listed companies have been established in most MENA countries, though Lebanon is lagging, having only recently issued guidelines, albeit voluntary, for the banking sector based on BIS guidelines.

International best practices, codes and regulations are a valuable resource we can draw from, but regulations do not always travel well. There is no 'one size fits all'. This is particularly true in the realm of corporate governance, where the appropriate model depends on a number of structural realities such as the prevalent ownership structures of MENA companies (mainly family or state-owned), the ready availability of liquidity and financing from regional banks, and the relatively underdeveloped capital markets that are dominated by retail investors, not to mention the prevalent business culture and existing legal frameworks.

The Arab firestorm and corporate governance

In the initial years of Hawkamah's existence, we had to keep making the business case for corporate governance. We had to prove that good corporate governance made sense, that it should be seen as basic risk management. We had to show studies linking good corporate governance practices to increased share prices; that in Russia well-governed were at a premium of 30-40% compared to their peers. In the last few years, events themselves have made the case for corporate governance.

The Great Financial Crisis made the case. The GFC did not result from macroeconomic mismanagement or weak economic fundamentals, nor did it result from extraneous shocks. The underlying issue was corporate governance malpractices and outright failures of boards and regulators in fulfilling their mandates.

The "Arab Spring" or "Arab firestorm" as it is more aptly termed, is proving to be another example. Although the contexts and objectives of the various uprisings have not been the same, the underlying theme behind the firestorm has been a call for better governance.

The protestors are demanding reform and deep transformation of both political and economic governance in their countries. In the directly affected countries and more widely across the region, weak political and economic governance reflects itself in public concerns regarding issue of dignity ("Karama") in the disregard of civil & citizen rights, social justice, fairness, accountability and access to public services. Political and economic repression has, not surprisingly, led to widespread calls for the restoration of Karama, human dignity and for change and reform, as expressed by the "*Kifayah*" (enough) movement in Egypt.

Dissatisfaction with governance in many Arab states is also fuelled by the perception that all too often natural resources and national assets - including state-owned enterprises (SOEs), have been captured by special interests and that state control of the media has stifled the 'voices' of citizens and society.

The three themes that come out of the Arab firestorm are job-creation & employment, 'trickle-down' and transparency & accountability. These directly relate to the need for private sector growth and reform of the state-owned enterprises, and all require implementation of sound corporate governance practices.

Family governance

The MENA region needs to move its focus of corporate governance beyond the realm of listed companies. Family businesses constitute the dominant form of business organization, not only in the MENA, but in the world.

Studies have shown that family-owned companies outperform their non-family counterparts in terms of sales, profits, and other performance measures. But the problem with family businesses is that most have a very short life span beyond their founder's stage; some 95% of family businesses do not survive the third generation of ownership. This is largely due to failures to address succession planning and manage conflicts, which, in turn, is often the consequence of a lack of preparation of the subsequent generations to handle the demands of a growing business and a much larger family.

Family businesses can improve their odds of survival by setting the right governance structures in place. But family governance presents a number of unique corporate governance challenges. Corporate governance within listed companies is relatively straight forward compared to family governance. Family-owned businesses are often more complex in terms of governance than non-family businesses because of the family element and because of the sensitivities involved. You have to separate the family's business from the business of the family!

This is what Future Pipe Industries (FPI) has achieved. FPI is a successful Lebanese family company that has setup a corporate governance framework and established a board with a majority of non-executive directors. The entrepreneurial founder early on allowed succession and brought on his young son, Rami, as CEO, after a process of induction into the company.

As Rami Makhzoumi noted: "*Good succession planning does not merely involve designating a family member as the next chief executive and training him or her for the job. Rather, it involves a long-term, continuous effort to balance often-competing interests and pressures that are integral to a family business. These interests and pressures include not only the family members who are directly involved in running the day-to-day business, but also non-family managers and family members who do not work in the business*."

Addressing family governance and formulating adequate governance frameworks is not only a concern for the individual families and their businesses, but for our region as a whole. Some 85% of companies in the MENA are family owned and along with SMEs account for 70% of employment. We have recently issued corporate governance guidelines for Dubai based SMEs/FOEs as part of an initiative to support promising young companies.

The economic well-being and development sustainability of the region depends to a large extent on how the governance challenges within family businesses are addressed. We need this important segment of our economy to grow if the region is to tackle chronic unemployment and create jobs. Just for Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia, some 18 million new jobs are required by 2020 and some 100 million for the Arab countries!

For the MENA private sector to grow, a policy priority is to ensure access to finance. Growth companies need patient, long-term capital. The region's capital markets are tailored for large companies. A stock exchange with minimal regulatory burden should be created to meet the needs and the ambitions of

SMEs/FOEs and growth companies. A second tier equity market for young and growth companies can become a key driver in the development of a liquid capital market and provide long-term capital for the growth of the dynamic, entrepreneurial segment of the economies of the region. Suitably designed listing requirements would also facilitate the introduction of corporate governance into this important segment of the economy, and thereby become a key driver of corporate governance.

Corporate governance and state-owned enterprises

The other key area of corporate governance the region needs to focus on is the governance of state-owned enterprises (SOEs) and Government Related Enterprises (GREs).

The public sector of many Arab countries has been at the heart of the turmoil. The finger of blame has been pointed to government, to weak and poor governance and the implementation of inadequate policies serving special interest groups, personal interests of leaders, political clientelism and not servicing the public at large. The results are cancerous for the economic, political and social fabric and can lead to 'failed states'. Bribery & corruption become rife; the State and its agencies are subject to 'capture' and while natural resources may be plentiful, growth and development are dismal. The core issue is clearly mal-governance and lack of accountability.

We need to reinforce SOEs ownership function, delineate and avoid the mixing of political or social policy and business decisions, improve transparency, empower SOE boards and improve their accountability.

There should also be a clear separation of ownership from regulation, policy-making and other state-related functions of SOEs, including industrial policy. The separation of the ownership function ensures a level-playing field with the private sector and provides for a healthy environment for competition. SOE governance reform is a policy priority following the Arab firestorm, not only in countries such as Egypt and Tunisia but also Lebanon and across the MENA. The countries of our region should rapidly introduce corporate governance codes for their SOEs and

GREs as part of an overall policy of reforming the role of government and its regressive impact on private sector growth and expansion opportunities. All too often SOEs and GREs are advantaged with privileged access to finance or government support, leading to a crowding-out or squeezing out of the private sector. Typically it is young SMEs and FOEs that suffer the greatest impact and damage.

The corporate governance challenge

The Arab Firestorm should be a wake-up call to the region's governments and regulators to act. The imperative for governance reform has never been greater. The political response to the Arab Spring should be one that leads to greater accountability, disclosure and transparency in governance. This is a sizable challenge. However, this is a moment of opportunity and the promise of an Arab Awakening can become a reality.

My generation, indeed the Arab 'baby boomers, have endured the inferno of violent conflicts, civil and uncivil wars and their bitter consequences for our economies and institutions, for our social and political fabric and their foundations. We need to rebuild trust and confidence. We need to provide economic security and remove the barriers to prosperity facing our children.

We are living very interesting, momentous and turbulent times. The so-called Arab Spring, or rather Arab Firestorm, ("Arab Spring", after all, is a technical term for a gymnastic move whereby one does two flips and ends up in the same place one started from!) has been a call by the people for dignity, respect, jobs, accountability and the chance for a better life at a time of growing inequality and economic uncertainty. The Middle East is not the only region facing such challenges – the calls of the Occupy Wall Street movement have been distinctively similar.

The Arab Firestorm has laid bare challenges which urgently need a political, social and economic response. If this response is not rooted in instilling good corporate governance, it is not likely to be sustainable.

The Arab Firestorm is a wake-up call about governance. The economic growth of the region needs to be inclusive, to ensure the “trickle down” & “pull up” effects. We need to reduce chronically high unemployment, we need to accelerate private sector growth to generate productivity growth and economic diversification, and we need to address wide income disparities within countries and between countries of the region. Above all, we need to strengthen transparency, disclosure and accountability, which have proved to be the highest virtues in governance. I trust that the Rami F Makhzoumi Chair will be devoted to promoting those virtues.