The Imperative of Overshooting in Corporate Governance in the GCC and MENA

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The turmoil of the US and UK financial markets seems to have no end and in recent weeks the credit crunch has given way to a "credit quake", as Bloomberg has aptly dubbed the phenomenon, which is represented by financial institutions filing for bankruptcy or being bailed out. At the same time, several emerging markets are being adversely impacted by the current crisis indicating that the briefly fashionable theory of decoupling may not hold. Thus far, our region has remained largely unaffected, and recent reports suggest that savvy Western investors are turning away from Brazil, Russia, India and China (BRIC) in favor of the Middle East and North African (MENA) stock markets.

The increase in the relative appeal of the MENA markets, however, is affected by the general investor perception that risk has increased in our markets due to concerns of inflationary pressures, available liquidity given financing commitments, and transparency. The region's reputation has also been tarnished by the recent corporate scandals, though government action has been swift through the declaration and action on "a zero corruption policy". Stronger corporate governance addresses these issues, and solid corporate governance structures are crucial to attracting investment capital.

Market perceptions determine where global capital will flow, and it will flow to where it is best protected. Global capital flows will generally avoid markets where investor protection is perceived as weak or uncertain. The MENA and GCC markets stand to gain by adopting institutions and corporate governance frameworks that bolster investor trust through improved disclosure and transparency standards and rule of law. We cannot afford to ignore corporate governance; too much is at stake in our stock markets and credit markets.

But we should not stop there. A former chairman of Brazil's Securities and Exchange Commission made the point that emerging financial markets should "overshoot" in good corporate governance. The creators of the Novo Mercado, a listing segment of the Sao Paulo Stock Exchange, understood this point and set more stringent corporate governance standards than found in some European markets. After years of stock market stagnation, the setting up of Novo Mercado enabled companies (many of them family enterprises) to raise money through local equity and debt markets rather than rely on internal growth and development agencies for long-term capital. This illustrates how investor trust is fundamental for the growth of financial markets and how a significant economic transformation can be facilitated when corporate governance is taken seriously on a systemic and on a policy level.

Corporate governance comprises a combination of regulatory rules and private sector-driven guidelines. Both regulators and companies must understand what is expected from them by investors. Regulators need to address weaknesses in legal frameworks and strengthen surveillance and enforcement functions, while companies need to adopt best-practice principles and guidelines, engaging with new shareholders as true partners and treating them with impartiality, be transparent in governance and abide by the highest ethical standards.

The role of the regulator cannot be overestimated. The National Investor (TNI) in cooperation with Hawkamah, the Institute for Corporate Governance, recently developed a corporate scoring methodology to assess non-financial risks often associated with the regional stock market investments. Using this scoring methodology, 581 listed companies in the GCC were ranked and it was found that there was a low dispersion of scores within each GCC market, indicating that country effects are more important than company size, industry or sector. In other words, corporate governance improvements do not occur in a vacuum, but are often supported, incentivized, and facilitated by the regulator and by institutions. Overall, Oman and Bahrain obtained the highest scores on average.

Hawkamah has carried out studies and conducted surveys on the corporate governance needs of the region and, together with the International Finance Corporation, has published a list of recommendations in this regard. These recommendations include, among other things, the introduction of corporate governance codes, adoption of IFRS as an accounting standard for the corporate sector, strengthening the surveillance and enforcement functions at stock exchanges and regulator levels. The recommendations also advocate companies to be subject to more independent oversight through the appointment of independent directors and strengthening of rules on conflicts of interest and insider trading. These are challenges we should meet and overcome.

On the company-level, investor confidence is attained and maintained through the development of a culture of transparency and accountability. Companies need to adopt clear values and standards in business dealings throughout the organizations and develop appropriate checks and balances to deal with conflicts of interest. Maintaining effective systems of internal control and risk management is also a key ingredient.

In the current economic climate, there is a strong case for “overshooting” in corporate governance, whether on the country or company level as long as it is remembered that good corporate governance is not a box ticking exercise. Corporate governance is about companies embedding best practices in all levels of their organizations, starting from the top, from the Board, while governments set up proper enforcement mechanisms. One size does not fit all, but fundamental investor concerns need to be identified and addressed.

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Hawkamah runs specialized programs to develop corporate governance frameworks in the region and carries out corporate governance assessments on company and country level using tested methodologies against international benchmarks and best practices, reports and improvement plans. Its local expertise is combined with the important role it play in the global and regional policy dialogue on corporate governance via strategic partnerships with various international policy promoters and developers such as the Organisation for Economic Cooperation and Development, the International Finance Corporation, Institute of International Finance and Union of Arab Banks, among others.