OECD Journal: Financial Market Trends
Volume 2010 – Issue 2
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Pre-publication version, February 2011

The Second Corporate Governance Wave in the Middle East and North Africa

by

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Ten years ago, corporate governance was a nascent concept in the Middle East and North Africa (MENA). This article charts the evolution of corporate governance across the MENA region over the past decade – as a concept and in practice – and proposes potential avenues for future work in this area.

Initial interest in corporate governance in the region was propelled by the drive to attract foreign investment and the increasing development of local capital markets. A second wave now appears to be forming and its results will depend largely on the capacity of national regulators to enforce existing corporate governance provisions.

JEL Classification: G03, G34

Keywords: corporate governance, Middle East and North Africa (MENA), corporate governance code, security regulators, hawkamah

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I. Introduction

The first corporate governance wave was propelled by the drive to attract foreign investment

The first wave of corporate governance awareness occurred in the Middle East and North Africa (MENA) about a decade ago. It was propelled by a few specific trends. One of them was the drive to attract foreign investment, particularly by countries with no petrochemical resources, which required substantial funds to develop their infrastructure. Another was the development of the financial sector in the region, increasingly expected to provide efficient intermediation between corporates on the one hand, and investors or banks on the other. The shift towards market-based economic organisation in some countries of the region, such as Egypt or Syria, has only accentuated this trend.

Box 1. OECD work on Corporate Governance in the Middle East and North Africa

In 2005, the OECD established a **Working Group on Improving Corporate Governance in the Middle East and North Africa** within the framework of the MENA-OECD Initiative on Governance and Investment for Development. The Working Group is comprised of representatives of capital market regulators, stock exchanges, relevant government ministries, and the private sector from the 18 participating MENA jurisdictions.

It serves as a platform for dialogue and exchange of experiences among regional policymakers, their OECD counterparts and the private sector on priority corporate governance issues. The Working Group meets annually to discuss progress achieved in reforming corporate governance frameworks and practices and to agree on future priorities. It also supports individual countries in their efforts to develop or revise relevant corporate governance standards. To date, the OECD and its partners have supported the development of corporate governance codes, based on the **OECD Principles of Corporate Governance** and the **OECD Guidelines on Corporate Governance of State-Owned Enterprises,** in Morocco and Egypt.

At the outset, the Working Group decided to focus on corporate governance of banks and state-owned enterprises (SOEs). Two regional taskforces were established to examine the frameworks and practices in these sectors and to develop consensus-based policy recommendations. The Taskforce on Corporate Governance of Banks published a **Policy Brief on Improving Corporate Governance of Banks** in the MENA region in November 2009. The Taskforce on Corporate Governance of SOEs will publish the results of its work in 2012. A new Taskforce of MENA Stock Exchanges for Corporate Governance, to be launched in 2011, will examine the mechanisms at the disposal of exchanges to promote better governance practices in listed companies.

For more information about the activities of Working Group on Improving Corporate Governance in the Middle East and North Africa, please consult: www.oecd.org/daf/corporateaffairs/mena.

This wave was also enabled by increasing development of the capital markets

In the context of developing capital markets, banking sectors in MENA countries have traditionally acted as a principal source of corporate financing (Table 1). However, the banks' ability to satisfy the demand for corporate borrowing was hampered by their relatively risk-averse profile and the general opaqueness of corporate borrowers. The disclosure-averse culture in the region, where controlling shareholders have often been reluctant to divulge operational or financial details of their business, has contributed to the general lack of transparency in the corporate sector. The ongoing development of capital markets created a requirement for greater transparency, hence slowly, but surely, pushing disclosure and broader governance issues onto the policy agenda.

Table 1. Domestic credit provided by the banking sector

As of 2008, in per cent of GDP

Country	Credit
Bahrain	115
Lebanon	169
Morocco	96
Egypt	77
Jordan	114
UAE	89

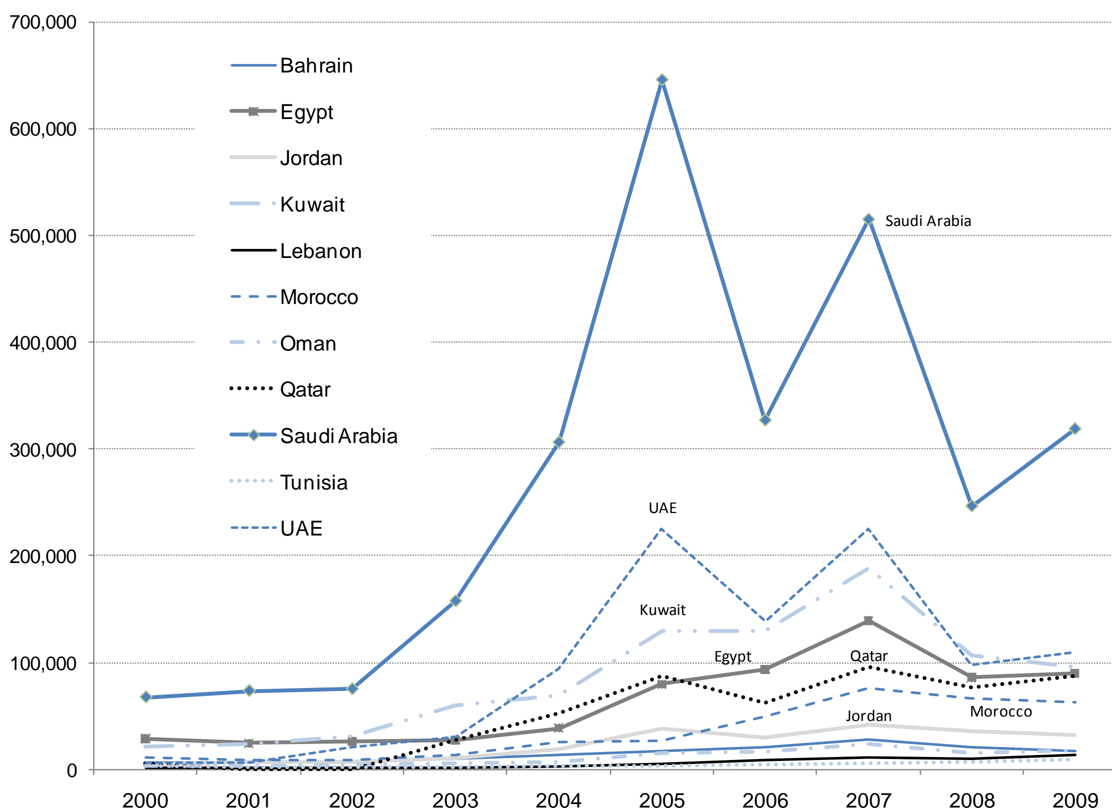
Source: World Bank development indicators.

The 2006 stock market crash played a role in bringing the corporate governance agenda to the forefront

Beginning in early 2000, the importance of good corporate governance practices began to percolate into the consciousness of regional regulators and the private sector. Then came the 2006 stock market crash – particularly pronounced in the Gulf Cooperation Council countries – which sent the local stock markets tumbling dramatically (Figure 1). While this stock market crash was not triggered by any particular corporate scandal (as with the cases of Enron or Lehman Brothers), it led regional regulators to reflect on how to make capital markets less prone to jitters and less rumour-driven.

Figure 1. Market capitalisation

2000-2009, in USD million



Source: World Bank development indicators.

Strengthening corporate governance of listed companies was a logical starting point. Although no specific corporate governance weakness was responsible for the 2006 crash, it became evident that a substantial number of investors were not sufficiently informed about their holdings, and that information provided by listed companies was inadequate and not subject to analyst coverage. Therefore, increasing the financial literacy of investors, while improving the information flow to the investing public, quickly became key priorities of the regional authorities. This is an important part of the story of how the first wave of corporate governance reforms in the Middle East and North Africa came about.

II. The first wave

The first corporate governance wave arose with the issuance of corporate governance codes

This wave started with the issuance of corporate governance rules by the national regulators, and somewhat in parallel, with the establishment of national corporate governance institutes. Oman and Egypt were the pioneers in the region, developing domestic governance codes in 2002 and 2005 respectively, both based on the OECD Principles of Corporate Governance. In a region where corporate governance was a nascent concept, such efforts were considered nothing short of revolutionary. Bearing in mind the tremendous need for education and training services, the emergence of corporate governance centres was only a natural extension of this process. The launch of the Egyptian Institute of Directors and of the Hawkamah Institute of Corporate Governance, was as much a response to the existing demand for governance know-how, as it was to create a stronger appetite for corporate governance in the region.

These initial steps foreshadowed a trend which gained regional momentum around the middle of this decade, when the majority of regulators in the region moved to introduce higher corporate governance standards. Between 2005 and 2009, 11 corporate governance codes were introduced by national regulations, in addition to specialised guidance for state-owned enterprises, banks and family-owned companies. The Egyptian Institute of Directors was the first in the region to introduce a governance code targeted specifically at state-owned entities, based on the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The Lebanese Transparency Association and Moroccan Corporate Governance Taskforce introduced specialised guidelines for family-owned small and medium-size enterprises, while the Jordanian, Palestinian and the Emirati regulators introduced codes for banks.

Today, almost all MENA jurisdictions have a corporate governance code

The process of issuing specialised standards is continuing unabated. The Moroccan authorities, which have already issued a general corporate governance code, plan to complement it with specific guidelines for state-owned enterprises, which will be discussed at the next regional meeting of the OECD Taskforce on Corporate Governance of State-Owned Enterprises. The Lebanese, Yemeni and Egyptian Central Banks are currently working on developing guidelines on corporate governance of banks. All these efforts have borne fruit: today, only 3 out of the 17 MENA countries and territories surveyed do not have any corporate governance code or guidelines (Table 2).

Table 2. **Corporate Governance Codes and Recommendations in the MENA region**

Country	General Corporate Governance Code	Date of issuance	Compliance required	Other Codes/Guidelines
Algeria	Yes	2009	No	-
Bahrain	Yes	2010	No	Guidelines for banks
United Arab Emirates	Yes	2007	Yes	Code for banks
Egypt	Yes	2005, currently under revision	No	Code for state-owned enterprise Code for banks being drafted
Jordan	Yes	2008	Yes	Code for banks
Kuwait	No	-	-	-
Lebanon	Yes	2008	No	Code for small and medium-size enterprises Code for state-owned enterprises being drafted
Morocco	Yes	2008	No	Code for small and medium-size enterprises Code for state-owned enterprises being drafted Code for banks/credit institutions
Tunisia	Yes	2008	No	-
Saudi Arabia	Yes	2006, amended 2009	Yes	Guidelines for banks
Oman	Yes	2002	Yes	-
Qatar	Yes	2009	Yes	-
Syria	Yes	2008	No	Code of governance for financial intermediaries
Yemen	Yes	2010	No	Code for banks being drafted
Palestinian National Authority	Yes	2009	No	Code for banks
Libya	No	-	-	-
Iraq	No	-	-	-

Credit is due – perhaps in equal measure – to private sector and non-profit entities as well as governmental initiatives. In fact, support for the creation of sound corporate governance frameworks in the region has come from both quarters. In Algeria for instance, the Corporate Governance Commission, which drafted the Code, was formulated as a grassroots initiative by the private sector. In Oman, Egypt, Saudi Arabia and a number of other countries, key support for the corporate governance agenda has come directly from the public sector; indeed in these countries, the corporate governance centres operate under the umbrella of governmental institutions.

At the outset, corporate governance codes were voluntary

Irrespective of whether codes were private sector or government-initiated, most of them were introduced as voluntary guidelines, providing best-practice recommendations based on international standards, notably the OECD Principles of Corporate Governance. Until recently, when regulators attempted to introduce stricter requirements (beyond the voluntary recommendations contained in the codes), they often faced resistance from the corporate sector. The Omani Capital Markets Authority, for instance, was forced to withdraw one of its regulations in light of the disagreements this measure generated domestically.

Over the years, voluntary recommendations have in some instances been incorporated into the regulatory and legal frameworks. In Egypt, board independence requirements first stipulated in the governance code were subsequently incorporated into the listing standards of the Egyptian Stock Exchange. Generally speaking, however, the process of making specific governance standards more binding has advanced at a cautious pace. Listing requirements on some regional exchanges remain quite lax compared to their international peers, and corporate legislation has generally not been able to keep pace with the rapid evolution in this field internationally.

This is changing as the business case for good governance is becoming increasingly accepted

The end of this decade marks the end of the first corporate governance wave in the region, and it is undeniable that it has brought tangible results. Corporate governance, or *hawkamah* in Arabic, is no longer a term that needs defining, nor is its business case unclear. Even from a family business perspective, the case for better governance needs less justification today than it did only five years ago. This is not to deny that market regulators and stock exchanges across the region continue to face challenges in enticing family-owned companies to list their equity. The reluctance of family-owned firms to open their equity to outside shareholders is perhaps a key factor stifling corporate growth and further development of the region's capital markets.

That being said, within the region, resistance to corporate governance as a concept has shifted from the centre to the periphery – evidence of successful awareness-raising campaigns. Moreover, during the past two years, regional regulators have been abolishing the voluntary nature of governance standards. The Emirati, Saudi, Jordanian, Omani and the Qatari securities regulators have all moved to require corporate disclosure regarding compliance with local corporate governance codes. The substance and structure of the required disclosures varies, as does the mandate and capacity of regulators to ensure compliance.

III. The second wave

The second corporate governance wave has brought implementation into focus

Arguably, these developments mark the beginning of a new wave of corporate governance in the region, focusing on implementation as opposed to awareness-raising. This second wave is being manifested through the revision of governance codes in order to clarify and tighten provisions. In Egypt, the Institute of Directors is in the process of revising the corporate governance code published five years ago. Other regulators have taken a more gradual approach, amending specific articles shown in practice to be insufficiently

precise or ambitious. The Saudi Capital Market Authority has, for instance, recently amended the definition of an "independent board member", clarifying that the ownership of 5% or more of a company by a member of the board will be considered inconsistent with independence (CMA, 2009).

While these efforts demonstrate a clear transition, the impact of these changes should not be taken for granted. A critical ingredient to ensure the effective implementation of exiting corporate governance provisions is the role of the regulator. Do regional regulators have the capacity to monitor companies' compliance and to take enforcement action when necessary? What measures can be taken to further promote the capacity of relevant regulatory bodies?

Promising signs can be seen and regulators' enforcement powers are evolving

Though the answers to these questions are far from evident, some promising signs can be noted. For instance, the Saudi Capital Markets Authority is already publishing enforcement actions on its website, including in relation to its Corporate Governance Regulations. Although this might seem like a globally accepted practice, the notion of publicly "naming and shaming" is novel in MENA countries. Historically, enforcement authorities imposed penalties or forced companies to take corrective actions, without publicly announcing the details of the enforcement actions as they occurred.

While most securities regulators in the region are now endowed with significant regulatory and enforcement powers, the ability of other organisations to materially contribute to upholding better governance standards is evolving. Stock exchanges in the region have substantially less self-regulatory powers compared to their OECD counterparts, and generally speaking, play a less significant role in standard setting and enforcement (with the possible exception of insider trading cases). Important exceptions in this regard are the Egyptian and Kuwaiti exchanges, which over the past several years have moved to delist numerous non-compliant companies.

IV. Moving forward

Will the second wave of corporate governance be as effective as the first?

It is impossible to foretell whether the second wave of corporate governance in the region will be as effective as the first. Regulators' capacity to transparently monitor and enforce breaches of existing regulations, and to fine-tune them when necessary, will continue to be tested. While the rescue of financial and industrial entities in Europe and North America might be seen as "remote", home grown developments with Etisalat, Dubai World, Saad and Algosaibi Groups have most certainly been noted. Regulators will need to learn from these cases, taking into account international developments, which will only gain importance as the region becomes increasingly integrated in the global financial architecture.

Some "bread and butter" issues still need to be addressed

Whereas efforts to establish common regional or sub-regional corporate governance policies may not be the immediate objective, ongoing dialogue between regulators will be crucial. The ability of regulators to address "bread and butter" corporate governance issues in the coming years will be paramount to upholding investor confidence in the MENA markets. Particularly at a time

when restrictions on foreign investment are being removed in some markets, the ability of regulators to review the governance arrangements of listed entities will help prevent potential scandals, serving to attract further foreign interest in MENA markets. Regulators' ability to combat related-party transactions, improve transparency and disclosure, and foster effective board outcomes will determine whether the next wave will be a powerful tide or just a splash.

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