THE MENA REGION'S CORPORATE GOVERNANCE JOURNEY: THE PAST 10 YEARS

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Hawkamah the Institute for Corporate Governance is celebrating its 10 year anniversary this year. The institute was set up with the grand vision to "bridge the corporate governance gap" in the Middle East and North Africa (MENA) region. What this has meant in practice is that Hawkamah's activities have ranged from awareness-raising to research, from policy work to standard setting, and from capacity building of board directors to providing advice to companies and regulators. The range of activities reflects the rapid development of corporate governance in the region. This article looks into the region's governance journey over the past 10 years.

Hawkamah was established at a time when corporate governance was a relatively new concept in the MENA region. In 2006, for example, Oman was the only

Gulf Cooperation Council (GCC) country to have issued a corporate governance code. A 2007 joint study by Hawkamah and the International Finance Corporation (IFC) found that while companies recognized corporate governance to be important, very few could credibly claim to have undertaken broad scale governance reform. The same study also found that only 3% of the surveyed companies could be rated as following “good practice” and none following “best practice”.

Disclosure practices, even by listed companies, was extremely weak. Prior to 2009 it was very difficult to obtain any publicly disclosed information of listed companies beyond the names of the board members and basic financials. A 2008 Hawkamah’s joint study with The National Investor found that the contact details of investor relations officers were available for only a handful of GCC listed companies, only 3% of them held analyst calls, 90% of them did not pre-announce their result publication dates, and it was not unusual to come across instances of interim financial results which were handwritten, often illegibly.

Boardrooms were largely populated by insiders, appointed on the basis of trust, who were, more often than not, sitting in multiple other boards. The expectations placed on board members were unclear and there was little regard to issues such as independence and time commitment. Board evaluations were non-starters.

Discussions on corporate governance were often centered on why corporate governance was needed, or indeed, whether it was not needed at all. The term itself was often mistaken to mean the same as corporate social responsibility or even corporate management, as our 2007 joint study with the IFC indicated.

The governance landscape has changed drastically in 10 short years. Corporate governance codes have been issued by regulators across the region for listed companies, and many of these codes have already been revised and improved. Some countries have issued such codes for state-owned companies, and numerous frameworks and guidelines are in place for family-owned businesses, banks, Islamic Financial institutions, and even SMEs. The discussions on corporate governance are now focused on how to best implement governance.

Perhaps the best way to visualize the governance developments in the region is to pick up a 2006 annual report of a regional listed company and compare it to this year’s annual report. Today, the average annual report issued by a listed company in the region is 102 pages in length and this is increasingly supplemented by information disclosed on the company website and even in a separate sustainability report.

Regulators in several parts of the region have also begun reforming the overall legal frameworks. The United Arab Emirates and Qatar, for example, have issued new company laws. Both countries have also been upgraded from frontier market to emerging market status by the MSCI. Similarly, insolvency laws are under review and are forthcoming in some countries.

The role of boards has received much attention from the regulators and companies alike. Delegation of authority matrixes are now widely in place, detailing the decisions the boards need to take and approve. Board committees are now the norm and even board evaluations are becoming accepted (approximately 13% of the 150 largest MENA listed companies conducted such evaluations in 2012). The regulators have played their part too. Oman's code requires new directors to go through corporate governance training. The UAE now mandates female representation in the boards of listed companies and government-owned entities. The UAE's recently issued corporate governance regulations also provide a comprehensive list of key processes – ranging from strategy to risk management, from internal controls to stakeholder management – which the board needs to be proactively overseeing.

We, as a region, should be proud of these developments. Governance frameworks are now largely in place and companies have taken significant steps in governance implementation. This, however, is no time for complacency. In many ways, we have accomplished the easy part, the next challenges are far harder to accomplish. Our achievements have largely been focused on structures, now it is time to focus on the substance. For example, it is far easier to set up an audit committee than it is to ensure that the audit committee works effectively and adds value to the business.

What this requires is leadership and self-awareness, i.e., soft skills, and for the region to move to the next level, we need

to change our approach to corporate governance. There is certain eagerness in the region, most notably in the GCC, to utilize international best practices, to seek certification to various international standards and to use international benchmarks as guides. Companies often have a tendency to follow the same logic when looking to improve corporate governance practices but this mentality is unlikely to yield desirable results.

Firstly, most of the international theories on corporate governance stem from the UK and markets with similar characteristics. The UK Corporate Governance Code represents an extremely well thought out set of governance principles, which have evolved and been revised numerous times since 1992. However, the UK Code addresses the governance issues arising in the UK corporate ecosystem where there is a prevalence of fragmented ownership. This is a market where shareholding of 3% is considered significant. The nature of the ownership structure means that the relative power rests with the board and the management, as opposed to the shareholders. A typical governance issue in the UK relates to excessive executive remuneration, which is a logical outcome of such power dynamic.

The MENA markets are markedly different, where companies are controlled by bloc holders. In this power dynamic, the power rests squarely with the majority shareholder. This situation raises a number of potential governance issues such as conflicts of interest, related party transactions, lack of independence and scrutiny mechanisms, protection of minority shareholders and etc., but the problems are not the same as in the UK.

Secondly, the international-certification mindset often misses the point about governance. Governance, like strategy, should be uniquely tailored to the company's business, circumstances and vision, within a clear framework of principles. We need board members who understand the thinking behind best practices and we need to empower them to reflect on the purpose of their company/organization. The boards should then formulate the overall vision and identify the key values for the business, while linking these with its stakeholders. The optimal governance approach for the company is derived from this process. This also forms the basis on which the board, in partnership with the management, develops the company's strategy and risk appetite. Deriving from these, the company should set objectives, embed these in the incentive structures and control practices, and keep them under regular review. Boards need to shift their focus from merely providing (financial) oversight of the business to becoming actively engaged in directing the company. This means that it is the boardroom that should be driving corporate governance practices if the region is to continue its progress on the governance journey.

To reuse the German proverb often quoted by Hawkamah in its early years, "when sweeping the stairs, you need to start from the top." Ten years on, the proverb continues to apply.