The Corporate Governance in Saudi Listed Companies

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***Abstract*—** Shareholders' rights are protected through many sources: the law, the judicial system, regulatory control measures, or recently adopting the company codes of Corporate Governance (referred to as CG), including the CG principles and internal control systems. Furthermore, CG principles offer a range of measures for improving the practices of within the business environment, making them more transparent, accountable and responsible; CG may be considered as one of the most important sources for improving shareholder protection. Not only does CG address the protection of minority shareholders, it also offers a great deal of advice for anyone who has a relationship with a listed company. It can be argued that CG contributes to raising the level of shareholder control over the company through a combination of internal and external mechanisms, as well as protecting the beneficiaries of a company, and creating an environment free from corruption (thereby attracting additional capital).

***Keywords*—** shareholders, Corporate Governance, Saudi Arabia.

I. Introduction

THE CG principles among countries are not identical; [1] this is due to differences in the economic, political and other aspects of each state. It is the same when attempting to define CG; it is not possible to give one definition because of varying perspectives of those who have tried to do so. In fact, it could be defined in relation to economics or to law, and these will deliver different definitions. Thus, the definitions of CG differ according to subject-matter (business, economics, investment, etc.), in addition to where it is practiced (in regard to the level of a country's development). It also depends on the type of trade policy followed, the practitioner, and the researcher or theorist.

Nevertheless, in general, CG can be referred to as "the system by which companies are directed and controlled".[2] This definition appeared for the first time in the Cadbury Committee (1992); however, it is too broad and does not give specifically explain all the aspects of CG.

Recently, Mendez defined CG more accurately "Corporate governance is the framework of laws, rules, and procedures that regulate the interactions and relationships between the providers of capital (owners), the governing body (the board or boards in the two-tier system), senior managers and other parties that take part to varying degrees in the decision making process and are impacted by the company's dispositions and business activities. Corporate governance defines their respective roles and responsibilities and their influence in steering the course of the company." [3]

Theoretically, the concept of CG is related to various other fields, such as economics, management, finance and sociology. Hence, the CG system can be explained in relation to these fields; [4] however, most researchers working on the concept of CG contend with two main theories: the theory of agency, which is related to finance and economics, and stakeholder theory, which is related to the social perspective of CG. [5]

It could be said that the most important CG principles are those issued by the OECD in 1999, which is charged with assisting all Member States as well as non-members in the development of legal and institutional frameworks for the application of CG (both public and private companies, whether listed in the capital markets or not), through providing a number of guidelines to strengthen CG practices, the efficiency of capital markets, and the stability of the economy as a whole. Those principles have been divided into five major groups, as in the following: 1) The Rights of Shareholders; 2) The Equitable Treatment of Shareholders; 3) The Role of Shareholders; 4) Disclosure and Transparency; 5) The Responsibility of the Board.

The question that arises in this paper is that: what is the status of CG in KSA? Has it contributed to raising the level of protection of minority shareholders in JSCs against the more dominant parties in the company? KSA was the second state in the Gulf Cooperation Council (GCC), [6] after Oman, [7] to adopt CG for its public companies. The Saudi Corporate Governance Regulations (referred to as SCGRs) have been historically voluntary since their issuance in 2006. It was during that year that the Saudi Stock Market (referred to as Tadawul) crashed, and the general index fell nearly by 25%. [8] The Saudi Capital Market Authority (referred to as CMA) insisted on issuing new rules to prevent further crises; it announced a first draft code of the SCGRs with many applications, all of which were optional until the beginning of 2009, becoming compulsory in 2010 for listed companies in terms of implementation. However, the listed companies are now only required to demonstrate adherence to the SCGRs on a 'comply or explain' basis. [9]

It could be said that the objective of the SCGRs is to provide a general guideline of best practice for listed companies and their shareholders; this was meant to increase the level of protection for all shareholders, especially the

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minority ones. Furthermore, in 2009, Saudi listed companies were required to establish audit committees comprising at least three non-executive directors (one of whom had to come from a financial background). [10] The audit committee was to be responsible for, amongst other things, establishing robust internal controls, dealing with external auditors, and devising appropriate accounting policies.

The SCGRs cover five main areas, which are: the introduction and definition of CG, the rights of shareholders and the GM, disclosure and transparency, the board of directors, and closing provisions. A great deal of criticism has been directed at this list within the SCGRs, and some of the shortcomings shall now be reviewed in brief.

Most of SCGRs are just recommendations, except for those stated as being mandatory, i.e. they are optional in application and there is no penalty for non-compliance. This is somewhat negative because it opens the way for many companies to evade following the provisions. The SCGRs are completely free of any definition of what is meant by the term CG, although it is the term that needs the most clarification, due to its novelty on the one hand, and the need for each person to be aware of its gravity and to know what it entails on the other; many shareholders do not know the full meaning of the concept of CG.

The SCGRs also overlook any consideration of the employment of modern technology (Internet and video conference) in holding GMs. As a result, it has deprived many shareholders from voting on GM decisions online or through any other modern means of communication. Undoubtedly, this gap has had negative consequences for many shareholders, as it is not reasonable to ask a shareholder who owns a limited number of shares to travel from one city to another in order to vote on GM resolutions in person when modern means of communication should suffice, i.e. he should be able to vote on GM matters wherever he is, in a secure manner and without incurring travel, accommodation and other expenses. In addition, the lack of employment of modern technology in GM meetings is inconsistent with the need for speed and credibility, on which business is based.

Despite the above, the SCGRs deal well with the issue of disclosure and transparency, which is arguably the most important aspect in the context of CG, but they overlook stating any sanctions for violating the rules of disclosure and transparency. A further issue is that many of the provisions within the SCGRs are actually listed as obligatory and binding within SCL 1965. The CMA, when preparing the regulations, quoted many of the provisions from SCL 1965, which caused some problems. For example, Article 3 of SCGRs is taken from the first lines in Articles 108 and 78 of SCL 1965; Article 5(A) of SCGRs is taken from the ending of Article 84 of SCL 1965.

All the above SCGR articles are stated as being for guidance only, and so the CMA had to reassert that they are indeed mandatory in order to avoid any conflict and ramifications for JSCs, and in order not to violate any provisions of higher legislation. In terms of application, the provisions of SCL 1965 are paramount. Therefore, the SCGRs that are taken from SCL 1965 are in fact obligatory and should be followed accordingly, not on the basis of or in accordance with the concepts stated in the SCGRs. Thus, corporations tend only to apply those SCGRs that are included in SCL 1965 under threat of penalty, being unable to argue that they are not mandatory, even though those same regulations are stated as being for guidance only in the SCGRs. Owing to these problems, the SCGRs must be modified to comply with SCL 1965, and all conflicts should be resolved by MOCI and the CMA in the public interest.

Some may argue that the SCGRs are for guidance and should not be mandatory; certainly, most of the principles in the SCGRs take the form of guidance, but it does not matter that some of them be deemed mandatory when needed. This is now the case with the SCGRs in KSA, wherein some are now deemed mandatory; indeed, there is no reason why a rule should not be mandatory if it is in the public interest or if it is to correct a mistake.

On the other hand, one of the defects in the SCGRs is that there are many contradictions between its articles and the provisions of SCL 1965. For example, Article 88 of SCL 1965 requires publication twenty-five days before the date of any GM, whereas the SCGRs require only twenty days.[11] Also, incompatibility exists between Article 79 of SCL 1965, which is related to the issue of the board of directors appointing a chairman and a managing director from among its members and the possibility that one board member could occupy both posts, and the SCGRs, which states, [12] "D) It is prohibited to conjoin the position of the Chairman of the Board with any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager". The irony is that the text uses the word 'prohibited' although the context is for guidance only. In any case, such conflicts are not in the interests of the company and its shareholders, and for any defect the law or regulations, there must be clear and accurate legal provisions to prevent confusion in their application.[13]

Economists have noted that the current SCGRs are (theoretically) being applied in JSCs but that many companies are trying to evade their application. This situation will open the door to corruption on the part of those companies, and therefore the competent authorities must endeavour to enforce the application of the SCGRs in order to close that door before those members of boards of directors and corporate officials who wish to exploit the absence of application can damage the company and its shareholders.

In general, protecting the rights of minority shareholders is actually the fundamental goal of corporate governance; this is in addition to providing the necessary legal devices that help them exercise their rights and counter any oppression on the part of majority shareholders. However, minority shareholders should not have to depend on company rules alone in seeking to preserve their rights. [14] In this regard, the OECD

emphasizes that, "[T]o ensure an effective corporate governance framework, it is necessary that an appropriate and effective legal, regulatory and institutional foundation is established upon which all market participants can rely in establishing their private contractual relations".[15]

In the case of KSA, there is an opportunity the CMA to enhance the protection of minority shareholders through the following procedures: increase the accountability of the members of board of directors, reduce the power of controlling shareholders in the company, grant minority shareholder extra tools to strengthen their participation in decision making, and force listed companies to adopt electronic communication.

In fact, it has been argued that reforming the laws concerned with investor protection and improving judicial quality are quite difficult, lengthy, and require the support of politicians and relevant bodies; on the other hand, improving corporate governance at the firm-level seems to be a feasible goal. [16] However, it is the CMA that has the greatest opportunity to adjust the SCGRs and to change its status from being 'comply or explain' to being obligatory, particularly given that reforming the CL has taken longer than expected.

In its Report on Observance of Standards and Codes (ROSC), the World Bank mentioned that CG in KSA is still in a nascent concept but one that reflects the international standard, particularly the OECD principles; [17] however, the CMA is still in the process of finalisation, and therefore still has the opportunity to improve the text and enhance the implementation of the SCGRs. In this, the CMA and all public agencies and private parties (such as listed companies, universities, media, etc,) should play a role in educating all parties engaged in the capital market (such as directors, shareholders, auditors, etc.). Furthermore, workshops, seminars and committees should be established to assess the efficacy of the SCGRs, determining how to improve the implementation of the regulations, identifying the parties that can benefit from their implementation, and addressing the problems facing that implementing; these together would serve to create reasonable recommendations and to improve the reputation of the SCGRs..

II. Conclusion

In summary, many shareholders are unfamiliar with the term CG; there is a general weakness in spreading the concept of CG, and the functions of the CMA in terms of educating investors are limited. Also, there is a need to include other organizations in the dissemination CG; for example, public and private universities in KSA should adopt teaching CG, as the number of academic studies on this subject is very low. This interest in the subject of CG is found in many countries around the world, for example in the UK, where we find many universities teaching CG, emphasizing its importance and the benefits that can flow for the national economy; many academic studies are published every year in these countries, adding new information to benefit their business communities.

Such attempts would definitely contribute to the dissemination of investment culture among shareholders, and increase knowledge of their rights within the company, which would then result in the exercise of those rights in an efficacious manner. Their observation of the deeds of board of directors would also increase and, in general, this would contribute to improving the legal and commercial environment in KSA.

References

[1] Organisation for Economic Co-operation and Development (OECD). 2004. p. 13

[2] The UK Cadbury Report (1992)

[3] Miguel A. Mendez. Corporate governance; a US / EU comparison, available at: www.forumpartnerships. zsi.at/attach/ miguelmendezfinal. pdf

[4] Some major theories have sought to interpret the concept of corporate governance, the earliest of which was the agent-principal relationship. A variety of approaches appeared to expand that theory to others, such as to stakeholder theory, stewardship theory, transaction cost theory, and finally resource dependency theory.

[5] Christine M. Corporate Governance and Accountability. New York, Oxford University Press. 2004. p. 16.

[6] Gulf Cooperation Council (GCC) is: KSA, Qatar, Oman, Bahrain, UAE and Kuwait.

[7] Issued by Circular No. 11/2002 Dated 3 June 2002, as Amended by Circular No. 1/2003. Available at: www.soharpower.com /Uploadimage/ ccg%20eng.pdf

[8] See: Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Kingdom of Saudi Arabia. 2009 p. 8. Available at: www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf

[9] See: Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Kingdom of Saudi Arabia. 2009 p. 8

[10] See: http://cma.org.sa/ar/Pages/home.aspx

[11] Article 5 (C) of the SCGRs.

[12] Article 12 (D) of the SCGRs

[13] Another aspect of no less importance is that the SCGRs do not mention the penalties when the violating the obligatory rules, leaving this matter to CMA, which has the right to punish according to its estimation. Therefore, it is necessary to state in the list the sanctions and penalties for violating corporate disclosure and transparency rules as laid down in the regulation, the most important of which is to impose fines on offending companies, stop their trading in the capital market, and announce it to the public.

[14] Cited from: Mahmoud Al-Madani. Reforming minority shareholder protection in Saudi Arabia and UAE (Dubai): does English company law offer a way forward? PhD Thesis. University of Leeds. 2011. p. 56

[15] Organisation for Economic Co-operation and Development (OECD) 2004, P: 31.

[16] Leora F. & Klapper Inessa Love. Corporate governance, investor protection, and performance in emerging markets. Journal of Corporate Finance, Vol 10, 2004. p. 22

[17] See: Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Kingdom of Saudi Arabia. 2009 p. 12. Available at:www.worldbank. org/ifa/rosc_cg_ saudia_arabia.pdf