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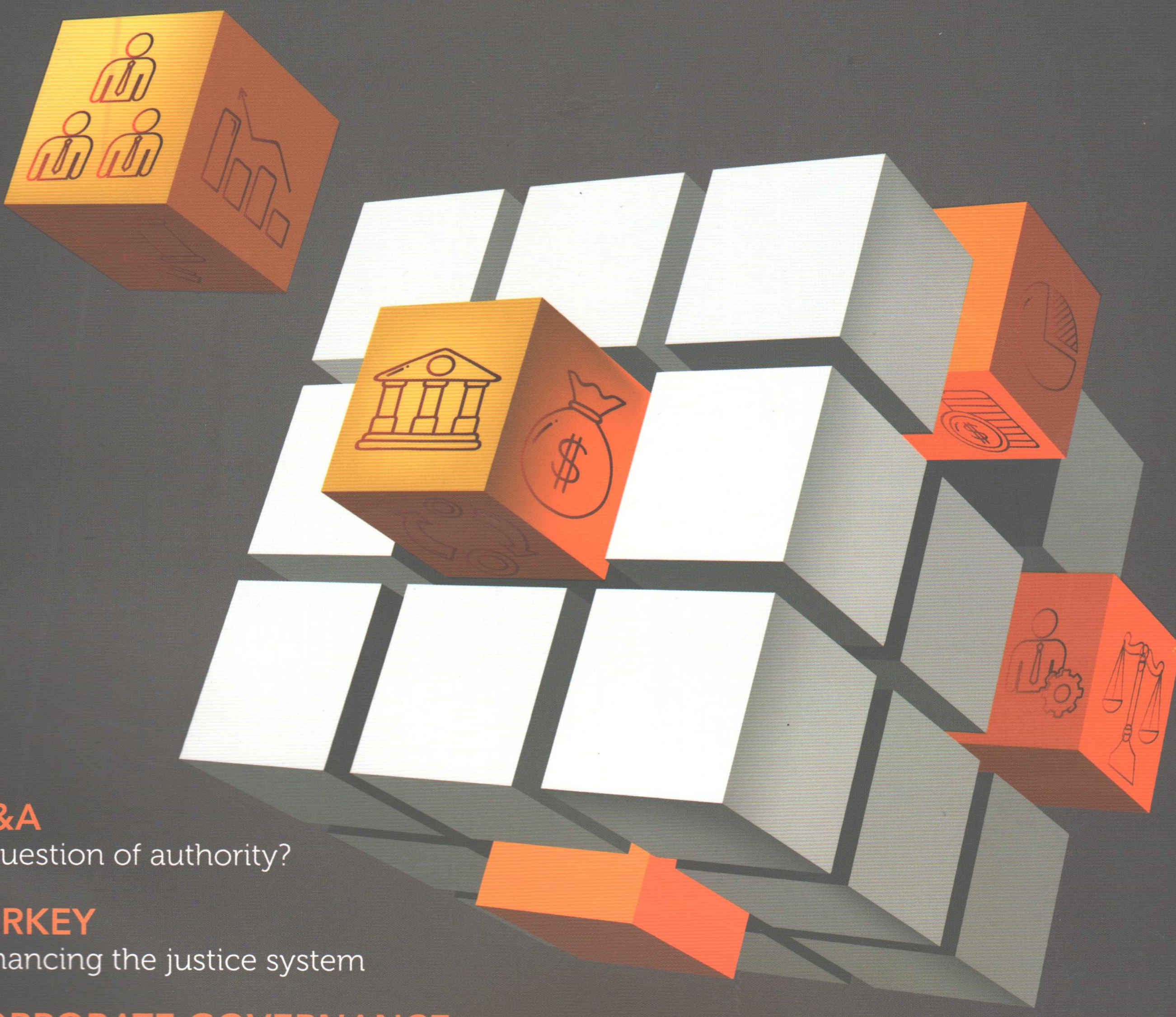

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Winds of change

Oraib Qubbaj shares her insight on the changing landscape of corporate governance in the Middle East.

There are many different definitions and understandings to what corporate governance means. In the broadest sense possible, governance is a principle built on a set of values; namely: accountability, fairness, and transparency.

However, when considering governance in the corporate sense it can be defined in terms of more tangible pillars. Corporate governance for the purpose of this paper is built on the IFC framework of five pillars:

1. Commitment to corporate governance
2. Board Structure and Role
3. Control Environment
4. Transparency and disclosure
5. Stakeholders

Although the pillars have been a constant for decades, the focus within each has varied substantially over time.

BRIEF BACKGROUND

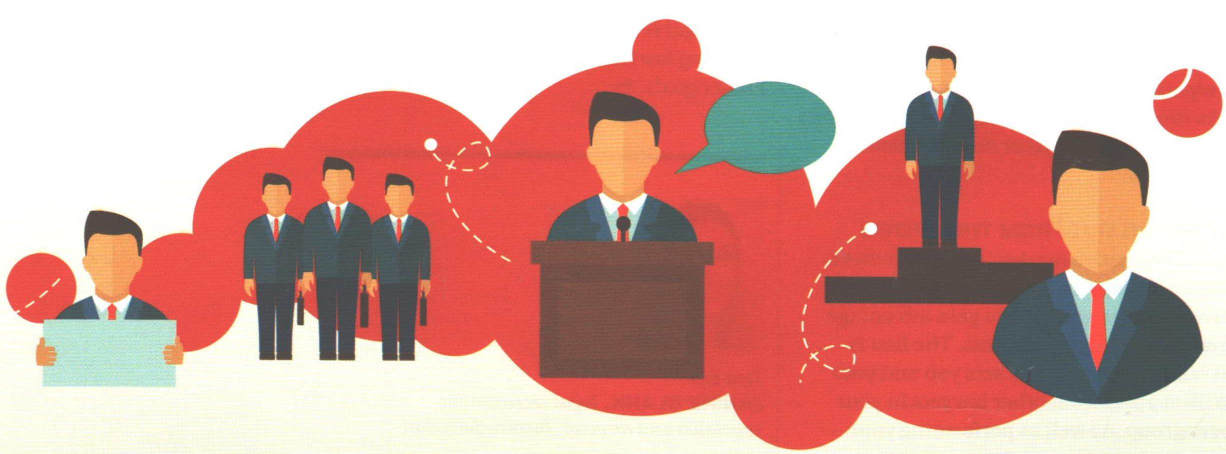
Initially, the rising interest in corporate governance in the Middle East was a result of an increased interest in attracting foreign investment and diversifying economies. This interest was reinforced at the wake of the financial crises in 2006, thanks to corporate scandals from Enron and Lehman Brothers. The result was a growing trend to raise awareness on the importance and value of corporate governance and increased corporate governance regulations.

At this stage, the focus was to create a baseline understanding of corporate governance, terminology associated therewith and the tangible value behind certain practices. In essence, a broad understanding of the key principles such as differentiating between the role of the board of directors and that of management, the importance of independent directors, the value of disclosure and transparency in communication, etc.

Such an improved understanding was well-received by the investment community by granting higher valuation of companies with good governance.

Many basic principles of good corporate governance were codified. Several corporate governance regulations were put in place by Financial Market Regulators, Central Bank Regulators, and other regulators. In order of priority and strength of regulation, the financial sector takes the lead followed by listed companies and then for all other companies. Some countries also regulated state-owned enterprises.

Many regulations were tentatively issued



as voluntary codes or 'comply or explain' models, and with time this was amended to either be fully mandatory or with certain rules mandatory showing the increased commitment towards governance.

Developing an overall understanding towards corporate governance and codifying the key practices transformed the challenge to the next level which is two-fold: enforcement and private sector buy-in.

MOVING TARGETS

As mentioned earlier the pillars for corporate governance have been constant but within each pillar the focus over the years has changed.

COMMITMENT TO CORPORATE GOVERNANCE

Initially, this was set as a pillar to raise a red flag on the importance of corporate governance. A mere discussion on corporate governance in the boardroom was the first step.

With codification of corporate governance practices, this became a tick boxing exercise, do certain policies exist such as the code of ethics, governance manual etc., to get companies to appreciate what a commitment corporate governance is. Now, although this may appear to be the simplest of pillars this is one of the hardest to conform to. The focus is now on creating a corporate governance aware culture. A culture that understands the premises of corporate governance and the fine line between bureaucracy and achieving accountability.

The commitment has transformed from a policy-based practice to a culture. The need to constantly fine-tune existing policies to suit the changing needs of the business but constantly in line with a system of checks and balances.

BOARD STRUCTURE AND ROLE

This is one of five pillars but truly at the heart of all corporate governance practices. The Board is said to be the engine behind every organisation. It manages shareholder expectation whilst monitoring management performance.

However, traditionally in the Middle East, the board of directors is a body composed of shareholders or members of the management team and in many instances composed of people that are both. This results in a board of directors that does not serve the spirit for which it was created.

At the outset of corporate governance discussions, much awareness was necessary on what the role of the board truly entails and what is the right composition to ensure that the role is properly performed. After many codes and regulations tried to codify the best practice of increasing the number of independent directors, separating the positions of chairperson and CEO, and clearly outlining the role of the board versus that of management, many companies hesitantly complied at first for the sole purpose of compliance. After sensing how much value can be gained from such practices there has been a growing interest in related practices.

Aside from increasing the number of independent directors, there is more in terms of board of directors' development programs, director evaluations, clearer procedures in conducting board meetings

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and growing interest in diversity in the boardroom.

CONTROL ENVIRONMENT

This area of corporate governance is often overlooked until an effective board is put in place. A control environment focuses on ensuring the right internal audits are in place expanding the focus from a purely financial audit practice to a more holistic audit practice that considers risk management, authority matrices and other relevant procedures. It addresses the independence of auditing practices and the hierarchy of supervision.

It is often the case that internal auditors are to audit those they report to which would appear counter-intuitive and does not really serve the purpose of fairness and accountability. Best practices of corporate governance provide guidance on how best to structure such controls and from an implementation perspective there has not been much resistance into expanding and developing the already existent practices into what can be called as international best practices.

Having said that, there has been a noticeably increased focused on this pillar amongst SME's. This is a key success factor for growing and developing SME's. It comes at a critical stage integral to making the jump from a one-person show business to a company with clear policies and procedures.

TRANSPARENCY AND DISCLOSURE

What should a company disclose? To whom should a company disclose? What is the different between transparency and disclosure?

Key questions which were not really addressed until corporate governance was a topic to be discussed around the boardroom. Culturally in the Middle East disclosure has not been one of our strong suits. Companies are resistant to sharing information. However, regulations did encourage increased disclosures clarifying the distinction between what is confidential information that does not need to be disclosed and information that should be disclosed since it may influence investors or stakeholders' decisions.

Although disclosure practices have improved, there is still a struggle in transparency. Disclosure of the right information to the right audience at the right time in sufficient enough detail. This is not an easy balance to achieve and from current practices it appears that companies are still adjusting their practices to identify their disclosure appetite.

STAKEHOLDERS

Traditionally, many companies operated with a tunnel view of who they affect: their customers, their shareholders, and their employees. This is not a complete picture. Any company that has a functioning business also affects numerous other stakeholder groups. How a company engages with their stakeholders is slowly climbing up the ranks in board room considerations but still at its infancy.

Engaging stakeholders is key to the sustainability of any business and although businesses have started to consider sustainability as an issue, the depth of such contemplation is still not where it needs to be.

MOVING FORWARD

Great strides have been made to improve corporate governance practices in the Middle East. However, current practices are not yet where they need to be.

To further such improvements, and advancement in corporate governance, on-going monitoring and enforcement is necessary. It is questionable whether there is sufficient capacity to monitor corporate governance performance and ensure compliance with existing codes and where applicable evolving best practices.

Further, since majority of businesses are non-listed companies increasing overall buy-in in corporate governance is critical to reach a tipping point towards overall compliance with corporate governance principles.

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