




CORPORATE GOVERNANCE FREQUENTLY ASKED QUESTIONS.

In partnership with Japan's Ministry of Finance
and Spain's Ministry of Economy



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With strong donor support, IFC continues to strengthen corporate governance programs in underserved regions, particularly in Sub-Saharan Africa, Latin America, and the Middle East and North Africa, by closely integrating its investments and advice, and focusing on capacity building of intermediaries, resulting in improved operational efficiency.

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Introduction.

This guidebook is designed to address common questions on corporate governance that are frequently asked by owners and managers of companies in the Middle East and North Africa (MENA) region. It familiarizes readers with the basic concepts of corporate governance, providing a comprehensive overview of the subject matter, using case studies as practical examples of corporate governance application in a commercial context. Overall, it demonstrates the value of corporate governance for businesses and for the region as a whole.

The guidebook is designed to either be read in its entirety, as a complete work, or in sections, according to the reader's interest. For ease of reference, the guidebook is organized into the following eight sections:

- A Commitment to Corporate Governance.
- B Corporate Governance for Small- and Medium-Sized Enterprises.
- C Board of Directors' Role and Composition.
- D Functioning of the Board of Directors.
- E Control Environment.
- F Shareholder Issues.
- G Disclosure Issues.
- H Corporate Governance for Family-Owned Businesses.

The approach of the guidebook is to explain technical concepts using plain language to help the reader become familiar with concepts that may sound new and unusual but are, in fact, part of the way business is commonly conducted, organized, and controlled. The list of questions presented is not exhaustive, but provides a simple introduction to corporate governance, which can help improve business practices and assist the reader in understanding complex corporate governance guidelines.

Acknowledgments.

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A

Commitment to Corporate Governance.

1 What is corporate governance?

The term "corporate governance" refers to the structures, rules, and processes through which companies pursue their objectives. In other words, "corporate governance is the system by which companies are directed & controlled."¹ It encompasses a variety of issues, ranging from shareholder rights to a company's internal decision-making processes and control systems.



What is good Corporate Governance?

“ We came into a market that nobody believed in. So we structured ourselves and had good governance in place to give our shareholders the comfort and faith that while they were absorbing a lot of market uncertainty, at least the company from an operating perspective or from a governance perspective can mitigate that risk to the best of our abilities.²

Emile Cubeisy, Vice President, Accelerator Technology Holdings, Jordan

¹ Committee on the Financial Aspects of Corporate Governance and Gee and Co. LTD "Report of the Committee on the Financial Aspects of Corporate Governance," Gee, December 1992, accessed September 1, 2015, <http://www.icaew.com/~media/corporate/files/library/subjects/corporate%20governance/financial%20aspects%20of%20corporate%20governance.ashx>

² Center for International Private Enterprise Global Corporate Governance Forum, "Advancing Corporate Governance in the Middle East and North Africa," Center for International Private Enterprise Global Corporate Governance Forum, February 2011, accessed on September 1, 2015, http://www.ifc.org/wps/wcm/connect/c50638804d97d579904db548b49f4568/MENA_CaseStudies_web.pdf?MOD=AJPERES, p. 35.

This checklist can guide your preliminary assessment of your company's governance practices.

Commitment to corporate governance. ✓

- ✓ Board takes responsibility for corporate governance.
- ✓ Corporate governance is regularly reviewed and improvements are planned accordingly.
- ✓ Appropriate resources are committed to corporate governance.
- ✓ Policies and procedures are formalized and distributed to relevant staff.
- ✓ Corporate governance code and/or guidelines are developed.
- ✓ Company is publicly recognized as a corporate governance leader.

1



Good board practices. ✓

- ✓ Board role and authority are clearly defined.
- ✓ Duties and responsibilities of directors are understood.
- ✓ Board is well structured.
- ✓ Board has an appropriate composition and mix of skills.
- ✓ Appropriate board procedures are in place.
- ✓ Director remunerations are in line with best practices.
- ✓ Board self-evaluation and training are conducted.

2



Appropriate control environment. ✓

- ✓ Independent audit committee established.
- ✓ Risk management framework/structure is present.
- ✓ Internal control procedures are in place.
- ✓ Internal audit function is in place.
- ✓ Independent external auditor conducts regular audits.
- ✓ Management information systems are established.

3



Disclosure and transparency. ✓

- ✓ Financial information is disclosed.
- ✓ Non-financial information is disclosed.
- ✓ Financials are prepared according to International Financial.
- ✓ High-quality annual report is published.
- ✓ Web-based disclosure and investor site is in place.

5



Shareholder Rights. ✓

- ✓ Minority shareholder rights are formalized and protected.
- ✓ General Assembly meetings are conducted and are well organized.
- ✓ Related party transactions policies are in place.
- ✓ Extraordinary transactions polices are in place.
- ✓ Dividend policies are precise and clearly defined.

6



What is good Corporate Governance?

In the event of a family owned company, it is also assessed on the existence of appropriate mechanisms to help govern the involvement of the family in the business and address other family matters.



2 Why is corporate governance relevant to me?

Corporate governance is relevant to companies of any size and in any market. In fact, good corporate governance has a number of widespread benefits. The below outlines some of these benefits, from the point of view of MENA Private Equity Investors.

MENA Private Equity Investors on the Impact of Good Corporate Governance on their Investee Clients



Improved Access to Finance

Governance improvements were a significant factor (attributed at about 80%) in helping an energy company secure capital of \$4.5 million. Company is now seeking additional \$16 million, where again good governance is reportedly playing a key factor.



Improved Valuation

One investor cited recent strategic sale exit which attracted 40% premium over market price, due largely to good corporate governance.



Improved Performance

Technology investee company improved profitability by 20% over two-year period due to improvements at board level and several changes in management control.



Improved Risk Management & Cost Control

One investor cited an energy services investee where there was an approximate 30% risk factor in new projects due to poor governance. This was eliminated due to improvements in project risk management activities and increased board oversight and control. Improvements also led to better decision-making and 20% improvement in process efficiency.

Source: IFC, "Corporate Governance Success Stories," IFC, 2015, accessed September 1, 2015, http://www.ifc.org/wps/wcm/connect/6fd9498048ec689dazc9fe1b17326f85/CG_success_stories_MENA062015.pdf?MOD=AJPERES

*“We expect that our governance efforts will allow SABIS® to continue on its impressive growth path by creating the necessary corporate and family structures to support that growth. Building robust governance structures will ensure the long-term sustainability of the company and help guide future generations to continue to contribute to the SABIS® success story.”*¹⁴

Joe Achkar, Board Member, SABIS® Educational Holding S.A.L., UAE

SABIS® is a global education network that operates on four continents serviced through three independent corporations headquartered in the United States, Lebanon, and the United Arab Emirates. Schools in the SABIS® Network operate in 15 countries and educate close to 65,000 students. Corporate governance changes positively impacted SABIS' board effectiveness, management control, and family governance. This also had the effect of improving company sustainability, enhancing board stewardship, and increasing organizational efficiency.

Two of the most significant benefits of good corporate governance are that it stimulates performance improvement and facilitates access to capital.

Performance Improvement

Corporate governance best practice is ultimately directed at ensuring that your business' activities and strategic planning are conducted effectively and that risk is managed properly. This will serve to enhance your company's value over the long term, as well as increase your company's ability to access and retain crucial human resources. A study by Deutsche Bank of the S&P 500 companies shows that companies with strong or improving corporate

governance frameworks outperformed those with poor or deteriorating governance practices by about 19 percent over a two-year period.³

Research on corporate governance is a new and emerging area of study and the pool of literature is still developing. In spite of that, the majority of scholars are already able to draw a link between corporate governance and a firm's operational and market performance. As Inessa Love states in her 2011 study published in the World Bank Research Observer: "[Most] research supports the positive correlation between firm-level corporate governance practices and different measures of firm performance."⁴

³ Renato Grandmont, Gavin Grant, and Flavia Silva, "Beyond the Numbers - Corporate Governance: Implications for Investors," Deutsche Bank, April 1, 2004 as cited in IFC, "The Irresistible Case for Corporate Governance", September 2005, <http://www.ifc.org/wps/wcm/connect/c6b3750049585fa9a052b519583b6d16/FMS-CorpGov.pdf?MOD=AJPERES>

⁴ Inessa Love, "Corporate Governance and Performance around the World: What We Know and What We Don't," World Bank Research Observer, Volume 26, Issue 1, page 42-70, February, 2011.

Access to Capital

Having a good governance framework can help with financing as it can increase your company's transparency and accountability to investors and credit institutions, which can enhance its financing capabilities. In other words, good governance puts potential investors in a better position to understand how things work within your company and can provide assurance that investors' interests will be protected. For example, instituting corporate governance best practices can reduce the risks associated with the abuse of power by controlling shareholders or management to seek inappropriate gains.

BUTEC Holding S.A.L. presents a good example of how good governance practice facilitates a company's access to capital. BUTEC is a company located in Lebanon that provides engineering, procurement, and construction operations in Lebanon, Algeria, Qatar, and Abu Dhabi. After IFC conducted a corporate governance assessment, the

company made several changes to its corporate governance practices. Once these changes were implemented, BUTEC reported that access to capital had improved substantially with many banks offering it credit on more favorable terms. Accordingly, good governance practices assisted BUTEC in accessing \$30 million to \$35 million, which was largely due to banks' and investors' recognition of positive changes within the company.⁵

Today, an increasing number of investors include corporate governance criteria as part of their investment process. Investors expect companies to implement certain corporate governance practices and want to be sure that corporate governance is prioritized. For example, MENA Private Equity Industry Association members have identified corporate governance as one of the top three challenges for the industry.⁶ It is increasingly clear that private equity investors analyze carefully the corporate governance of investee companies ahead of finalizing any deal.

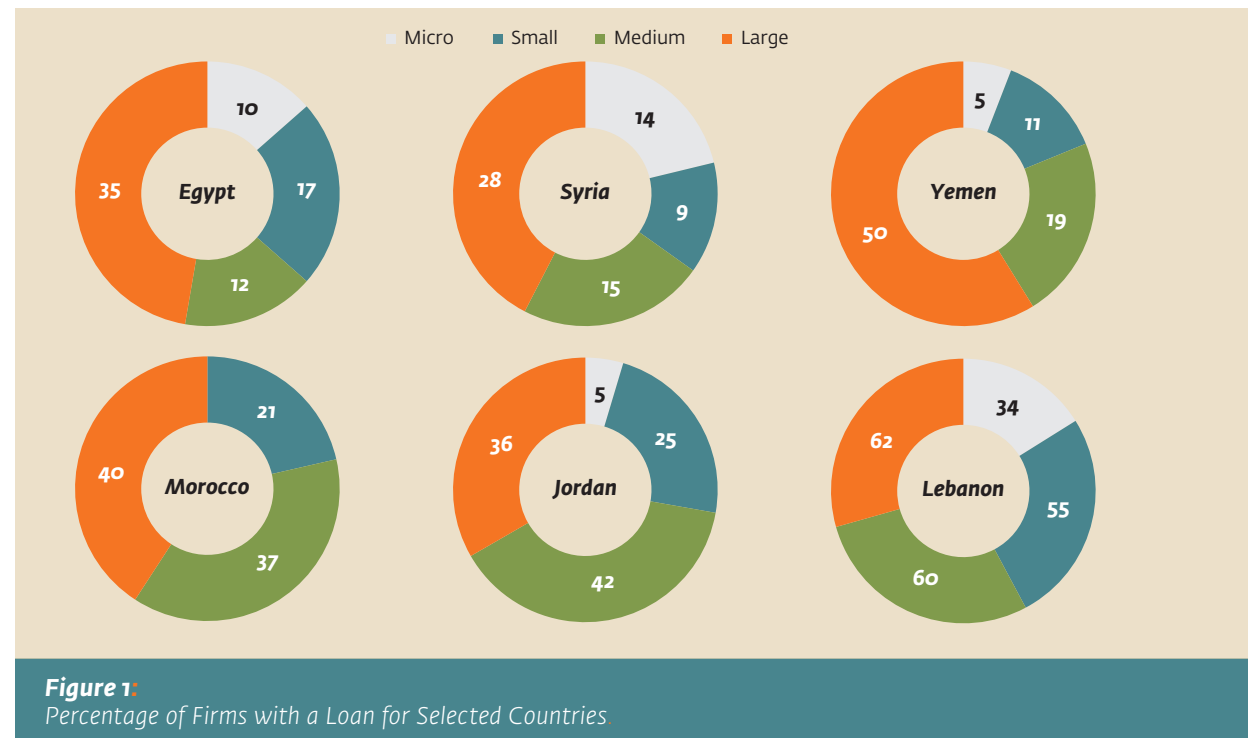


Figure 1: Percentage of Firms with a Loan for Selected Countries

Source: Nasr and Pearce, "SMEs for Job Creation in the Arab World, Middle East and North Africa Region."

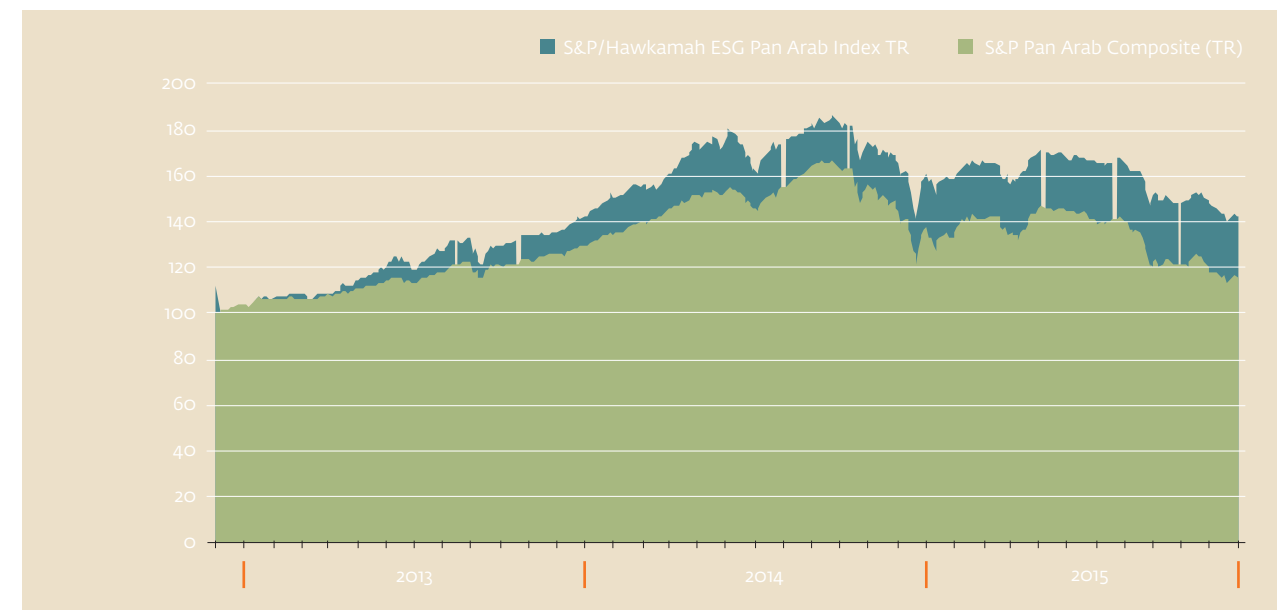


Figure 2: Performance of the Hawkamah/S&P Pan Arab ESG Index vs the S&P Pan Arab Composite Index from 2012-15.

Source: McGraw Hill Financial, Chart Source: "S&P Dow Jones Indices," McGraw Hill Financial, accessed September 1, 2015, <http://eu.spindices.com/indices/equity/sp-hawkamah-esg-pan-arab-index>

Furthermore, the importance of corporate governance is recognized by banks in their credit analyses. Credit agencies such as Moody's and S&P also take corporate governance into account when rating a company; corporate governance factors such as board and management effectiveness, transparency of financial information, and related-party transactions are included in their rating criteria.⁷

Finally, in developed markets, academic studies found evidence that companies – especially small companies – with better corporate governance have significantly higher credit ratings.⁸

Good governance practices can increase investors' confidence in a company. This correlation between good governance and access to capital is of critical interest to companies in MENA, as they often face difficulties in raising funds either from banks or capital markets. This is reflected in a World Bank study that highlights the

difficulties for small and medium enterprises (SMEs) in many countries in the region to access finance. Figure 1 shows the notably lower rate of usage of credit services by SMEs compared to larger firms in Egypt, Syria, Yemen, Morocco, Jordan, and Lebanon.⁹

Good corporate governance is considered by banks and investors alike as critical to reducing the risk associated with providing capital to a company. Banks typically cite the lack of company transparency and a weak infrastructure as the main obstacles to investment.¹⁰

Many investors are willing to pay a premium for well-governed companies. This is reflected in the Hawkamah/S&P Pan Arab ESG Index, which tracks listed companies in 11 markets within MENA that have superior performance according to environmental, social, and governance (ESG) criteria. As Figure 3 illustrates, the ESG Index has outperformed other indexes in the market every year

5 IFC, "Corporate Governance Success Stories."

6 MENA Private Equity Association, "2013 Annual Report", MENA Private Equity Association, accessed September 1, 2015, <http://www.menapea.com/research-association.php?fileid=2013-Annual-Report2.pdf>

7 Moody's Investors Services, "Corporate Governance of Banks: A Credit Rating Agency's Approach," Moody's Investors Services, accessed September 1, 2015, <http://www.ebrd.com/downloads/legal/corporate/moody.pdf>

8 See for example: Fatima Alali, Asokan Anandarajan, and Wei Jiang, "The effect of corporate governance on firm's credit ratings: further evidence using governance score in the United States", *Accounting & Finance* 52, no. 2 (2012): 291–312.

9 Nasr and Pearce, "SMEs for Job Creation in the Arab World, Middle East and North Africa Region."

10 Sahar Nasr and Douglas Pearce, "SMEs for Job Creation in the Arab World, Middle East and North Africa Region," *The International Bank for Reconstruction and Development / The World Bank*, 2012, accessed September 1, 2015, <http://www.ifc.org/wps/wcm/connect/1115c70045539e51af04af6c66d9c728b/SMEs+for+Job+Creation+in+the+Arab+World.pdf?MOD=AJPERES>

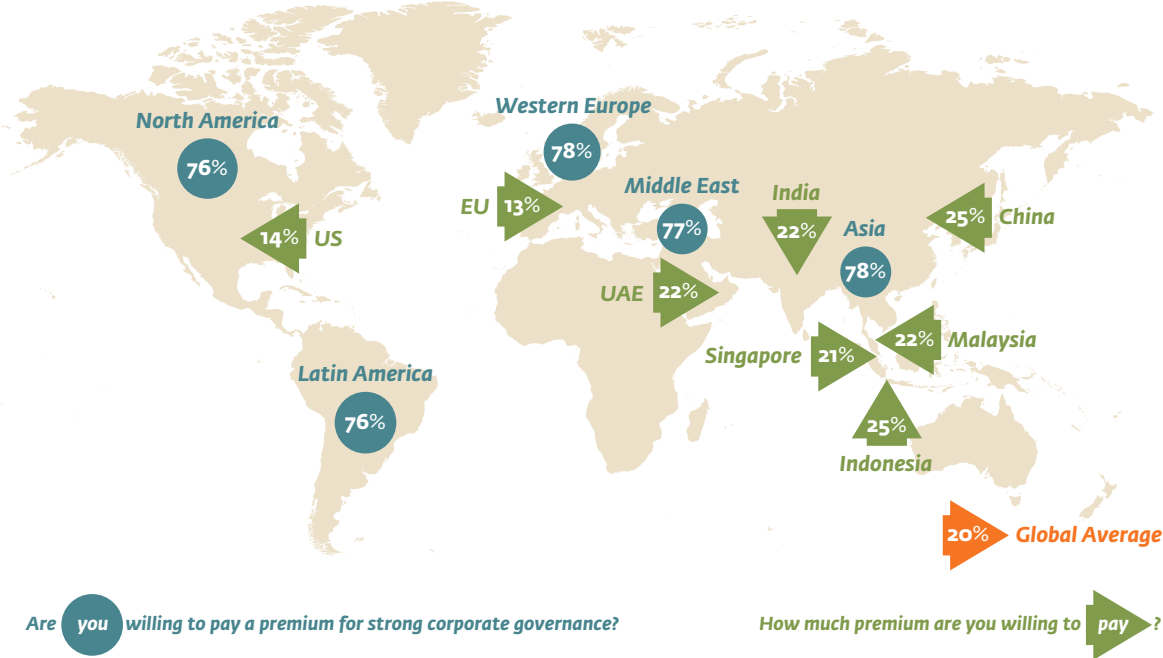
11 Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index," Hawkamah Institute in association with Ernst and Young, 2013, accessed September 1, 2015, http://hawkamah.org/wp-content/uploads/2014/10/ENVIRONMENTAL.SOCIAL.AND_.CORPORATE.GOVERNANCE.PRACTICES.IN_.THE_.MENA_.REGION.2007-2012.pdf

12 Mark Fulton, Bruce Kahn, and Camilla Sharples, "Sustainable Investing: Establishing Long-Term Value and Performance," SSRN, June, 2012, accessed September 1, 2015, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2222740

since 2009.¹¹ This demonstrates that companies with higher performance in the areas of environmental, social and governance issues have enjoyed higher valuations over the period considered. In fact, governance has been identified as the single most important factor, which

suggests that companies can affect market opinion by focusing on their corporate governance systems.¹² Further examples of the premiums paid by investors for higher corporate governance practices are presented below.

Willingness by Investors to Pay a Premium for a Company with Strong Corporate Governance.



Source: McKinsey and Company, McKinsey Global Investor Opinion Survey on Corporate Governance 2002: Key Findings, 2002, <http://www.mckinsey.com/client/service/organization/leadership/service/corpgovernance/pdf/globalinvestoropinionurvey2002.pdf>

How Important is Corporate Governance in Investee Companies?



Source: IFC, "Corporate Governance Success Stories."

Case Study¹³

Majid Al Futtaim is a company that owns shopping malls, supermarkets, hotels, cinemas, entertainment centers, and fashion stores in the United Arab Emirates. The business grew rapidly from its inception in the 1990s. The founder, Mr. Majid Al Futtaim, ensured sustained growth and control through the creation of an efficient and transparent corporate governance framework within his company.

Corporate Governance Measures.

The governance system was based on international best practice, which was adapted to fit local needs and then applied in a step-by-step process. For example, a strong board of directors with clear delegation of authorities was created both at the holding and subsidiary level. Moreover, a sophisticated system of internal controls permitted real accountability and ensured growth and management motivation. These efforts, among others, promoted clarity of roles and process, and, ultimately, changed the way in which Majid Al Futtaim was seen by the market.

Impact.

By establishing a good corporate governance system and having this system communicated to the market, Majid Al Futtaim solidified its excellent reputation, became a sought-after employer in the region, and secured high caliber board members and top talent for its management team. This also helped its business reputation with banks and the listing of debt instruments on the local and international stock markets. Majid Al Futtaim was awarded the highest credit rating (BBB) of privately held entities in the region by both S&P and Fitch Ratings.

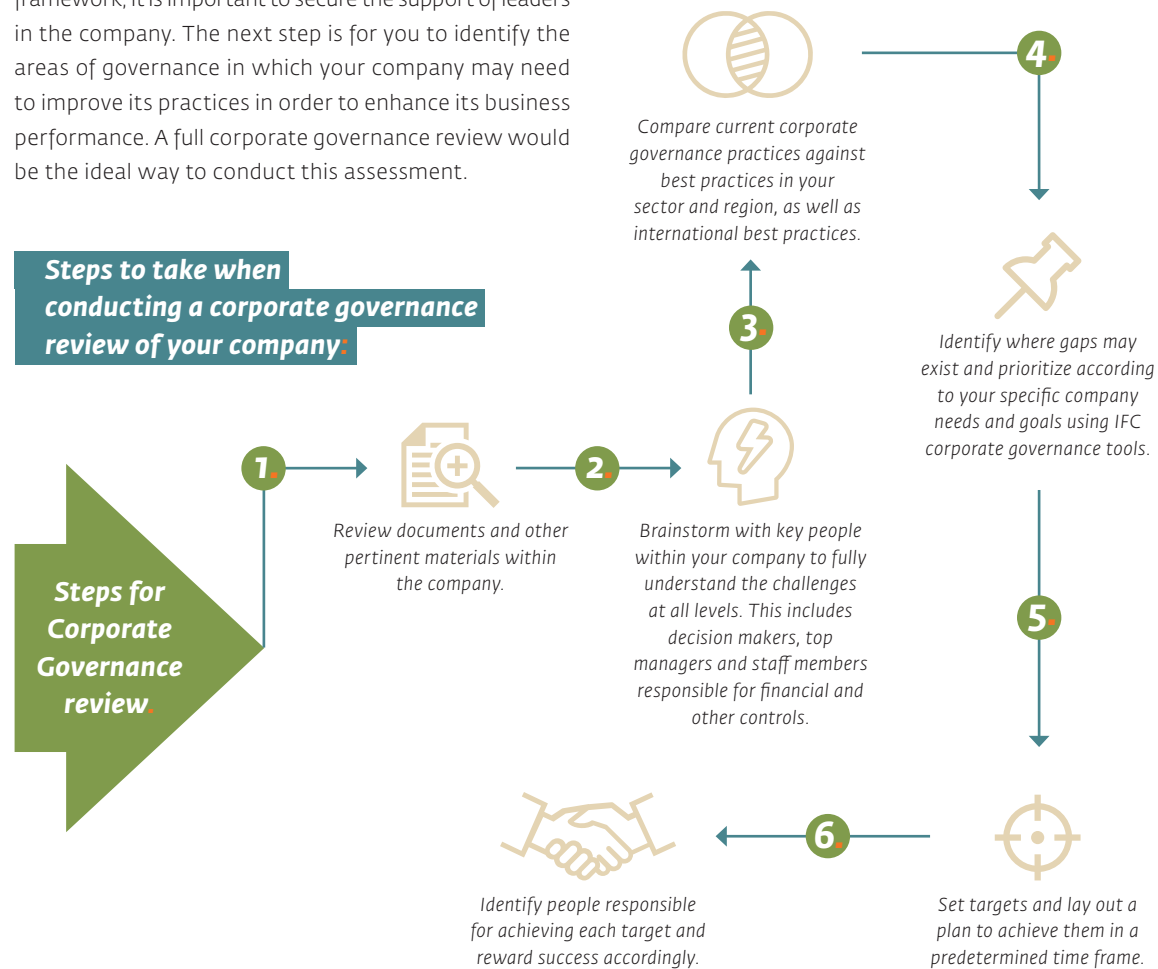
¹³ Tharawat Family Business Forum and Pearl Initiative, "Good Governance in Family Firms, five case studies from the Middle East," Tharawat Family Business Forum and Pearl Initiative, 2014, accessed September 1, 2015, http://www.pearlinitiative.org/tl_files/pearl/img/jiana%20Folder%202014/Good%20Governance%20in%20Family%20Firms%202014_Final_English.pdf



3 How do I implement an effective corporate governance system within my company?

To successfully implement an effective corporate governance framework, it is important to secure the support of leaders in the company. The next step is for you to identify the areas of governance in which your company may need to improve its practices in order to enhance its business performance. A full corporate governance review would be the ideal way to conduct this assessment.

Steps to take when conducting a corporate governance review of your company:



In addition, there are a number of tools and resources available for free online that can guide your initial assessment. IFC offers corporate governance tools that can be downloaded to guide a corporate governance review. IFC also provides a progression matrix, which can be used to identify how a company is performing in various areas of governance.¹⁵ It is important to remember that these tools apply to companies of all sizes and sectors and, therefore, may need fine-tuning and tailoring. In other words, there is no "one size fits all" approach, and all governance solutions must be customized.

Over and above these tools and resources, a company can seek formal advice. Advice offered by IFC and other qualified specialists can provide you with an independent and professional diagnosis, with the added advantage of comparing your individual situation with that of your peers. This advice includes recommendations for improving your corporate governance framework and an action plan for implementation. It should be noted that implementation is critical since a review without implementation is like a bicycle without wheels.



“We had one new investor tell us that our corporate governance changes played a major factor in their investment decision. Specifically, he noted the changes we made at the board level and our efforts to prepare the company for its second generation of leadership.”
Mohamed El Kalla, Chief Executive Officer, Cairo Investment and Real Estate Development (“CIRA”), Egypt

¹⁵ IFC, “Corporate Governance Success Stories.”
¹⁶ IFC, “Corporate Governance Success Stories.”

CIRA operates 15 schools with a combined enrolment of 14,000 students. CIRA was established in 1992 and is now listed on the Egyptian Stock Exchange.

B

Corporate Governance for Small and Medium Enterprises.



4 How can good governance improve the performance of SMEs in emerging markets?

Staff motivation and retention are affected by fairness, transparency, and accountability – key corporate governance values. The implementation of these values can be more effective than monetary incentives when trying to retain employees. This is especially true in smaller companies where average salaries are usually lower than they are in larger ones. Fairness and transparency of rules and responsibilities are powerful motivational tools for attracting and retaining the best staff.

Increasing Transparency and Accountability



Good corporate governance assists in formalizing strategic planning, budgeting, and other key processes. It focuses the business and its key people who have to deliver certain results within a prescribed timetable. It also guides manager and employee expectations. For example, an advisory board or a board of directors, which is an integral component of good governance, improves the strategic planning process by scrutinizing the company's strategic plans and subjecting it to a vigorous debate. This process brings additional perspectives and ideas to the table.

Formalizing Processes



2

Defining Roles Clearly



1

Establishing a Consistent Approach to Risk Management



3

4

“Corporate governance is a core component of our value creation strategy. We generally target early stage SMEs, with the goal of increasing revenue five-fold in two years. About 20–30 percent of that value creation is from improved corporate governance.”¹⁸

Ennis Rimawi
Catalyst Private Equity

Catalyst Private Equity is an Arab region Investment Company that specializes in the energy and water sectors. It is uniquely structured to have a positive strategic and financial impact on the region.

¹⁷ See Question 22 for more.

¹⁸ IFC, “Corporate Governance Success Stories,” p. 149.

5 Why should corporate governance matter to SMEs?

While public attention mostly focuses on governance for larger and listed companies, many business leaders of smaller companies understand that the fundamental principles of corporate governance such as transparency, responsibility, accountability and fairness are beneficial to all companies, regardless of listing status or size.

Corporate governance is crucial for increasing an SME's ability to attract funding from both direct investment and credit institutions. Good governance is particularly important to shareholders of unlisted SMEs. In most cases, these shareholders are less protected by regulators, have limited ability to sell their shares, and are dependent on controlling shareholders. Accordingly, the higher risk implicit in owning a stake in an unlisted company increases the demand for a good governance framework.

For example, Tourism Promotion Services (Pakistan) Limited, a subsidiary of The Aga Khan Fund for Economic Development, and an unlisted company, underwent corporate governance reform in 2007. This included changes to board effectiveness, management control, disclosure and transparency, and shareholder/stakeholder relations. These positive corporate governance changes had the impact of improving access to credit, allowing the company to access facilities of approximately \$20 million to \$30 million in 2008. There has also been the additional impact of helping the company position itself for an eventual IPO, as the changes helped send a signal to the market about the company's emphasis on good governance.²⁰

SMEs, in general, also find it difficult to obtain credit from financial institutions. A recent survey by the World Bank and Union of Arab Banks of over 130 MENA banks shows that only 8 percent

of lending goes to SMEs across MENA, and even less in Gulf Cooperation Council (GCC) countries. These results are comparatively low when compared to middle- or high-income country averages, as Figure 4 shows.²¹ The survey also reveals that 95 percent of MENA banks find the lack of transparency among SMEs a 'very important' or 'important' obstacle to financing (Figure 3).²² This may have, in part, contributed to MENA SMEs' inability to easily obtain funding.

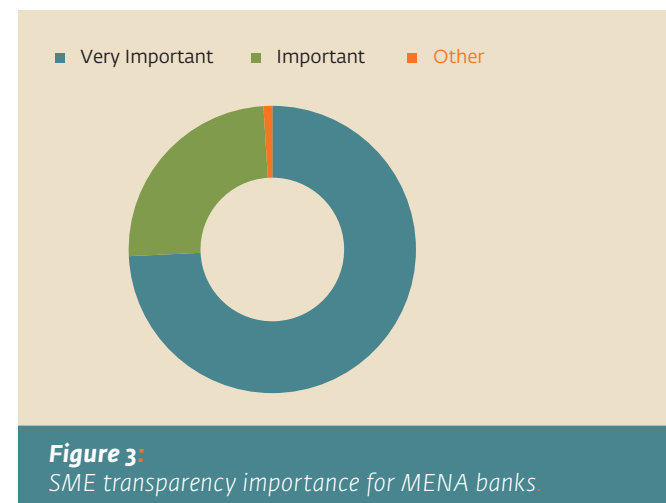


Figure 3: SME transparency importance for MENA banks

Source: Rocha, Farazi, Khouri, and Pearce, "The Status of Bank Lending to SMEs in the Middle and North Africa Region: The Results of a Joint Survey of the Union of Arab Banks and the World Bank."

“One critical enabling factor for SME development is corporate governance. Indeed, practicing good governance will help SMEs establish robust business processes and prepare them for future expansion. In short, corporate governance lays the foundation for SMEs to be more accountable and transparent in their operations, thus enabling them to be more bankable and investable.”
H.E. Sami Dhaen Al Qamzi, Director General
The Department of Economic Development, Dubai

Foreword in the Corporate Governance Code for Small and Medium Enterprises: Building the Foundations for Growth and Sustainability, Mohammed Bin Rashid Establishment for SME Development (2011) ("Dubai SME Code").

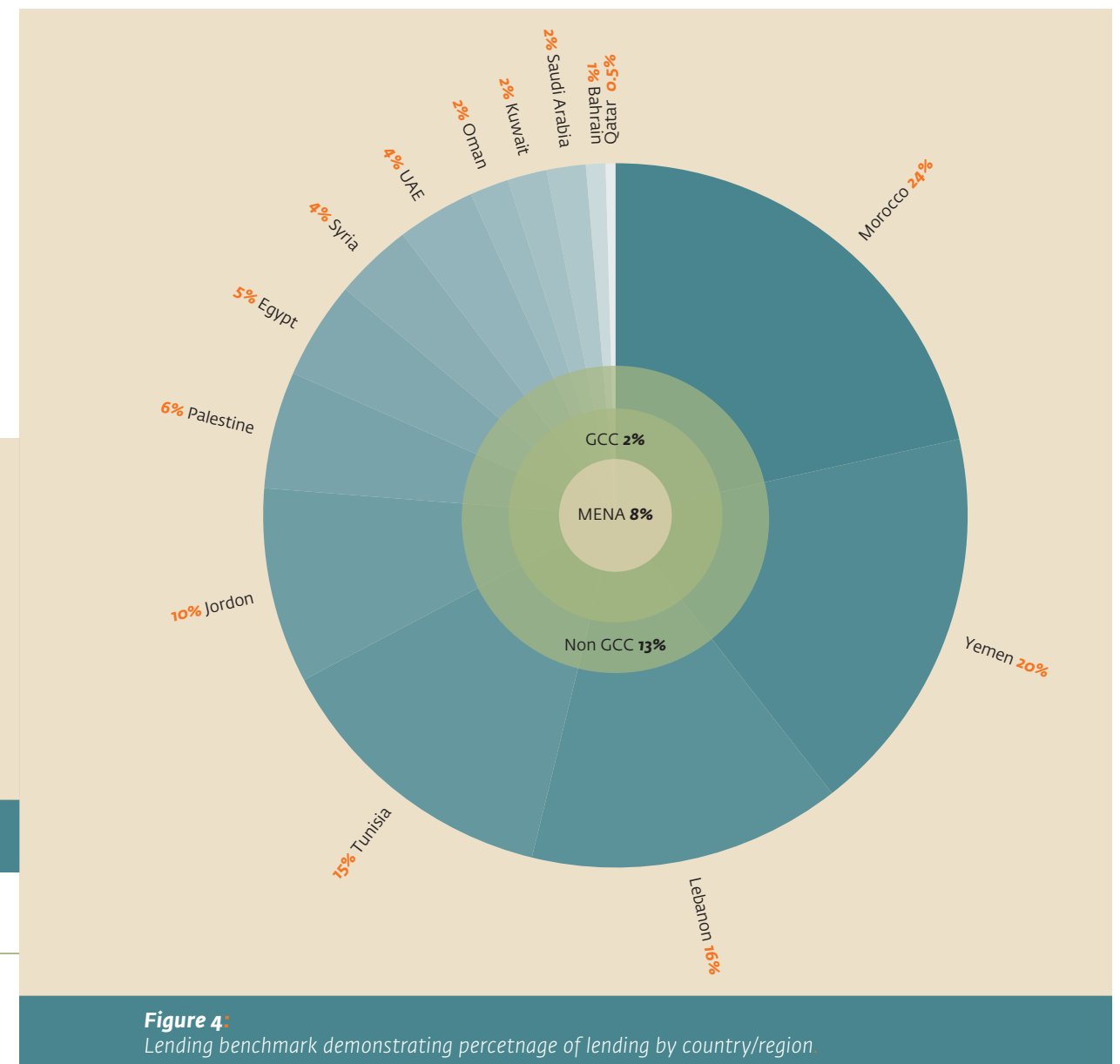


Figure 4: Lending benchmark demonstrating percentage of lending by country/region.

Source: Saleem, "Overcoming Constraints to SME Development in MENA Countries and Enhancing Access to Finance."

19 Mohammed Bin Rashid Establishment for SME Development, "Corporate Governance Code for Small and Medium Enterprises: Building the Foundations for Growth and Sustainability," Mohammed Bin Rashid Establishment for SME Development, accessed September 1, 2015, <http://hawkamah.org/wp-content/uploads/2014/10/Dubai-SME-CG-Code-En.pdf>

20 IFC, "Corporate Governance Success Stories."

21 Qamar Saleem, "Overcoming Constraints to SME Development in MENA Countries and Enhancing Access to Finance", IFC Advisory Services in the Middle East and North Africa, accessed September 1, 2015, http://www.ifc.org/wps/wcm/connect/1e6a19804fc58e529881fe0098cb14b9/IFC+Report_Final.pdf?MOD=AJPERES

22 Roberto Rocha, Subika Farazi, Rania Khouri, and Douglas Pearce, "The Status of Bank Lending to SMEs in the Middle and North Africa Region: The Results of a Joint Survey of the Union of Arab Banks and the World Bank," World Bank and Union of Arab Banks, June 2010, accessed September 1, 2015, http://siteresources.worldbank.org/INTMNAAREGTOPPOVRED/Resources/MENAflagshipSMEFinance12_20_10.pdf

6 Do international corporate governance standards apply to emerging markets?

According to the Center for International Private Enterprise, "Successful development efforts demand a holistic approach, in which various programs and strategies are recognized for their important contributions to progress and prosperity. In this regard, linkages between corporate governance and development are crucial... Yet, corporate governance and development are strongly related. Just as good corporate governance contributes to the sustainable development prospects of countries, increased economic sustainability of nations and institutional reforms that come with it provide the necessary basis for improved governance in the public and private sector. Alternatively, corporate governance failures can undermine development efforts by misallocating much needed capital and resources and developmental fallbacks can reinforce weak governance in the private sector and undermine job and wealth creation."²³

Globalization of finance and trade has supported the widespread adherence to common underlying corporate governance principles. They are not country-specific and have been applied in various and diverse emerging markets, adjusted for local regulations and business traditions. Corporate Governance Principles:

These principles are reflected in the corporate governance codes adopted in many countries around the world, including in the MENA region.²⁴ A corporate governance code is a set of non-mandatory guidelines that companies are encouraged to follow. Notably, in some MENA countries, multiple corporate governance codes exist. In fact, some MENA countries have a code that is solely directed to small and medium enterprises, as is the case in the United Arab Emirates, Morocco, and Lebanon.²⁵

Your local code should be the first resource to compare when it comes to your company's corporate governance practices. Since the publication of the Oman Corporate Governance Code in 2002, almost all countries in MENA have introduced a corporate governance code.²⁶ In general, corporate governance codes are a non-mandatory instrument that provides guidelines and recommendations to companies in any given market. In many instances, companies are given the option of either complying with the code or explaining why other solutions work better for their situation, as no one prescription is correct in all circumstances.

Your company will need to decide how to adapt and modify the general governance principles in its market in line with its current needs and aspirations. IFC can provide expert advice to suggest which governance solutions may be better suited for your specific company.



“Corporate governance is not something that has to be imposed on corporations from outside. I can tell you in my case what developed and what evolved in Nuqul Group was done in response to challenges and actual needs on the ground - and it turned out to be what you call corporate governance.”²⁷

*Ghassan Nuqul, Vice Chair,
Nuqul Group, Jordan*

Nuqul Group runs different investments and industries led by 5,100 team members spanning several continents. It embodies two major holding entities; FINE Hygienic Holding (FHH) being the umbrella for paper mills, FINE hygienic paper companies and supporting industries; and The Promise Holding which includes diverse investments in different sectors and modes.

²³ Center for International Private Enterprise, "Corporate Governance - The Intersection of Public and Private Reform", Center for International Private Enterprise, 2009, accessed September 1, 2015, http://www.cipe.org/sites/default/files/publication-docs/CG_USAID.pdf
²⁴ See Annex 1 for a full list of corporate governance codes adopted in MENA.
²⁵ See Question 6 for more details.
²⁶ See Question 1 for more details.
²⁷ Center for International Private Enterprise Global Corporate Governance Forum, "Advancing Corporate Governance in the Middle East and North Africa."

7 Is corporate governance “costly”?

Corporate governance reforms involve the use of time and resources; however, these costs should be considered as an investment in the future of your company. Setting up a board of directors, for example, will require attracting respected, credible, independent directors; which may involve considerable effort to identify the right people, and costs in terms of their fees. This cost, however, is incredibly worthwhile since a board’s presence is likely to offer credibility in the market and help your company obtain credit approval from banks.

Another area where potential benefit exceeds cost is risk management; the proper management of risk inevitably involves various expenditures. However, such a system prevents losses in the face of undesirable events and circumstances.²⁸ For example, managing cash flow volatility is vital to ensure your company can cover its debt on time. This requires the establishment of certain practices, which will vary depending on the nature of your business, to minimize the risk of not being able to deliver products or services (e.g. relationship with suppliers), not being paid time by customers (e.g. customers’ credit check), or having inadequate internal accounting (e.g. punctuality of accounting records).

While there is a certain cost involved in preparing documentation and establishing tools of governance, these represent only a fraction of the potential costs that could arise from disputes with partners and employees due to of the lack of internal transparency or poorly defined roles and responsibilities. Overall, it is important to remember that implementing good governance practices is a flexible and gradual process. Start by governing your company around good governance principles, and you will soon find that costs can be controlled and assessed against benefits.

“ One cannot think in terms of ‘costs’ when it comes to governance systems. It is more appropriate to talk about an investment (in time and effort), the returns one will get from this investment, and whether one can ensure long-term success without such an investment.

*Carl Bistany, President,
SABIS® Educational Holding S.A.L.*

SABIS® is a global education network that operates on four continents serviced through three independent corporations headquartered in the United States, Lebanon, and the United Arab Emirates. Schools in the SABIS® Network operate in 15 countries and educate close to 65,000 students.

²⁸ See questions 19 and 20 for more on internal controls and question 40 on risk management.



The Board of Directors' Role and Composition.

8 What is commonly regarded as a well-constituted board?

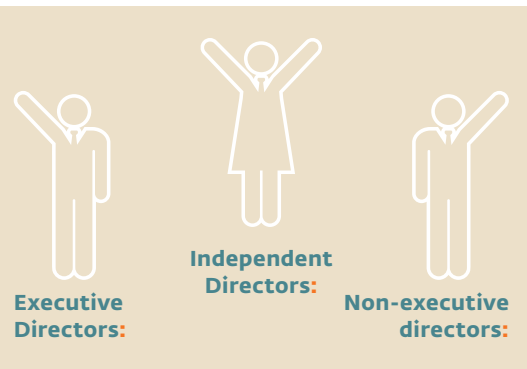
There is no such a thing as a typical board of directors, since size and composition will vary according to a company's needs. Board size can range from five to eighteen board members, though the average board size across MENA stands at about nine members.²⁹ Regardless of board size, there are certain practices that should be followed to achieve optimal results.

Overall, it is important to establish the desired board profile for your company by identifying the types of directors needed in relation to your business goals. To do this, many companies regularly review the list of skills that are desirable on the board and match them with board members' profiles. Directors' "softer" skills and personalities should not be forgotten as they are instrumental in establishing appropriate board dynamics.

When deciding on the composition of your board of directors, you should keep in mind the balance between the number of executive directors (board members who are part of the company's executive team) and non-executive directors (board members who are not part of the company's executive team). You may also want to consider having independent non-executive directors on the board.³⁰ On average, 49 percent of board seats in MENA are held by independent, non-executive directors.³¹ Such directors can bring real value to your company by providing new business opportunities and more independent, objective advice. They also can provide constructive criticism, to an extent which is unlikely to come from within the company.

When thinking about your board's profile, you should keep in mind the practicalities related to the size of the board. In other words, consider that the effectiveness of the discussion is impaired when there are too many people around the table. Larger boards of directors are not always the best source of constructive challenge or

Defining Different Types of Board Directors:



Executive directors: Directors simultaneously serving as members of the company's executive management.

Non-executive directors: Board members who are not part of the company's executive team, but are somehow related to the company; examples being previous employment or family ties.

Independent Directors: Board members who have no material relations with the company's management, owners, or other stakeholders that may influence the independence of his or her judgment.

fresh ideas. Generally common convention suggests that a board size of between seven to 10 directors is optimal for most companies.

Equally important is the issue of gender balance. This issue has received a lot of attention recently, since women tend to be under-represented on boards. In MENA, in particular, this issue is pertinent, since only about 12 percent of boards have a female board member.³²

²⁹ Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index."

³⁰ See Questions 10 and 11 for further discussion.

³¹ Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index."

³² Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index."

³³ Tharawat Family Business Forum and Pearl Initiative, "Good Governance in Family Firms, five case studies from the Middle East."



“ A major milestone in the project was the definition of the roles of the board of directors and senior management. By implementing board composition regulations and detailed procedures, for example concerning meeting frequency, SABIS® was able to improve decision-making structures and executive control. The board currently comprises eight family members (some of whom are non-executive) and one non-family director. The plan is gradually to increase the number of independent board members while maintaining the number of family members at a minimum of 50 percent. ³³ ”

SABIS® is a global education network that operates on four continents serviced through three independent corporations headquartered in the United States, Lebanon, and the United Arab Emirates. Schools in the SABIS® Network operate in 15 countries and educate close to 65,000 students.

Case Study.³⁴

Nuqul Group is a Jordan-based conglomerate of 30 companies operating in manufactured goods production.

Corporate Governance Measures.

Thirty years after the Group's creation, Ghassan Nuqul took over from his father as leader of the company. At the time, he realized that an excessive concentration of power existed at head office level, and that there was a lack of accountability at subsidiary levels. This made Nuqul less attractive to investors.

The Group established a strong board of directors comprised of both family and non-family members. This addressed the insufficient delegation of authorities and institutionalised processes, job description, and increased accountability at all levels.

Nuqul's board profile has been carefully selected and includes non-executive directors independent from the Group, family members, executive directors and directors with relevant expertise.

Impact.

A better system of ensuring accountability permitted a more efficient delegation of authorities and redefined roles and responsibilities. Nuqul Group benefited from the institutionalization of the process by setting a long-term strategy that followed global best practices. This led to continuous growth both in terms of size and net profits.

³⁴ Arab Business Review, "Case Studies: Corporate Governance in the Middle East," Arab Business Review, accessed on September 1, 2015, <http://www.arabbusinessreview.com/en/article/case-studies-corporate-governance-middle-east>

9 What is the board's role?

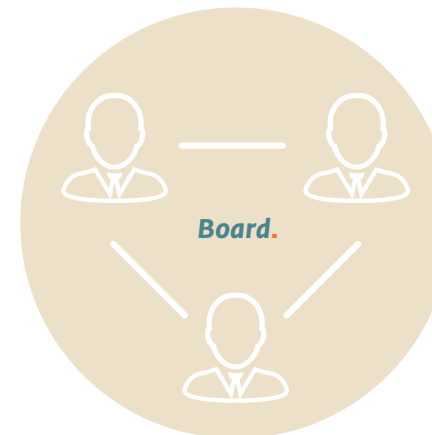
With all the emphasis on corporate governance and the increased responsibilities being placed on boards, it is important that your directors remain conscious of the important role that they play. It is critical that they understand their role and responsibilities within the company, which will help maintain a balance between running the business and supervising how the business is run. While the board needs to actively participate in strategy and be well-informed about the company's activities, it needs to refrain from interfering with day-to-day management.

Due to the increased focus on regulatory requirements and other best practice guidelines your company will experience, your board can easily fall victim to complying

with rules that do not fit your company. If the focus is on meeting the letter of the law, there is a definite risk that the real issues behind your company's governance becomes obscured.

Notably, if the focus on governance processes leads the board being too slow or overly risk-averse in making decisions, your company or shareholders may not benefit. Business is never about a "sure thing," and bold moves are never without risk. If your board's focus on process overcomes its willingness to take risk, shareholders will not be better off. In the end, your board must take more into account than strict compliance to the code. It is important that the board be responsible for the overall performance of the company.

The Board Role in Management Decisions.



Approves strategic direction.

Approves business plans and budgets.

Organizes work of the board.

Monitors and guides managerial performance.



Develops effective executive board or mgmt. team.

Develops/recommends business plans and budgets.

Develops/recommends strategic direction.

Carries out corporate activities to achieve corporate strategy and business plans.

10 What is an independent director?

A director is considered independent when he or she has no material relations with the company's management, owners, or other stakeholders that may influence the independence of his or her judgment. In general, shareholders, business partners, clients, and family members tend not to be considered independent. National codes, listing requirements, and individual companies define when a relationship should be considered "material". Though the criteria for independence varies in different countries, the main principles defining independence remains the same.

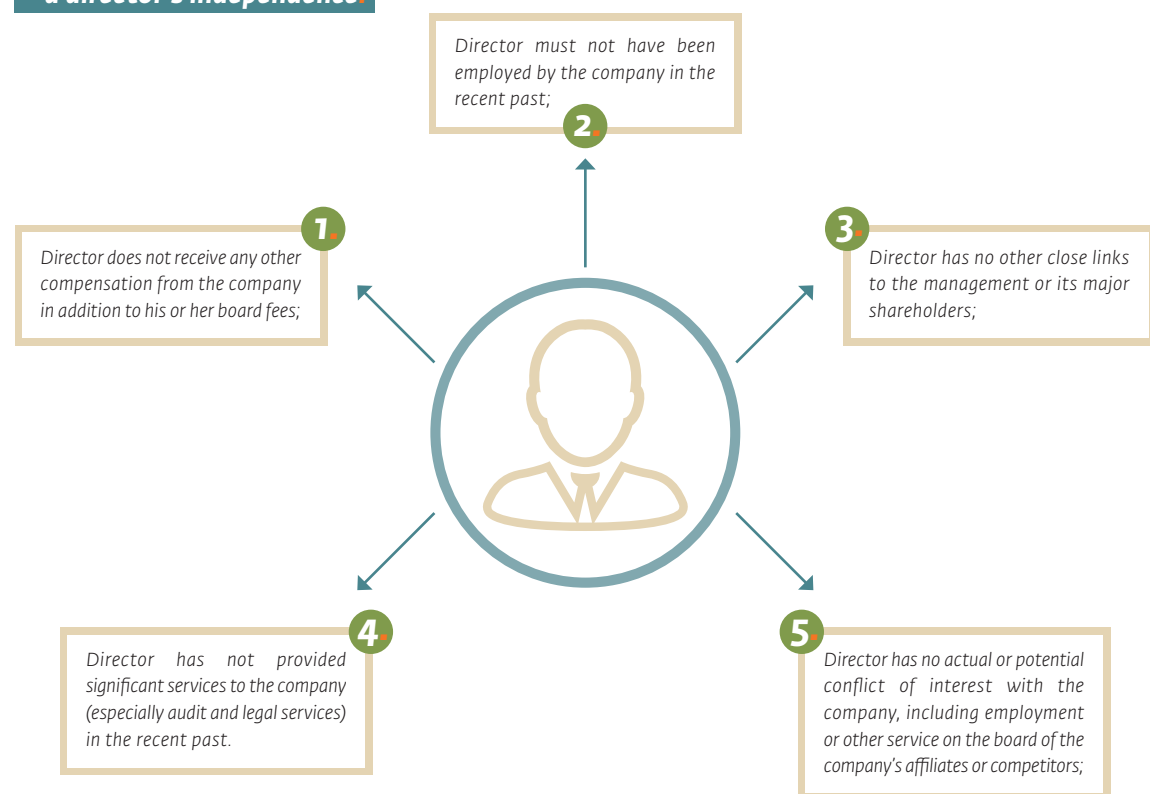
Directors nominated by one or more shareholders, namely shareholder nominees, who serve in their individual capacity and not as a representative of the shareholder(s), also have characteristics defining their independence.

Shareholder nominated directors are considered independent as long as they:

- are not paid by these shareholders;
- do not have any material connection with the nominating shareholder(s);
- do not report directly to the nominating shareholder(s); and
- cannot be asked to resign by the shareholder(s) who nominated them.³⁵

In the MENA region, the proportion of independent board members is on the rise, becoming more widely accepted. According to one survey, the proportion of independent board members in GCC countries increased from 46 percent in 2009 to 64 percent in 2011,³⁶ which is aligned with best practice.

Criteria defining a director's independence:



35 More details examples of definition of independence can be found here: IFC, "Indicative Independent Director Definition," IFC, 2012, accessed September 1, 2015, <http://www.ifc.org/wps/wcm/connect/9d10d4804091a9a7b3f4b3cdd0ee9c33/Independent+Director+IFC+Definition+2012.pdf?MOD=AJPERES>

36 GCC Board Directors Institute, "Embarking on a Journey – A Review of Board Effectiveness in the Gulf," GCC Board Directors Institute, 2011, accessed September 1, 2015, http://gccbdi.org/wp-content/uploads/2013/09/embarkingonajourney_2011_english.pdf

11 What value can an independent director bring to my company?



Constructive Criticism and External Perspective

Independent directors contribute to a company's success by providing innovative opinions and creative perspectives, and by constructively challenging management. These directors can provide valued contributions and a fresh perspective to board discussions, which may be lacking in the closed circle of owner and employees. When there are shareholder representatives sitting on the board, an independent director can also present a critical, unbiased, and non-affiliated perspective. At the end of the day, the quality of the contribution of a director is not a function of his formal independence, but of his/her competence and courage in challenging prevailing opinions and widely accepted views.

Accountability and Transparency

Investors often request that independent directors sit on a board, as their presence promotes accountability and transparency. Placing independent directors on the board is also a necessary step to attract external funding, or when planning to list a company on local or international stock exchanges. Formal independence is useful as an indication to outsiders of the willingness of your company to address potential conflict and comply with widely accepted norms. Since effective independence and willingness to speak up on issues is what brings real value to the board, careful selection of directors through a formal and objective process is important. It is also important to note that for listed companies in certain jurisdictions, it is mandatory to have independent directors sit on certain board committees such as the audit committee.

"SME owner-managers, even those that choose to set up a board, may view the board as a threat to their control and, therefore, decide to appoint family members or friends, who are unlikely to ask hard questions, as non-executive directors. Such a board will provide little value to the company. As companies evolve, it is important for companies to appoint "outside" or independent non-executive directors to their boards."³⁷

– Dubai SME Code (2011)

"In emerging markets where external governance mechanisms are weaker, boards' ability to effectively monitor managers on behalf of shareholders has been crucially important for corporate governance. However, this board function may be undermined if shareholders and managers (ownership and control) are not fully separated. This is a particular concern for minority shareholders in emerging market companies. Therefore, corporate governance codes commonly recommend a high level of board independence—especially independence from management."³⁸

37 Mohammed Bin Rashid Establishment for SME Development, "Corporate Governance Code for Small and Medium Enterprises: Building the Foundations for Growth and Sustainability," p 18.

38 Harvard Law School Forum on Corporate Governance and Financial Regulation, "Corporate Governance in Emerging Markets," Harvard Law School Forum on Corporate Governance and Financial Regulation, 2011, accessed September 1, 2015, <http://blogs.law.harvard.edu/corpgov/2011/08/24/corporate-governance-in-emerging-markets/>

12 How do I trust independent directors with confidential information?

Having only “insiders” on your board would ensure confidentiality, but this also means missing out on the benefits of a more lively debate and external points of views provided by independent directors.³⁹ However, in order for independent directors to contribute meaningfully to any discussion, they need access to confidential information.

Most jurisdictions condemn the divulgence of non-public information received by board members while serving on a board of directors. However, many MENA region jurisdictions have imprecise definitions of board members’ duties and obligations, which can undermine potential legal liability with respect to the disclosure of confidential information.⁴⁰ Therefore, in addition to legal and other statutory protections, it is advisable for your company to protect itself by having a board code of conduct, and a confidentiality policy.

Code of Conduct

Upon appointment, non-executive directors should be asked to sign a code of conduct, to be incorporated into their contractual obligations. Your board code of conduct that directors are bound by a duty of loyalty to the company, which includes the duty not to disclose non-public information and bans directors from using such information to conduct any transaction for their own personal interests or gains.

“The duty of loyalty includes a duty [...], not to disclose confidential information of the company or use it for his personal profit, not to take business opportunities of the company for himself, not to compete in business with the company, and to serve the company’s interest in any transactions with the company in which he has a personal interest.”⁴¹

– Corporate Governance Code, Kingdom Of Bahrain (2010)

Confidentiality Policy

Notably, while a confidentiality policy may not be easily enforceable on legal grounds, it serves the dual purpose of educating board members and motivating their behavior, through the creation of a moral obligation.

Private companies usually take a while to become open with outside directors, so access to confidential information might be gradual.

³⁹ See Question 10.

⁴⁰ Alissa Amico, “Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities”, OECD Corporate Governance Working Papers, No. 15, OECD Publishing: <http://dx.doi.org/10.1787/5jxws6scxg7c-en>

⁴¹ Central Bank of Bahrain, “Corporate Governance Code – Kingdom of Bahrain,” Central Bank of Bahrain, accessed September 1, 2015, <http://www.moic.gov.bh/En/Commerce/DomesticTrade/Corporate%20Governance/Documents/bb9903e050a24fc6b65190cfcd637cd1BahrainCGCodeEN.pdf>



13 What is the role of the chair of the board of directors?

In the MENA region, the role of the chair varies. In some companies, it is an honorary position, while in others the chair retains considerable power and an active managerial role if the chair is also the Chief Executive Officer (CEO). This section examines the role of a non-executive chair and his or her main responsibilities. The chair's powerful and complex position is well reflected in this quote from a study that focuses on MENA countries, in particular, Egypt and Saudi Arabia:

"In summary, the findings from this study indicate that, contrary to the norms in most developed countries and many developing ones, the chair rather than the CEO holds the most powerful position in the board of directors, although this is frequently the same person (Lorsch and MacIver 1989; Prowse 1994; Conger and Lawler 2001). This finding is common across both countries [Saudi Arabia and Egypt], and across different companies regardless of the ownership structure. Moreover, the study confirms that the chair is the company's highest authority and the boards' main source of information because of his ability to expend personal resources on gathering information and formulating company strategies. This phenomenon is more pronounced in family companies, but is nevertheless, also present in other company types including state and foreign-owned companies in both countries."⁴²

*"The chair should take an active lead in promoting mutual trust, open discussion, constructive dissent and support for decisions after they have been made."*⁴³

– Corporate Governance Code, Kingdom Of Bahrain (2010)

Leading the Board

By managing the board's agenda, the chair can influence how the board tackles crucial topics such as strategy, risk management, senior executive appointments and remuneration. Furthermore, with the assistance of the company secretary, the chair can ensure the timely flow of information to the board.

Through his or her leadership, the chair can inspire trust among board members and assist in developing the appropriate dynamics at board meetings. To this end, the chair needs to be a facilitator and a moderator. In particular, the chair should make sure that different views and constructive criticism can be freely expressed throughout any decision making process. However, the chair must, at the same time, make sure to manage dissent in order to have a productive and efficient group discussion. A good chair aims to lead the conversation so that the board makes decisions by consensus, and not simply through a majority vote.

Evaluation and Succession Planning of the Board

As the board leader, the chair also has the task of supervising the evaluation of the board's effectiveness and the succession planning of its members and that of the board's committees, if any. Notably, about 13 percent of listed companies in MENA conduct board evaluations.⁴⁴

14 Why should we split the roles of chair and CEO?

The roles of chair and CEO are intrinsically different and, depending on the circumstances, you should consider separating. The chair leads the board in carrying out its duties of monitoring, remunerating, and replacing management. Due to the CEO's management position, there is an intrinsic conflict if the CEO were to lead the board in its duties to oversee management. This would be like a football referee also being a player in the same match. The problem is partially addressed by the creation of certain committees, such as a remuneration committee that objectively assesses the pay and performance of the CEO and other management.

It is important to note that a key mission of the board is to productively challenge management. It is very difficult to achieve that if its leader is at the same time the person to be challenged. The practice of splitting the two roles has also been adopted not only by listed companies, but by successful private family owned companies.

Another reason for splitting the roles is time availability. CEOs are very busy people, and their executive duties usually take priority over board leadership duties. The board is a critical organ of any well-structured governance system and requires dedicated leadership and commitment that only a non-executive chair can provide.

The clear and transparent division of roles at the top of the company is one of the cornerstones of good corporate governance, so it should not be surprising that many MENA corporate governance codes favor the separation of these roles. These include the codes in Bahrain, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. In fact, the roles of chair and CEO in MENA countries are separate over 80 percent of the time.⁴⁵

In SMEs with many shareholders, the split of the roles of chair and CEO is more common and often required. For

example, Growthgate Capital, a MENA-focused private equity house, reports that one of its portfolio company's doubled its revenues and earnings before interest, taxes, depreciation, and amortization in five years "by taking steps like separating the role of chair and the CEO, empowering and incentivizing key members of the senior management team, and making restructuring initiatives such as defining adequately the senior officers' roles..."⁴⁶

However, there are circumstances when one person in the dual roles of chair and CEO is beneficial. Such unity of command might be especially helpful in the early stages of business development or in periods of crisis and transition. Like many good governance practices, every company should be mindful about applying a solution that is tailored to their situation. Whether you should split the role of CEO and chair depends on your company's needs and circumstances.

"Large companies should consider separating the roles of the chairman and the chief executive.

*For the board oversight over management to be truly effective, the roles of the chairman and the chief executive should be separate. In smaller companies, such a separation may not always be possible or feasible."*⁴⁷

– Dubai SME Code (2011)

According to a 2008 Hawkamah-IFC survey covering MENA, 65 percent of interviewed companies stated that the positions of chair and CEO are held by different individuals. Notably, 72.2 percent of banks followed corporate governance best practices in this respect. In contrast, 42.3 percent of listed companies combined the functions of CEO and chair.

42 Jenifer Piesse, Roger Strange, and Fahad Toonsi, "Is there a distinctive MENA model of corporate governance?" *Journal of Management and Governance* 16, no. 4 (2007): 645-681.

43 Central Bank of Bahrain, "Corporate Governance Code – Kingdom of Bahrain."

44 Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index."

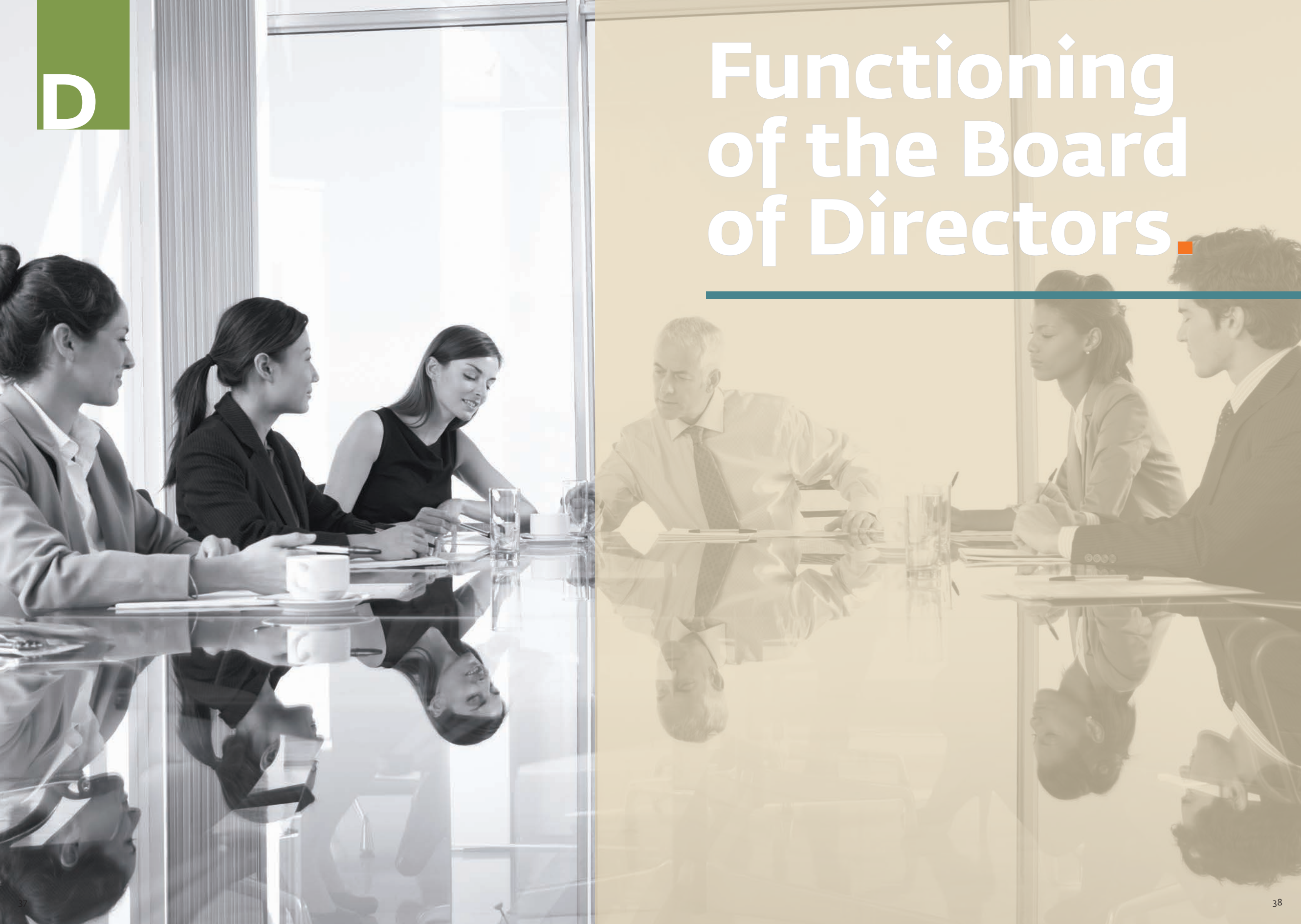
45 Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index."

46 Samer Kallas, Elie Nammar, Sheharyar Malik, "Doing Well While Acting Good, Benefits of Good Governance, Insights from MENA", Harvard Business School and GrowthGate Capital, 2013, accessed September 1, 2015, http://www.growthgate.com/imagesadmin/articles_pdf/14012807051848.pdf

47 Mohammed Bin Rashid Establishment for SME Development, "Corporate Governance Code for Small and Medium Enterprises: Building the Foundations for Growth and Sustainability," p. 18.

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Functioning of the Board of Directors.



15 How many times a year should a board meet?

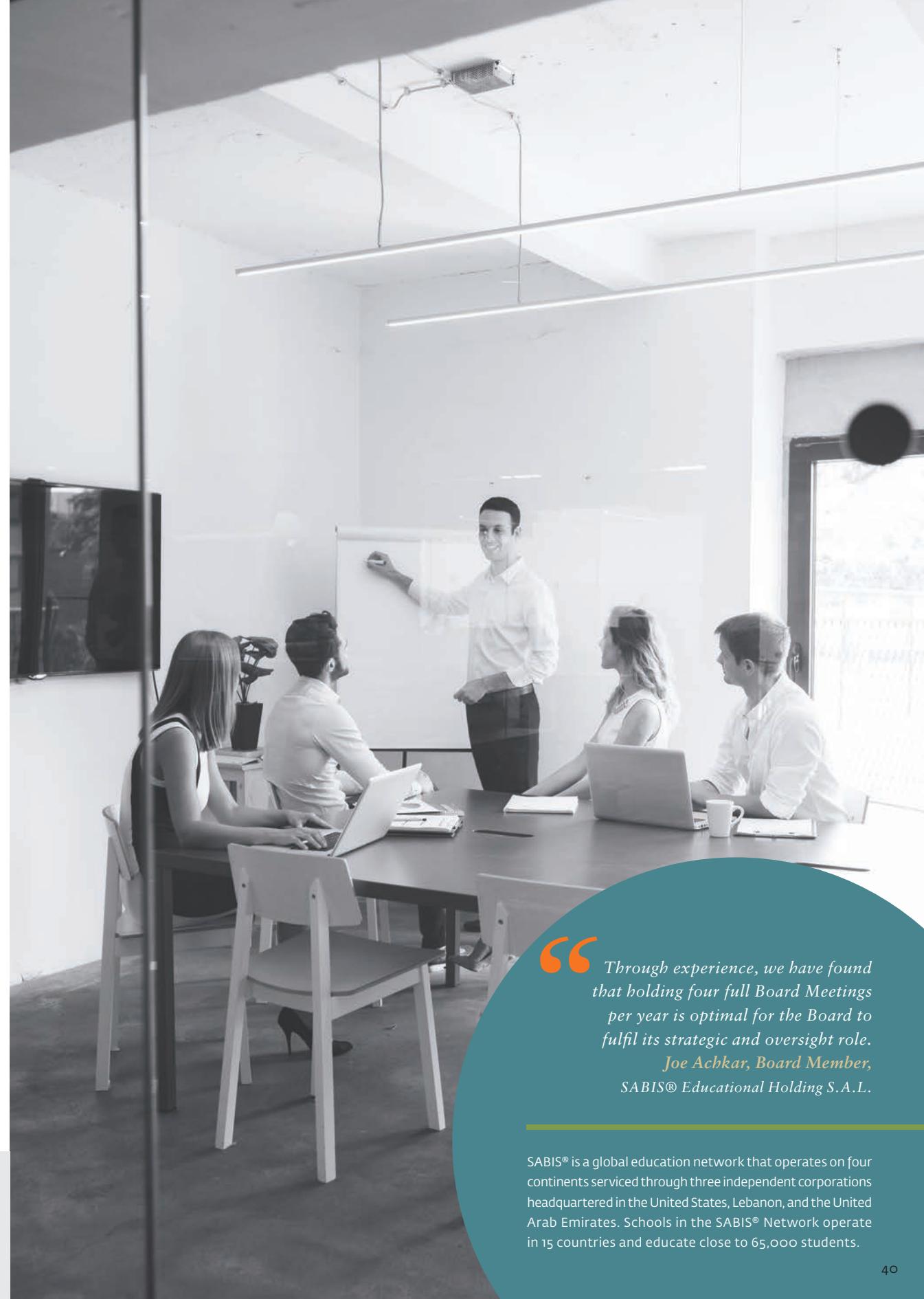
There is no magic number as to how many times a year a board should meet. However, even in small businesses, a board of directors should meet at least quarterly, with additional meetings determined by specific circumstances. For larger companies, it is common to schedule around eight meetings a year and sometimes more.

Before the beginning of the year, your board chair, with the support of the board secretary, should develop an annual work plan that defines which matters should be discussed at particular times in the board of directors' annual cycle of meetings. This will provide you with the list of necessary meetings and principal issues designated to be covered at each of the meetings in the annual cycle.

If meeting this frequently is difficult or too expensive, your company should make full use of modern means of communication to organize meetings by phone or

videoconference, and use written approvals when urgent matters arise at short notice. Do not forget that the number of meetings reflects the board's relative power. The more power management has, the less likely the board will need to meet.

Attendance is also worth pointing out; every director should be encouraged to attend meetings to promote a full and dynamic dialogue, as well as continuity. A study that includes 150 of the largest companies listed on the stock exchanges of 11 markets in MENA ⁴⁸ shows that of the 41 percent of companies that provided disclosure on this topic, only 11 percent of boards had full attendance at more than 75 percent of meetings. ⁴⁹ This, indeed, is a cause for alarm, especially since only 2 percent of boards had full attendance at more than 90 percent of meetings. ⁵⁰



“Through experience, we have found that holding four full Board Meetings per year is optimal for the Board to fulfil its strategic and oversight role.”
*Joe Achkar, Board Member,
SABIS® Educational Holding S.A.L.*

48 These markets included Bahrain, Egypt, Jordan, Lebanon, Kuwait, Morocco, Oman, Qatar, Kingdom of Saudi Arabia, Tunisia, and the UAE.

49 Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index."

50 Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index."

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16 How are non-executive board members compensated?

Non-executive board member compensation varies dramatically according to the size of the business, the sector in which it operates, and local business traditions and workload. While it is not possible to determine a figure that can be applied to everyone, the pay structure and the rationale for diverse compensation within the same board applies to the majority of privately held companies. In order to structure your non-executive director remuneration policy, you should take into account international best practice, as well as the local business culture and traditions.

Directors are not employees of the company but are still remunerated for their services. According to corporate governance best practice, non-executive directors receive only 'fixed' remuneration. Normally, non-executive directors receive an annual fixed fee for their participation on the board, and additional fees for each committee membership. Additionally, any out-of-pocket expenses incurred while performing duties are covered by the company. It should be remembered that if you are looking for highly qualified non-executive directors who will make a real contribution to the business, it is in the company's best interest to ensure that they are fairly and properly compensated.

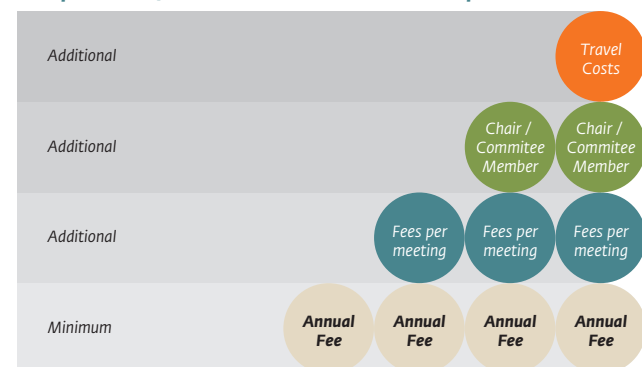
Committee fees are often not the same; audit and risk management committees receive larger fees due to the higher time commitment required of their members. Individuals with more responsibilities, such as board and committee chair, vice-chair, and senior independent directors, also receive higher fees. In some countries, it is customary to give an attendance fee per board meeting or committee meeting as an incentive to participate.

Unfortunately, very few companies in MENA disclose their remuneration policies. However, there have been improvements in recent years and some companies are starting to disclose executive pay structures.⁵¹

Some publicly listed companies require non-executive directors to also become shareholders in order to align their interests to those of other shareholders. These shares are usually paid for by the non-executive director and are deducted from him or her through an appropriation of part of their director's fees. One relatively simple formula to use is shown below.

Board Remuneration – Sample Schemes for Non-Executive Directors.

Components of a non-executive remuneration plan



How much should the annual fee be?

Annual fee can be comprised of cash or shares and will vary by country/market. However, here is a very simple formula that can be used:

1. Multiply the approximate CEO daily rate times the number of expected work days for the Director. (e.g., 1,000\$/day X 10 days/year = 10,000\$ fee).
2. Then you can add the supplemental fees (e.g., meeting fees, travel costs, etc) on top of that.

17 What is an appropriate tenure and term of service for members of the board of directors?

Term of Service

The period for which non-executive directors are elected to serve on the board (their term of service) varies by country and by company. When deciding what best suits your case, you should consider the two most popular options are a three-year term or a one-year term. The latter is normally adopted by companies with dispersed ownership, usually listed companies with no individual large shareholder. It ensures prompt accountability to the owners who vote on all board members once every year. The three-year term, on the other hand, provides a more stable board composition and continuity as it allows for a better understanding of the business and an institutional memory at board level. If you opt for a three-year term or another multi-year option, you should consider whether you prefer to have your directors elected or re-elected all at once, or if staggered elections are a more beneficial option.

According to best practices, executive members of the board (managers of the company) are subject to the same re-election process as non-executive directors. This makes managers directly accountable to the shareholders. In some countries, there is a practice that requires executives to remain throughout the duration of their appointment as an executive without having to stand for re-election, and only the non-executive directors are required to retire by rotation.

Tenure

There is no maximum length of tenure for board members imposed by law or suggested as governance best practice. However, boards with long tenures tend to be more aligned with management and may suffer from "groupthink": a phenomenon that happens in cohesive groups of people whereby, to maintain harmonious relations, decision making becomes skewed as group members want to minimize controversies and criticism.

If an independent director sits on the board for many years, he or she may develop a biased view and his or her capacity to independently judge management proposals can decrease. In order to foster constructive criticism of management proposals by the board, it is considered best practice to avoid renewing the position of an independent director for too long. There is a widely held belief that after serving for a period of between nine to 12 years, depending on the country, a formerly independent director is no longer considered independent. Consequently a decision may be required from the director to step down from the board.

*"[To] appoint independent directors by the founding general assembly or by the ordinary general assembly for a maximum period of three years renewable only once. The appointment of independent directors and the renewal of their mandate should be carried out according to clear, objective and transparent criteria."*⁵²

– Tunisia, Code of Best Practice of Corporate Governance (2008)

45 Hawkamah Institute, "Environmental, Social and Corporate Governance Practices in the MENA region 2007-2012: Review of the Hawkamah/S&P Pan Arab ESG Index."

52 Institut Arabe des Chefs d'Entreprises, "Code of Best Practice of Corporate Governance," Institut Arabe des Chefs d'Entreprises, accessed September 1, 2015, http://www.eiod.org/uploads/Publications/Pdf/tunisia_2008_en.pdf, p. 12.

18 Should we have board committees?

What are their duties?

A board committee is a smaller team of directors created to support the board in performing its duties. The committee structure, being smaller than the full board, facilitates in-depth discussion and benefits from regular management participation and input. Committees are also created to address conflict of interest issues, such as management auditing its own accounts or setting its own remuneration. However, it is important to note that the existence of a committee does not relieve the board of directors from its responsibilities from the issues addressed by the committee. These are generally advisory committees that make recommendations to the full board for final decisions.

*"The Board of Directors shall set up a committee to be named the "Audit Committee".*⁵³

– The Corporate Governance Code, Kingdom of Bahrain (2010)

Audit committees are the most common type of committee and are mandatory in certain countries and for certain companies. Audit committees are often established even in smaller, non-listed companies in order to ensure that time-consuming activities, such as the review of the company's accounts, are performed more efficiently and that a company benefits from the experience of board members who have financial expertise.

Committees that deal with corporate governance and remuneration issues are standard among listed companies. These committees are rarer in SMEs, where such tasks are carried out by the whole board or by the chair alone.

It is important that the roles and responsibilities of the committees are clearly defined and reviewed by the board on a regular basis. These rules and responsibilities are often delineated in a committee charter, which may also include rules with regard to committee composition. In certain committees, such as the remuneration committee, all members should be non-executive and independent

"The board shall establish an audit committee of at least three members of which the majority should be independent including the Chairman".

– The Corporate Governance Code, Kingdom of Bahrain (2010)

directors. Furthermore, it may be important for committee members to have an expertise present, such as an accounting expert on an audit committee. Overall, the number and types of committees should be determined by the needs of your board, keeping in mind that smaller boards tend to have fewer committees, and that these committees increase business efficiency.

Common Types of Board Committees in SMEs.



Audit Committee.

- ✓ To provide financial oversight and ensure for appropriate control structure
- ✓ Board chairman not a member; nor are executives; Should consist exclusively of independent directors
- ✓ Focus Areas:
 - Accounting issues and policies; review of financial information
 - Risk management, internal controls and audit procedures
 - External audit issues and report
 - May also consider legal matters and compliance



Nominations Committee.

- ✓ To ensure for appropriate board composition.
- ✓ Ideally, all independent; at minimum, chairman independent, remaining directors non-executive
- ✓ Focus Areas:
 - Nominations: Chooses the candidates for director and CEO; reviews and approves other senior appointments
 - Evaluation and training: Organizes or carries-out board evaluation; conducts performance appraisals of directors and senior management
 - Succession planning: For CEO, chairman and other key directors
 - Increasingly handles "corporate governance" issues



Remunerations Committee.

- ✓ To help set remuneration policy and structure to attract, retain and motivate directors
- ✓ Composition: Ideally, all independent; at minimum, chairman independent, remaining directors non-executive
- ✓ Focus Areas:
 - Considers matters relating to non-executive and executive remuneration
 - Approves changes to incentive and benefits plans applicable to senior managers

*"One of the things that make us unique, compared to many other institutions, is that we have a board committee devoted to corporate governance. We regularly review our corporate governance at least a few times a year. The board committee oversees the implementation of our action plan, stays abreast of developments in the market, continuously reviews our policies, as well as updates on best practices, development of training programs or evaluations to improve our governance."*⁵⁴

*Sonya Santolin, Corporate Secretary,
Abu Dhabi Commercial Bank (ADCB), United Arab Emirates*

ADCB was formed in 1985 as a result of the merger of Emirates Commercial Bank and Federal Commercial Bank with Khaleej Commercial Bank. The Government of Abu Dhabi, through the Abu Dhabi Investment Authority, holds 65 percent of ADCB shares.

⁵³ Capital Market Authority, "Corporate Governance Regulations in the Kingdom of Saudi Arabia," Board of Capital Market Authority, 2014, accessed September 1, 2015, <http://www.cma.org.sa/En/Documents/CORPORATE%20GOVERNANCE%20REGULATIONS-2011.pdf>, p. 26. Central Bank of Bahrain, "Corporate Governance Code – Kingdom of Bahrain," p. 15.

⁵⁴ Center for International Private Enterprise Global Corporate Governance Forum, "Advancing Corporate Governance in the Middle East and North Africa," p. 47.

E

ALL VISITORS

**DELIVERY PERSONNEL
MUST SIGN IN
AT FRONT OFFICE
BEFORE ENTERING**

Control Environment.

NO SMOKING



Wear safety glasses in this area.



Safety shoes required in this area.

**ALL
MIS
A**

19 I have heard the term “internal control”, but what does it mean?

In smaller or newer businesses, founders or managers usually control all operational processes, and all expenditures are approved by them. However, as the company grows, some decisions need to be delegated, making it crucial to establish more formal processes and corresponding controls.

The term internal control encompasses the procedures that your company has established, or needs to establish, so that management and the board can ensure that work done within the company is completed as intended. In other words, internal controls are a set of processes that guide all employees' actions, permit effective oversight, and prevent things from going wrong. It provides reassurance that the decisions taken are properly executed and helps managers be effective, while avoiding problems such as overspending, operational failures, and legal violations. Internal controls can relate to any aspect of your business - from human resources to information technology (IT) - and are designed to address risks that have been identified.

Good internal controls are a critical component of good governance. Flawed or poor information resulting from inadequate internal control systems can compromise any meaningful board decision relying on such information. According to international corporate governance best practice, the system of internal control is designed to

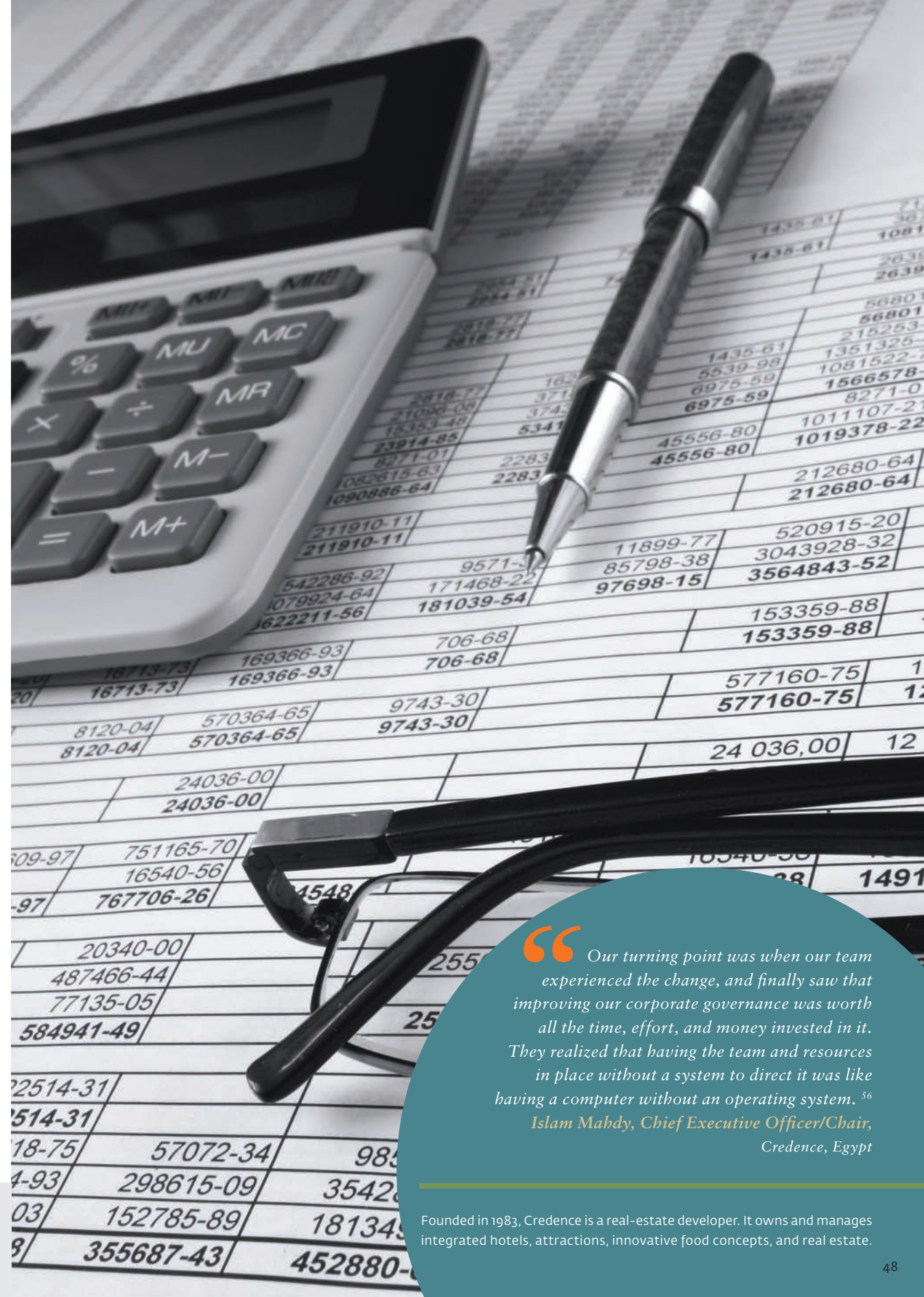
provide reasonable assurance about the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.⁵⁵

Internal controls usually prevent undesirable actions from occurring and can detect when things are about to go awry. Internal controls are usually comprised of preventative controls and detective controls. Examples of preventative controls include the requirement of having dual signatures on checks or having password-protected files. These types of controls both protect and limit access to business assets.

Detective controls include reconciling the bank or inventory counts. Typically, these internal controls are performed periodically to find out if there are any errors that require correcting. They often detect internal errors or problems, as well as external errors such as bank errors.

A typical control measure instituted by many companies is the segregation of tasks to avoid errors or malicious actions. Therefore, the authority of making certain decisions should be clearly mapped and documented, which is particularly important in businesses where a large number of people can take decisions that are binding with third parties.



“ Our turning point was when our team experienced the change, and finally saw that improving our corporate governance was worth all the time, effort, and money invested in it. They realized that having the team and resources in place without a system to direct it was like having a computer without an operating system.⁵⁶

Islam Mahdy, Chief Executive Officer/Chair, Credence, Egypt

55 COSO, “Internal Control Integrated Framework, Executive Summary,” COSO, May 2013, accessed September 1, 2015, http://www.coso.org/documents/990025p_executive_summary_final_may20_e.pdf

56 IFC, “Corporate Governance Success Stories,” p. 78.

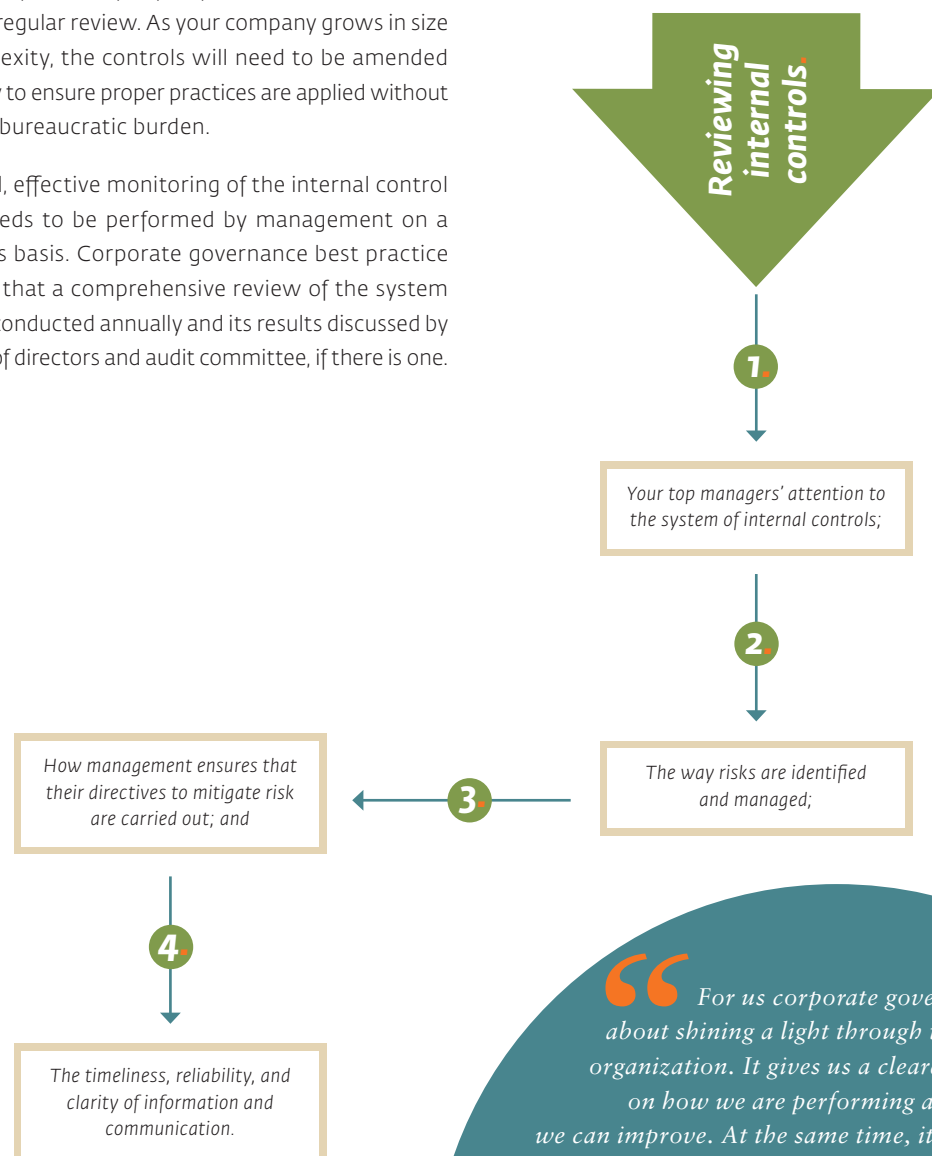
20 How should we review our system of controls?

In a small business the owner-manager controls everything. This is unlikely to continue once the business begins to expand. That is why there is a need for a system of controls within a company. Without these controls, the risk to the business, for example, from fraud or mismanagement, becomes too high. Internal controls should continuously evolve with your company's operations and should be subject to regular review. As your company grows in size and complexity, the controls will need to be amended accordingly to ensure proper practices are applied without creating a bureaucratic burden.

To this end, effective monitoring of the internal control system needs to be performed by management on a continuous basis. Corporate governance best practice advocates that a comprehensive review of the system should be conducted annually and its results discussed by the board of directors and audit committee, if there is one.

According to international best practice, your review of internal controls should, at a minimum, assess the appropriateness of the following elements:

Reviewing of internal controls as per international best practice



“For us corporate governance is about shining a light through the whole organization. It gives us a clearer picture on how we are performing and where we can improve. At the same time, it provides assurances to our key stakeholders.”⁵⁷
Roshaneh Zafar, Managing Director/CEO, Kashf, Pakistan

Kashf is one of the leading microfinance institutions in Pakistan. Kashf was set up in 1996 and is now ranked among the top 5 percent of microfinance institutions worldwide in terms of outreach.

Source: Center for International Private Enterprise Global Corporate Governance Forum, “Advancing Corporate Governance in the Middle East and North Africa,” p. 62.

21 What is the role and preferred composition of the audit committee?

The primary role of the audit committee is to assist the board of directors in ensuring the integrity of financial reporting prepared by management. In other words, the audit committee must ensure that the financial reports fairly represent the company's financial situation.

The audit committee performs the following tasks:

- Reviews financial results prior to formal announcement to shareholders;
- Challenges management on the adequacy of the financial reporting process;
- Reviews accounting policies and compliance with relevant accounting standards and regulations;
- Ensures that key financial reporting staff are competent and ethical; and
- Oversees internal auditors – whether in-house or outsourced – and supervises the relationship with external auditors to safeguard their objectiveness.
- Review the adequacy of control systems by using internal audits (if present)
- Acts as authority in certain sensitive control areas, such as those for related party transactions

Given its role, the audit committee should be staffed with non-executive directors, who are financially literate and typically independent. If possible, at least one member should possess accounting expertise through professional accreditation or working experience. Members with risk management experience or knowledge of internal controls are an added advantage. Executives often attend part of audit committee meetings, but should not be permanent members. In any case, it is good practice to conduct part of the meeting, usually the beginning, between committee members only, with no guests attending. The audit committee, like all board committees, should only be an advisory committee and make its recommendations to the full board for consideration.

“The most important features of this relationship [between the audit committee and the board, the management, and the internal and external auditors] cannot be drafted as guidance or put into a code of practice: a frank, open working relationship and a high level of mutual respect are essential, particularly between the audit committee chairman and the board chairman, the chief executive and the finance director. The audit committee must be prepared to take a robust stand, and all parties must be prepared to make information freely available to the audit committee, to listen to their views and to talk through the issues openly.”⁵⁸

– Financial Reporting Council, Guidance on Audit Committees, London (2012)

57 IFC, “Corporate Governance Success Stories,” p. 14.

58 Financial Reporting Council, “Guidance on Audit Committees,” Financial Reporting Council, September 2012, accessed September 1, 2015, <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-September-2012.aspx>

22 How can the board of directors ensure that appropriate procedures are followed within the company?

The internal audit function provides assurance that a company's policies and processes are appropriate and are being followed in the everyday course of the business. Each internal audit review should follow a well-defined annual schedule that is prioritized on the basis of risk.

The internal audit function is a powerful tool for the CEO and the board to oversee internal control systems⁵⁹, risk management⁶⁰ and governance of an organization through systematic reviews. Notably, the effectiveness of an internal audit depends on its independence from the company's management. The internal audit function is usually structured in such a way that the head of internal audit is accountable to the chair of the audit committee for the mandate and priorities of the internal audit, while

reporting to the CEO for administrative and procedural matters.

The board of directors should decide whether an internal audit function is completed internally or whether such reviews are outsourced, meaning not performed by a person within the company. Setting up a full-fledged internal audit function internally can be excessively costly or too complicated for small companies. It may be hard to dedicate internal resources with the appropriate skillset to conduct internal audit reviews, which is why so many companies decide to outsource this function. If a company decides to outsource the internal audit function, it is a corporate governance best practice to choose a provider different from the external auditors of the company.

*“Strong corporate governance and prudent risk management are crucial for sustainable growth. This will remain a priority for Capital Bank, as it focuses on maintaining its unique positioning in the market and implementing its expansion plans in Iraq.”*⁶¹

*Basem Khalil Al Salem, Chair,
Capital Bank, Jordan*

Since its inception in 1995, Capital Bank has grown to become one of the top financial institutions in Jordan, offering the Jordanian market a comprehensive set of commercial and investment banking services tailored to the needs of individuals and corporate clients alike. The Bank's major shareholders include the Social Security Corporation, IFC, the Darwazeh Group, the Nuqul Group, the Al Salem Group, the Abu Jaber Group, and shareholders from several other countries that include Saudi Arabia, the United Arab Emirates, and Iraq.

59 See Questions 18 and 19 for more on internal controls.

60 See Question 22 for more on risk management.

61 IFC, "Corporate Governance Success Stories," p. 73.

Case Study⁶²

Commercial Insurance is a family-owned insurance company based in Lebanon and founded in 1962 by Roger Zaccar. The company is currently led by the second generation of the family.

Corporate Governance Measures.

Commercial Insurance focused on improving its risk management, in accordance with international governance best practice. In particular, the company realised the need to better define roles, standardize procedures, and add an internal audit function.

Following the establishment of the new risk management procedure, the management felt the need to be reassured on how much they were being followed. The management adopted a step-by-step approach to introducing internal audit in the company. Initially only two interns were hired to conduct the first internal audit review (in order to avoid the threatening effect of the inspection).

Impact.

The impact of the better risk management system and appropriate internal audit function has been felt on all levels of the company, and has resulted in the more efficient use of management's time and increased motivation of employees. Furthermore, many decisions that were previously made at the top level could be delegated with minimal managerial review required. The processes that determine all decisions are now standardized, while more responsibility can be assigned at different levels in the company's pyramid and effective accountability is ensured.

62 For more information: Center for International Private Enterprise Global Corporate Governance Forum, "Advancing Corporate Governance in the Middle East and North Africa."

23 How can we manage risk?

Risk is an integral part of any business endeavor: without taking risks no profits would be generated. Taking risks is an integral part of exploiting strategic opportunities in any kind of business. To maximize returns, entrepreneurs need to adequately understand the risk associated with their ventures. A business that decides to protect itself against all risk is unlikely to generate much upside for its owners, but a business that exposes itself to the wrong types of risk may be even worse off. Therefore, decisions on how much risk to take and what type of risks to take are critical to the success of a business.

In fact, the most successful businesses have risen to the top by finding particular risks that they are better at exploiting than their competitors. Companies of all sizes that want to be successful in the long run have to take a systematic approach to managing risk. Given the strategic importance of risk, overseeing risk is one of the main responsibilities of top management and the board of directors. Boards are important when it comes to risk, because day-to-day management sometimes weakens executives' capacity to contend with the company's risks. It just takes a question or two from the board for the executives to recognize risks that would have otherwise been obscured.

Companies can't capitalize on risks they are not aware of; if you do not know certain risks exist, then you cannot manage or take advantage of them. That is why risk management starts with risk identification. Identifying risks may rapidly lead to a long list of risks that needs to be organized and analyzed in order to be valuable. Risks are not always of the same nature, have the same impact, or have the same likelihood of occurrence. In fact, some risks change more rapidly than others and require closer monitoring. Assessing risks helps to spot which ones are critical to the business. It also helps to determine the adequate treatment of each risk. Responses aim at lessening the likelihood of an undesirable event occurring or lessening its impact. For example, a risk can simply be rejected by terminating an activity, or it can be mitigated with a control by restricting access or setting-up an alert. Risk can also be transferred to a third party, by buying

insurance or outsourcing an activity, or it can be shared with others through a joint venture arrangement. Finally, a risk can be consciously accepted.

There also needs to be communication with staff at all levels to ensure that individual and group responsibilities are understood, and that everyone understands who is responsible for the management of each risk. Furthermore, risk management is not a one-off event but a dynamic process ensuring that new risks are addressed as they arise. Sound risk management is also cyclical, in the sense that it is necessary to establish how previously identified risks may have changed, and whether the risk response is still relevant.

Controls that mitigate risks are usually periodically assessed by internal audit, when this function exists in a company.⁶³ Ongoing functions such as compliance, risk management, financial control, and quality control play an important role in ensuring the adequacy of controls and of overseeing risks. However, in any organization, risks are primarily owned and managed by operational managers who are responsible for implementing corrective actions to address process and control deficiencies. Corporate governance best practice provides guidance on how to structure your company's decision-making process in relation to certain risks, depending on the complexity and size of the business.

“Managing the company's risks in a better way is one of the major reasons we felt the need for better corporate governance practices.”⁶⁴

Max Zaccar, Chair,
Commercial Insurance

Established in 1962 by the late Roger Zaccar, Commercial Insurance offers both life and non-life insurance services.

⁶³ Please refer to Question 21 for more information.

⁶⁴ Center for International Private Enterprise Global Corporate Governance Forum, "Advancing Corporate Governance in the Middle East and North Africa," p. 31.

Case Study.⁶⁵

Sorouh Real Estate PJSC is one of the largest real estate developers in the United Arab Emirates.

Corporate Governance Measures.

Sorouh went through considerable corporate governance changes, including improving its internal control and risk management systems such that they were in compliance – ahead of the compliance deadline – with the UAE Securities and Commodities Authority's standards.

The governance changes involved a revamped whistle-blower mechanism, empowered by better internal disclosure and transparency. An Insider Share Dealing Policy was approved and an enterprise-wide risk management system, which formalized existing risk management practices, was implemented.

Impact.

According to Sorouh's Chief Corporate Officer, Afshar Monsef, "The actions we took for our corporate governance had a direct impact on the rating we received for our Sukuk [Islamic certificates] and ultimately the interest rate premium, which resulted in paying a lower premium compared with other companies in the region."

Sorouh issued more than \$1 billion worth of securitized Islamic certificates, which met a favorable market reaction thanks to its corporate governance practices. This saved millions for the company. Moody's rated the majority of the notes "AA3" while S&P rated them "A".

⁶⁵ Arab Business Review, "Case Studies: Corporate Governance in the Middle East."

F

Shareholder Issues.



24 What governance issues do investors look at before investing in my business?

As part of their pre-investment due diligence, investors in emerging markets tend to carefully assess the corporate governance of companies. In fact, there is evidence that corporate governance plays an important role in the decisions of emerging market-investors.⁶⁶ The outcome of a governance analysis often influences the financial and non-financial conditions of the investment transaction. IFC's methodology for evaluating corporate governance risks and opportunities has been distilled into the "Corporate Governance Development Framework." This approach has been adopted by thirty-three Development Finance Institutions (DFIs) for use in their investment processes, though this approach has yet to be adopted by investors across the board.

Typically, investors analyze the company's governance, including the strength of management, the quality of succession planning, clarity of disclosure on the company's financials, presence and structure of the board of directors, and how related party transactions are managed. Investors will be particularly interested in the existence of measures that protect minority shareholders; for example, specific voting rights, or rights in connection with changes in control of the company.

In 2012, IFC conducted an Emerging Market Investor survey,⁶⁸ which shows that lack of transparency is a red flag for emerging market investors and that investors do not often invest in emerging market companies with poor corporate governance. The study also identifies the degree to which certain governance practices are deemed important by investors. A summary of the findings is presented in Figures 5 and 6 on the right.



66 See: Vikramaditya Khanna and Roman Zyla, "Survey Says...Corporate Governance Matters to Investors in Emerging Market Companies," IFC, 2012, accessed on September 1, 2015, http://www.ifc.org/wps/wcm/connect/dbfd8b004afe7d69bcb6bdb94e6f4d75/IFC_EMI_Survey_web.pdf?MOD=AJPERES

67 Skander Oueslati, e-mail correspondence to Nestor Advisors.

68 Khanna and Zyla, "Survey Says...Corporate Governance Matters to Investors in Emerging Market Companies."

*“As part of our due diligence, we carry out a detailed review of the Corporate Governance of target investee companies and make sure that we have a corrective action plan approved by all stakeholders before we make a commitment... If we don't fix these issues early on, it will hamper growth and, at the end of the day, our return on investment.”*⁶⁷

*Skander Oueslati, Senior Partner,
Africinvest*

AfricInvest was founded in 1994 and is part of Integra Group, an investment and financial services company based in Tunisia. AfricInvest has dedicated investment teams focused on North Africa and Sub-Saharan Africa, and employs 50 professionals based in six offices.



25 Why is the equitable treatment of shareholders important?

Equitable treatment of shareholders is a cardinal principle of corporate governance and crucial to building shareholders' trust.⁶⁹ Equitable treatment does not mean equal treatment. This is an important distinction, since in many countries, companies are permitted to have different classes of shareholders with different rights: not all shareholders are created equal. However, measures directed at granting an unfair advantage, such as disproportionate control to specific shareholders, raise concerns and likely hinder the capacity of your company to raise funds from the capital market. For example, as the universally accepted principles of corporate governance of the Organization for Economic Cooperation and Development (OECD) declare, "Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase." In other words, not all shares must have the same rights, but the differences must be clear and any change should be subject to approval by those classes of shares which are negatively affected.

The existence of minority shareholder rights tends to raise investors' level of comfort when it comes to investing in a company. This means that you may want to consider non-mandatory corporate governance best practices in addition to the mandatory minimum rights recognized by local

regulations. Showing goodwill by strengthening shareholder rights can go a long way, particularly in countries where the enforcement of legal provisions is weak. Examples of shareholder rights are numerous. These include, among others, obtaining qualified majorities in a shareholder meeting for decisions of exceptional importance, and ensuring pre-emptive rights when you want to raise capital by issuing new shares.

If you want to attract international investors, it is crucial that you consider practical solutions that ensure that national shareholders do not have any real or perceived advantage over foreign ones. To guard against such an unfair advantage, a company can, for example, ensure timely disclosure in English and make extensive use of its website to communicate with shareholders.

“ *The actions we took for our corporate governance had a direct impact on the rating we received for our Sukuk and ultimately the interest rate premium, which resulted in paying a lower premium compared with other companies in the region.*⁷⁰

*Afshar Monsef, Chief Corporate Officer,
Sorouh Real Estate PSJC, Abu Dhabi*

Sorouh Real Estate (P.S.J.C) is one of the largest real estate developers in the United Arab Emirates, and currently has over AED 70 billion (\$19 billion) worth of projects under development. Sorouh is now one of the largest real estate developers on the Abu Dhabi Securities Exchange.

⁶⁹ This concept was first introduced by the OECD Principles and is now accepted in virtually all best practice codes of corporate governance.

⁷⁰ Arab Business Review, "Case Studies: Corporate Governance in the Middle East."

G

Disclosure Issues.

26 Disclosure and transparency may harm my competitive position in the market, so why should I disclose more information?

Sufficient transparency is at the forefront of investors' agenda and is often a necessary condition for investment in a company. Better information promotes stakeholders' confidence in your company, not only attracting investors but also promoting your business' image with customers and regulators.

Local business practice and traditions may influence how much information your company discloses to the public. Despite having regulatory frameworks that are comparable to other emerging markets, existing MENA corporate governance practice is perceived as not promoting sufficient transparency.⁷¹ An OECD paper identifies the widespread opaqueness of MENA markets as a crucial impediment to attracting investment. An example of this is that only 15 percent of companies in the United Arab Emirates published a corporate governance report.⁷² In another example, in a survey of 200 publicly-listed companies in the GCC, 42.5 percent provided an annual report on their website or a copy upon request.⁷³

However, among listed companies in MENA, the culture of full disclosure and transparency is developing. Listed companies are subject to enhanced disclosure obligations in order to ensure the efficient and fair functioning of capital markets.

Financial and business information disclosure is crucial in order to attract capital. While there might be some moderate loss of competitiveness by making it easier on your competitors to find out about your company's position, your willingness to disclose signals strength to both lenders and the market, including your competitors. Furthermore, it is rare to find competitive information of high value disclosed in annual accounts. Disclosure of corporate governance information will not harm your competitive position, but rather it improves your company's reputation with investors and other stakeholders, which eventually lowers your cost of capital.

“As is the case for all companies, but especially in our industry, it is important to have a sustained flow of capital and highly competent manpower.

*To do that, creditors need to trust the information you provide them. For us, our commitment to serious auditing allowed us to gain that trust.”*⁷⁴

Mona Akl, Vice President and Corporate Secretary, BUTEC Group Holding S.A.L.

Founded in 1964, BUTEC is a leading contractor in MENA, with projects in areas such as water treatment, electrical installations, oil, gas, and industrial fields. BUTEC Holding company is family controlled (IFC has a 16.6 percent stake).

⁷¹ Amico, "Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities."

⁷² Amico, "Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities."

⁷³ GCC Board Directors Institute, "Embarking on a Journey – A Review of Board Effectiveness in the Gulf."

⁷⁴ Center for International Private Enterprise Global Corporate Governance Forum, "Advancing Corporate Governance in the Middle East and North Africa," p. 24



Abu Dhabi Commercial Bank (ADCB) is a UAE bank formed in 1985. After a period of sustained growth, the financial crisis of 2008 hit hard and ADCB suffered considerable losses. The bank's share price was negatively impacted as a consequence.

Corporate Governance Measures.

The leadership of ADCB reacted to the unexpected downturn by adopting global best practice in governance, transparency, and reporting standards. The Bank's CEO also adopted a culture of openness, both internally and externally, and the highest level risk management practices.

Impact.

Such commitment ensured staff retention and high motivation levels. It also supported the bank's fast recovery while global economic conditions remained challenging.

More transparency actually strengthened ADCB's competitive position by conveying an image of an established, well-structured, and organized company. Internally, transparency greatly motivated ADCB staff and was a source of pride for them. The bank did not try to "hide" losses on its balance sheet, and management and staff were motivated to make their best effort to cut costs and ensure a superior service to their customers.

75 A detailed case study can be found at: Stephen Mezas and Jane Williams, "From Stressed to Success: A Middle East Bank's Turnaround," INSEAD Knowledge, December 5, 2013, accessed September 1, 2015, <http://knowledge.insead.edu/business-finance/from-stressed-to-success-a-middle-east-banks-turnaround-3037>

27 What are related party transactions and why do they matter?

Related party transactions are business transactions between parties that have a pre-existing relationship, such as a subsidiary and a mother company. The way a company handles related party transactions has significant consequences on its reputation, especially with investors. Related party transactions create the possibility for abuse to the detriment of certain shareholders.

Related party transactions are the main way to undermine the necessary separation between a company's best interest and the best interest of stakeholders, which may conflict. If this separation is not clear, no one will invest in the company, fearing that assets, cash flows, or even talent can be channeled to someone else's pockets, usually an insider. Legislators in different countries tackle this challenge in various ways, mostly focusing on imposing a specific approval process and increased transparency pertaining to these types of transactions.

Related party transactions disclosure is included in the rules set by the International Financial Reporting Standards (IFRS), which currently applies in nearly all MENA countries. These rules clearly define who is considered a "related party," and require the disclosure of transactions with related parties, as well as outstanding balances with such parties. The OECD and the Union of Arab Securities

Authorities recently conducted a survey covering related party transaction practices in MENA. The results show that further development is needed across the region, from a review of definitions and procedures to an increase in reinforcement of the corporate governance and securities law breaches.⁷⁶

To ensure your company complies with best practice, you should fully disclose related party transactions, including whether these transactions have been conducted at arm's length and according to normal market terms. The timeliness of disclosure is also important. Disclosure should be periodic for recurrent transactions, and is communicated on an ongoing basis for exceptional transactions.

If your company has a board of directors, then company policy should ensure that related party transactions are reviewed and approved by the board. In particular, related party transactions should be discussed and decided upon by board members who are non-conflicted by the transaction in question. Requiring shareholder approval for related party transactions is a common practice in the MENA region. These approvals are obtained before or after the transaction, although according to the OECD, prior approvals are more effective.⁷⁷

*“Markets with poor corporate governance practices are less attractive to investors because of a heightened risk. The majority of companies in the Middle East and North Africa are family businesses. For those companies to thrive, they need to adopt better corporate governance practices, to create businesses that perform well, employ more people, and contribute to the overall good of each nation's economy.”*⁷⁸

*Mouayed Makblouf, Regional Director,
IFC, Middle East & North Africa*

76 Alissa Amico, "Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities."

77 OECD, "Guide on Related Party Transactions in the MENA Region", OECD, 2014, accessed on September 1, 2015, <http://www.oecd.org/corporate/GuideonRelatedPartyTransactionsMENA2014.pdf>.

78 IFC, "Corporate Governance Success Stories," p. 156.

A young man with a beard, wearing a white button-down shirt and dark trousers, stands in a gym. He is leaning on a piece of exercise equipment, looking off to the side. The background shows various gym machines and weights.

H

An older man with glasses and a beard, wearing a checkered button-down shirt, sits in a workshop. He has his hands clasped in front of him and is looking towards the camera. The background shows shelves with various items, possibly tools or parts.

Corporate Governance for Family-Owned Businesses.

28 Do family-owned companies need corporate governance?

The governance of family businesses, the most common type of business organization in the world, can be very complex. The additional layer of family relationships and the multiplicity of roles and responsibilities of family members—where family members can simultaneously be owners, managers, employees, and board members—complicate matters and reinforce the need for clarity and structure. Such clarity is essential not only for the business, but also for harmonious relationships among family members in the long run.

In an article entitled “Leadership Lessons from Great Family Businesses,” published in the April 2015 edition of the Harvard Business Review, establishing a baseline of good governance is identified as one of four key things in which every family-led company should engage.⁷⁹ The article also highlights the alarming statistic that only 30 percent of family businesses last into the second generation, while just 12 percent last until the third. Establishing a good governance framework can assist in maintaining a strong family business.⁸⁰

The implementation of good governance assists in formalizing the relationship between family members and the business, for example, by forming institutions such as a family assembly or a family council. This formalization allows for an orderly and transparent representation of family interests and can help in avoiding conflict inside

the family. The bigger the family group involved in the business, the more value is derived from formalizing family business governance.

Family governance institutions strengthen family harmony and the relationships within its business by, for example, increasing the communication link between the family and the business and providing opportunities for family members to network. One common family governance institution is the family assembly, which is a forum that allows family members to stay informed about business issues and opportunities, and helps in avoiding potential conflict by promoting discussion. Some family businesses also make use of a family council, which is a working governing body that is elected by the family assembly. The family council, among other things, is the primary link between the family, the board, and senior management, and deals with important matters to the family.⁸¹

Family-owned companies tend to have a longer term vision, as it is important that their business remains profitable from one generation to the next. Corporate governance can help you in achieving this goal by developing proper succession planning, which is among a number of important issues that can be resolved by implementing good governance practices. Further information about specific best practice is available in the IFC Family Business Governance Handbook.⁸²



“ We couldn’t have managed our fast growth if we did not implement a sound policy of corporate governance centered on transparency and a structured communication strategy with various stakeholders, including the family. ⁸³
*Slim Othmani, CEO,
Nouvelle Conserverie Algérienne-Rouiba, Algeria*

The Nouvelle Conserverie Algérienne – Rouiba specializes in the production of fruit juices and other fruit based drinks. It was listed in June 2013 on the Alegi Stock Exchange.

79 Claudio Fernández-Aráoz, Sonny Iqbal, and Jörg Ritter, ‘Leadership Lessons from Great Family Businesses,’ Harvard Business Review, April 2015, <https://hbr.org/2015/04/leadership-lessons-from-great-family-businesses>.

80 Fernández-Aráoz, Iqbal, and Ritter, ‘Leadership Lessons from Great Family Businesses.’

81 IFC, “IFC Family Business Governance Handbook,” IFC, 2011, accessed on September 1, 2015, http://www.ifc.org/wps/wcm/connect/6a9001004f9f5979933cfff0098cb14b9/FamilyBusinessGovernance_Handbook_English.pdf?MOD=AJPERES.

82 IFC, “IFC Family Business Governance Handbook.”

83 Center for International Private Enterprise Global Corporate Governance Forum, “Advancing Corporate Governance in the Middle East and North Africa,” p. 2.

The W.J. Towell Group is a family-owned conglomerate based in Oman in its sixth generation.

Corporate Governance Measures.

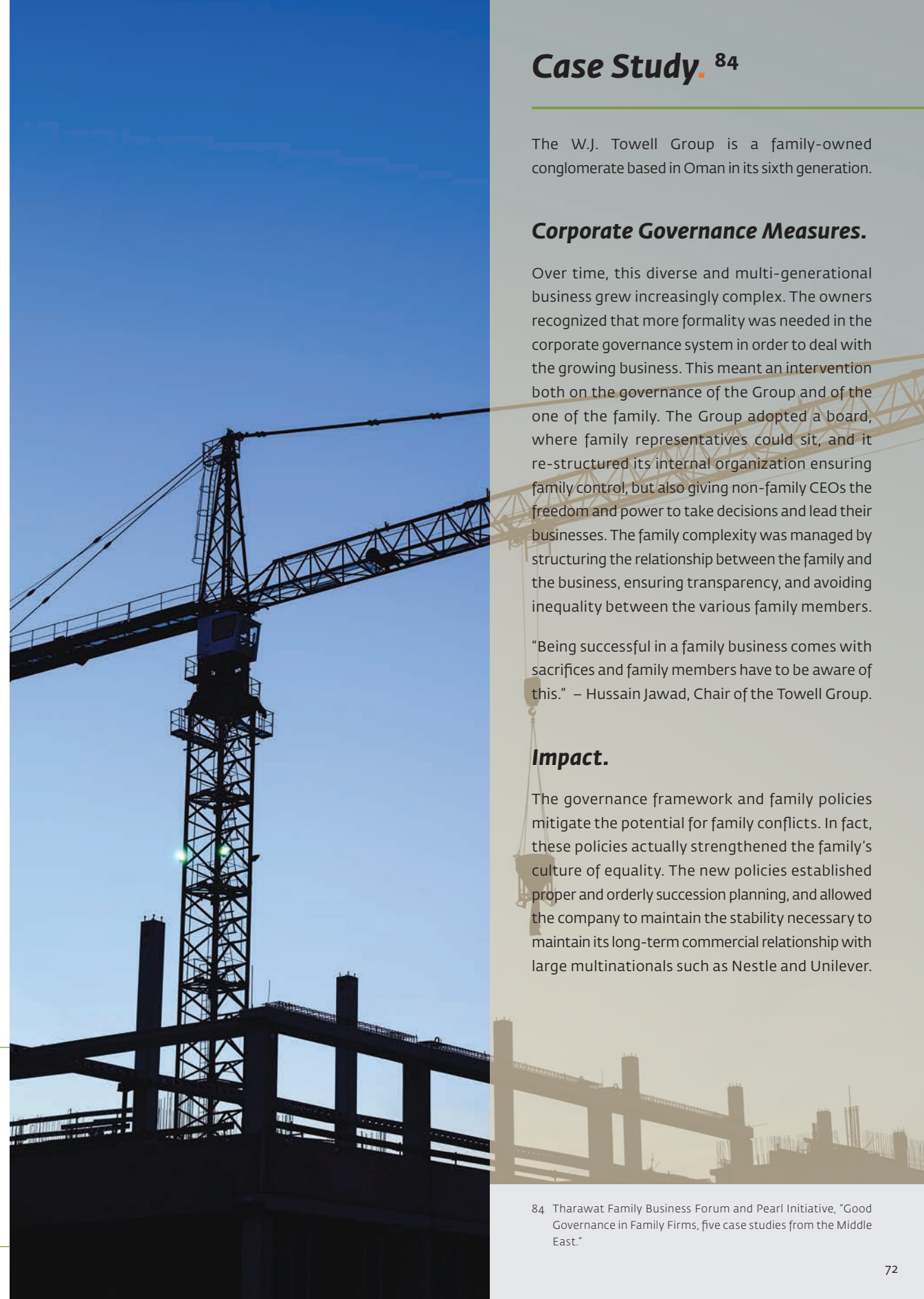
Over time, this diverse and multi-generational business grew increasingly complex. The owners recognized that more formality was needed in the corporate governance system in order to deal with the growing business. This meant an intervention both on the governance of the Group and of the one of the family. The Group adopted a board, where family representatives could sit, and it re-structured its internal organization ensuring family control, but also giving non-family CEOs the freedom and power to take decisions and lead their businesses. The family complexity was managed by structuring the relationship between the family and the business, ensuring transparency, and avoiding inequality between the various family members.

“Being successful in a family business comes with sacrifices and family members have to be aware of this.” – Hussain Jawad, Chair of the Towell Group.

Impact.

The governance framework and family policies mitigate the potential for family conflicts. In fact, these policies actually strengthened the family’s culture of equality. The new policies established proper and orderly succession planning, and allowed the company to maintain the stability necessary to maintain its long-term commercial relationship with large multinationals such as Nestle and Unilever.

84 Tharawat Family Business Forum and Pearl Initiative, “Good Governance in Family Firms, five case studies from the Middle East.”



Family Business make up

- 80% of companies worldwide
- 40% of Fortune 500 companies
- 19% of Fortune Global 500 companies
- 40% of the major listed companies in Europe
- 80% of Middle Eastern companies outside the oil sector

In Emerging Markets

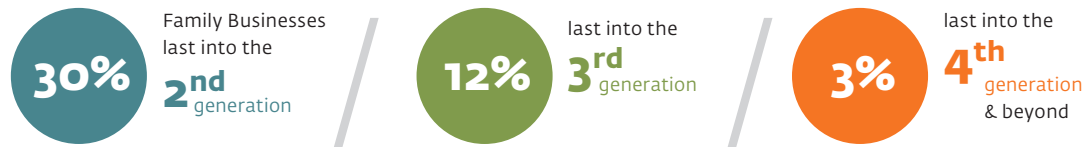
- 85% South-East Asia has
- 75% Latin America has
- 65% The Middle East has

\$1 Billion-plus businesses

Family Businesses play a key role in Economic Growth & Workforce Employment

However

only



Good Corporate Governance

has been identified as one of the

top 5 things

a Family Business can do to ensure

sustainability

Sources: “Business in the blood,” *The Economist*, November 1, 2014, <http://www.economist.com/news/business/21629385-companies-controlled-founding-families-remain-surprisingly-important-and-look-set-stay>

Claudio Fernández-Aráoz, Sonny Iqbal, and Jörg Ritter, “Leadership Lessons from Great Family Businesses,” *Harvard Business Review*, April 2015, <https://hbr.org/2015/04/leadership-lessons-from-great-family-businesses>

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Lisa Wirthman, “Handing It Down: The Changing Dynamics Of Family Businesses,” *Forbes*, September 25, 2013, <http://www.forbes.com/sites/northwesternmutual/2013/09/25/handing-it-down-the-changing-dynamics-of-family-businesses/>

29 How does a good board of directors help a family-owned business?

The board of directors helps the management in making better decisions and simultaneously ensures that the interests of all shareholders are considered. In businesses where more than one family member owns shares, the family owners are best represented, and their interests better protected, when there exists a board of directors.

A board is often an instrument of succession planning. Younger members of the family are often non-executive directors, especially when they are in their formative years and gaining experience by working outside the family company. Trusted outsiders also bring a fresh perspective to the table, and their presence reinforces discipline. In the words of a family member who sits on the board of a construction company in the UAE: “[trusted advisors] are the reason the board does not become the family dinner table.”

When a family business is managed by a sole owner and family member, he or she may be reluctant to accept the idea of working with a board of directors. The owner/family member is likely to believe they know what is best for the company and does not want any interference with his/her decisions. In this respect, having a board of directors plays a crucial role in ensuring that management is making optimal decisions. Having to report to the board, internally, and obtain board approval for certain key decisions helps build discipline and accountability at various levels of the company. Furthermore, a board of directors brings about a fresh perspective by way of its members’ experience, expertise, and innovative thinking when making critical strategic decisions.

30 Our board meets around the family dinner table, why do we need formal board meetings?

Most families run their businesses in an informal way at the initial stages of development, but as the business or family grows larger, this informality may put the sustainability of the enterprise at risk. Formality has the key benefit of tracking the board’s progress and creating accountability. It keeps discussions focused, and keeps family interests and company matters separate. If board meetings take place around the dinner table, there exists an increased likelihood for family interests and business matters to be conflated and confused. Furthermore, in a more developed business where non-executive directors who are non-family members sit on the board, it is not possible to organize board meetings in an informal manner.

At a minimum, the board needs to have an agenda that is shared in advance of the meeting and minutes of the meeting circulated afterwards. The time and effort spent on these formalities allow for orderly and informed

meetings, and track the board’s discussions and decisions. For example, Wadi Holdings Company SAE is a family-owned company that is owned and managed by three generations of family members. Wadi’s board of directors suffered from infrequent meetings, no committees, and an unclear division of roles. Wadi reformed their corporate governance practices, including how they handled board effectiveness. This included implementing a schedule so that the board met on a routine basis and planned meetings in advance with formal agendas; establishing an audit committee; and clarifying the distinction between those that sit on the board and management. These changes contributed to significant improvements in the efficiency and functioning of the organization, a better handle on risks and control mechanisms across subsidiaries, and increased sustainability of the group for the next generation of leaders.⁸⁵

“ This type of decision-making [at family lunches during week-end] was not sustainable because the business was growing fast. It also meant that issues that were not pressing just dragged on.⁸⁶

Ramzi Nasrallah, Vice President and CFO
Wadi Group, Egypt

Wadi Group is an Egypt-based agribusiness conglomerate, privately owned by two Lebanese families.

85 IFC, “Corporate Governance Success Stories.”

86 Heba Saleh, “Family businesses: sons, daughters and outsiders,” Financial Times, October 21, 2014, accessed on September 1, 2015, <http://www.ft.com/cms/s/0/c41b0648-3a61-11e4-bd08-00144feabdco.html?siteedition=intl#axzz3McMJVhbx>

Annex 1

Annex 1 lists the corporate governance codes for each country in the MENA region, as well as some particulars for each code. In addition to the general corporate governance codes, the table identifies other codes or guidelines pertaining to specific sectors or type of companies such as financial institutions and state-owned enterprises.

The annex also determines whether or not a "comply or explain" system is in place. This is a system where a company has the option of complying with the corporate governance code or, if the company does not comply, it must explain why it has opted not to do so. All of the codes that specifically pertain to SMEs are in bold.

MENA Corporate Governance Codes.

Country	General corporate governance code's date of issuance	Comply or explain	Issuing Entity	Other Codes or Guidelines
Algeria	2009	No	Corporate governance institute	<ul style="list-style-type: none"> State-owned enterprise code under development
Bahrain	2010	Yes	Central bank	<ul style="list-style-type: none"> Guidelines for banks Guidelines for directors on state-owned enterprise boards
Egypt	2005, 2011 (currently under revision)	No	Corporate governance task force	<ul style="list-style-type: none"> Code for state-owned enterprises Code for banks Rules for governance of securities companies Principles and guidelines for hospitals
Jordan	2008	Yes	Corporate governance task force	<ul style="list-style-type: none"> Code for banks
Kuwait	2013	Still not in force	Capital market Authority	<ul style="list-style-type: none"> Guidelines for banks
Lebanon	2008	No	Transparency association	<ul style="list-style-type: none"> Code for small and medium enterprises Guidelines for banks
Libya	2007	No	Stock exchange	<ul style="list-style-type: none"> No corporate governance codes exist
Morocco	2008	No	Corporate governance task force	<ul style="list-style-type: none"> Code for small and medium-enterprises Code for state-owned enterprises Code for banks/credit institutions
Oman	2002 (under Revision)	Yes	Capital market authority	<ul style="list-style-type: none"> Guidelines for banks Code for insurance companies
Qatar	2009	Yes	Capital market authority	<ul style="list-style-type: none"> Guidelines for banks Qatar Financial Centre Regulatory Authority Guide for Qatar Financial Centre authorized firms
Saudi Arabia	2009 (amending 2006 first code)	Yes (partially mandatory)	Capital market authority	<ul style="list-style-type: none"> Guidelines for financial institutions
Syria	2008	No	Capital market authority	<ul style="list-style-type: none"> Corporate governance guidelines for traditional and Islamic banks Corporate governance act for insurance companies
Tunisia	2008	No	Corporate governance institute	<ul style="list-style-type: none"> State-owned enterprise code under development Guidelines for financial institutions
United Arab Emirates	2009	Yes	Capital market authority	<ul style="list-style-type: none"> Code for small and medium enterprises Code for financial institutions Code for real estate companies Dubai International Financial Centre Markets Law Dubai Financial Services Authority Market Rules
West Bank and Gaza	2009	No	Corporate governance task force	<ul style="list-style-type: none"> Code for financial institutions
Yemen	2010	No	Corporate governance task force led by Yemeni Business Club	<ul style="list-style-type: none"> Guidelines for banks

Annex 2

Program Purpose and Objectives

The IFC MENA Corporate Governance Program aims to drive best corporate governance practices across the MENA region. The program has been active since 2005. The goals of the program are to help MENA companies:

- Improve access to affordable financing, leading to greater investment, higher growth, and more employment.
- Improve performance through better strategic decision making and managerial oversight, leading to more efficient management and better asset allocation.

The intended developmental impact is to stimulate private sector development, to spur job creation and alleviate poverty.

To achieve these goals, the program has the following objectives:

- i. Build the business case for corporate governance among banks and companies and help them implement good corporate governance practices;
- ii. Assist investors in improving corporate governance practices of investee companies;
- iii. Build capacity of key market intermediaries, including regulators, advisors, institutes, educators, and the press, leading to sound market systems;
- iv. Help create sustainable corporate governance institutes, and institutes of directors.

Program Activities

Company assessments

A key part of our program is working with individual companies and banks in MENA to assess their corporate governance practices and identify opportunities for improvement. The goal is to demonstrate the impact of good corporate governance to the market by providing actual company experiences. When conducting assessments, we follow IFC's Corporate Governance Methodology (for more go to ifc.org/corporategovernance).

Broadly, the methodology considers these dimensions:

- Commitment to good corporate governance: Demonstrating a clear focus on effective structures and processes to achieve the benefits of good corporate governance.
- Board functioning: The existence of a competent, legitimate, well-structured, and effective board, with proper composition, structure, and work procedures.

- Management controls: The presence of an environment enabling the achievement of organizational objectives, management of risk, and the integrity of assets and financial information.
- Disclosure and transparency: The availability of timely, accurate, relevant, complete, and actionable information equally to shareholders and, as appropriate, to other stakeholders, including regulators.
- Treatment of shareholders and stakeholders: The equal treatment of all shareholders, including protection from abuse by company insiders.

Family-owned companies are also assessed on the existence of appropriate mechanisms to help govern the involvement of the family in the business and address other family matters.

The methodology is tailored to each company's needs. The primary outputs of each assessment are a list of recommended changes to improve corporate governance, alongside a plan for implementation.

Specialized services to IFC Clients

The program also provides help to IFC clients in:


- Improving board effectiveness
- Improving family business governance
- Improving the control environment

Capacity building in intermediaries

We help build capacity in market intermediaries—from regulators, corporate governance institutes and centers for directors to consultancies, educational institutions, and the media—to enhance best corporate governance practices sustainably across the region. We provide training to these varied groups on board practices, shareholder rights, risk management and control, transparency and disclosure practices, and family governance.

We also advise regulators on the development of codes and rules related to corporate governance. Through these various activities, we help promote diversity and gender participation. In addition, we work closely with SMEs, with an SME Governance Toolkit designed specifically with the governance needs of SMEs in mind.

IFC MENA PROGRAM RESULTS

35  recommended laws, regulations, amendments or codes were enacted with IFC support.

161  companies & banks were reached through in-depth advisory services.

10  corporate governance institutes of directors were launched in Egypt, Pakistan, Lebanon, Jordan, UAE, Yemen, Tunisia, Morocco, and Algeria with IFC support.

123  entities reported an improvement in their company's performance resulting from IFC assistance.

\$577  million in financing was facilitated by companies' improved governance practices.

6,477  entities received advisory services through training and awareness-raising events.

23  corporate governance codes were launched in 15 countries with IFC's assistance.

82  entities received investment and/or financing due to IFC's assistance.

24,586  participants from over 10 countries attended the program's workshops, training events, seminars, and conferences.

60  financial journalists and more were trained in 4 corporate governance workshops in Egypt, the UAE, and Morocco.

39  new training modules were developed and 565 people were trained on corporate governance.

(Includes efforts of partners)

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