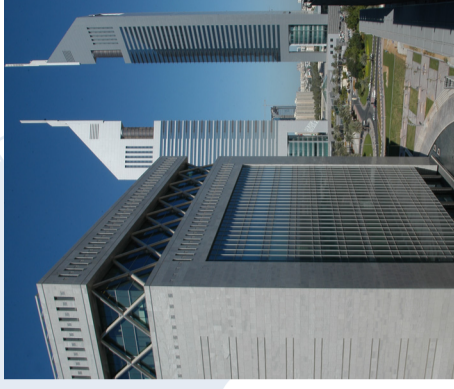


A CORPORATE GOVERNANCE SURVEY OF LISTED COMPANIES AND BANKS ACROSS THE MIDDLE EAST & NORTH AFRICA

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The following limitations apply to the information contained in this report.

- The scope of work did not include conducting an ‘audit’ of corporate governance practices of the surveyed banks and listed companies in the MENA region. As such, no tests have been carried out to confirm the validity of companies’ and banks’ responses.
- The survey is unable to “look beyond the numbers”. For example, while the survey can capture quantitative data on the number of respondents that have established audit committees, it is unable to comment on whether these audit committees and their members are properly fulfilling their roles and responsibilities.
- The information presented in this report was obtained as a result of analyzing a set of completed questionnaires and interviews conducted with responding companies and banks between July 2006 and July 2007. Any subsequent developments were not taken into consideration in the analysis of the survey findings.
- The surveyed sample was divided into two broad categories: listed and non-listed banks, and listed companies. Although the report outlines the practices of the surveyed sample according to these categories, it is pertinent to mention that the objective of this survey was not to highlight and comment on the differences across these categories. It was to provide an accurate representation of corporate governance practices in the MENA region as a whole.

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THANK YOU NOTE TO PARTICIPATING BANKS AND COMPANIES

IFC and Hawkamah would like to thank all the survey participants for the considerable time spent preparing their responses to the survey questionnaire and for their participation in the interview process. The information we received from the respondents was indispensable for the conduct of the survey, and for developing the resulting conclusions and recommendations.

IFC and Hawkamah hope that this survey and its recommendations prove to be useful in improving corporate governance practices in the MENA region, and indeed for the individual listed companies and banks that participated in this survey. Each respondent is to receive copies of this report, which we hope they will find helpful in improving their own corporate governance practices.

The report will also be posted on the websites of the IFC (www.ifc.org/corporategovernance/mena) and Hawkamah (www.hawkamah.org).

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Hawkamah's mission is to promote corporate sector reform and good governance, assist the countries of the region in developing and implementing sustainable corporate governance strategies adapted to national requirements and objectives. Regional cooperation will facilitate exchange and allow countries to learn from successful experiences, combine efforts, move towards harmonization of corporate governance frameworks, and build on synergies resulting from national actions and initiatives.

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Section A. Executive summary: recommendations and key findings

I. Demonstrating Commitment to Corporate Governance

- *A variety of stakeholders—in particular market and bank regulators, local corporate governance institutions and institutes of directors, as well as international organizations and development institutions—should continue to organize awareness raising events that stress the benefits of corporate governance in the MENA region.* In fact, today a great majority of respondents—76% of banks and 67% of listed companies—cite corporate governance as being either important or very important for their businesses. This is an encouraging sign and points to a growing awareness of corporate governance.
- *However, we also recommend that in addition to awareness raising events, these same stakeholders should organize targeted seminars and workshops that focus on how to implement good corporate governance, so that the benefits of corporate governance are not only understood in theory but may also translate into practice.* Indeed, 53% of respondents were unable to properly define corporate governance, confusing the term with corporate social responsibility or corporate management. Further, most respondents cited improved compliance (60.7%) and reputation (61.3%) as benefits rather than access to capital (34.7%) or lower cost of equity (19.3%). Most importantly, not a single responding bank or listed company could claim to have applied corporate governance reforms holistically, i.e., to have followed a set of 32 indicators which could reasonably qualify a bank or listed company as following ‘best practice’. Only five respondents, or 3%, could be deemed to follow ‘good practice’, having implemented between 16-23 indicators. The great majority of companies, 92% in all, fall under the ‘emerging practice’ or ‘improved practice’ sections (8-15 indicators). Five percent (5%) had only implemented 0-7 indicators, qualifying them as ‘underdeveloped practice’.
- *Companies should formalize key governance structures, policies, and processes.* The use of a company-level code of corporate governance or code of ethics is not wide-spread among banks or listed companies. Only 36.5% have implemented such codes. A company-level code of corporate governance and ethics code are excellent first steps in setting the overall tone for corporate governance reforms. Regulators may wish to include similar recommendations for disclosing such documents in voluntary codes of corporate governance.
- *The chairmen of the board and chief executive officer (CEO) should set the ‘tone at the top’ and champion corporate governance reforms with the support from a professional company secretary.* Just under half of surveyed banks (47%) and listed companies (49%) assign the responsibility for corporate governance policies to the board—in-line with good practice. However, only a small minority of respondents involve the chief executive officer (CEO) (8%), chairman (4%), and company secretary (4%) in developing corporate governance frameworks; and only 11.3% have implemented board-level corporate governance committees.
- *Policy-makers and regulators should strongly encourage—possibly mandate—directors and senior managers to undertake a minimum of corporate governance related training; banks and companies should, in turn, encourage their directors and senior managers to attend such events to preempt regulatory action. Corporate governance institutes and institutes of directors, too, may wish to build their expertise and capacity to meet the growing demand for specific corporate governance training.* The two largest barriers in implementing corporate governance reforms are a lack of internal corporate governance know-how, as well as the unavailability of external qualified specialists in the region (44.9% for both barriers).

II. Implementing Good Board Practices

- *The survey demonstrates that the role of the board—to provide strategic guidance to and oversight over management—is not always understood in practice. Banks and listed companies should thus review, clarify, and formalize the role of the board vis-à-vis management and shareholders in a corporate governance code or board charter.* Ninety three percent (93%) of banks and 87% of listed companies stated that the board and not management was responsible for setting company strategy, contrary to good practice which calls for management to develop, and the board to approve and then monitor management's execution of strategy. Moreover, most boards in the region may not have the necessary independence to properly fulfill its oversight function. Fifty six percent (56%) of boards either do not have a single or only one independent director, and only 26.4% of boards have audit committees with a majority of independent directors. Finally, less than half of respondents (40%) have a succession plan in place, again, an indication that the board may not be fulfilling its strategic and oversight function.
- *Boards in the MENA region generally have the right board size.* The majority of boards in MENA have eight or more members. Bank boards are usually composed of ten or more members, while the boards of listed companies typically have eight to ten. These numbers generally appear to be in-line with good practice, if slightly on the high size.
- Banks and listed companies should gradually increase the number of independent directors who sit on their boards, and specify in their annual reports their understanding of what constitutes independence and which director is deemed independent. Fifty seven percent (57%) of all listed companies and 54.3% of banks do not have any or only a single independent director on their board.
- Banks and listed companies in MENA should ensure for an appropriate mix-of-skills on their boards. An overwhelming majority of responding banks and listed companies require the combination of integrity (70%) and professional experience (69%), in-line with best practice. However; 75% of respondents chose "being a shareholder" as the most relevant requirement for being a director, which may lead to the creation of insider or shareholder boards that often do not act in the interest of the company and all of its shareholders—in particular when independent directors are not or only insufficiently represented on the board. With respect to female representation on the board, a vast majority of banks (78%) state that they do not have a single female director, while only 1% answered that they had more than one. On the other hand, one-third of listed companies had at least one or more female board members, a small but important step towards balancing the boardroom.
- Company stakeholders, in particular shareholders but also regulators, should continue to encourage banks and listed companies to separate the position of chairman and CEO. A significant majority of respondents (65%) state that the positions of CEO and board chairman are held by different persons, in-line with best practice. In particular banks (72.2%) follow this best practice, while 42.3% of listed companies continue to combine these two functions.
- Audit committees are well represented in the region, however, their independence needs to be strengthened; companies should also explore the benefits of creating other board committees to streamline the board's work. Eighty one percent (81%) of banks and 74.7% of listed companies have audit committees, in-line with good corporate governance, however, as already mentioned, only 26.4% of these committees are composed of a majority of independent directors. Other committees are less prevalent in the region, with only a minority of respondents citing that their boards also have nomination (22.5%) or remuneration (29.3%) committees.

- *Banks and listed companies may wish to create board-level remuneration committees to develop executive and non-executive remuneration policies, thus ensuring that banks and listed companies in the MENA region are able to attract, motivate, and retain talent.* With respect to non-executive remuneration, 42.9% of companies do not pay their directors an attendance fee; and only a minority of non-executive directors receives extra pay for taking on additional responsibilities, such as serving on committees (16.1%) or chairing the board (11.3%). With respect to executive remuneration, the survey demonstrates that the use of variable remuneration packages is, surprisingly, limited, with 53.8% of respondents citing that they do not offer their executives variable packages. Stock options, too, are not commonplace and only 9.8% of executives and 3.6% of non-executives have such plans. Thirty nine percent (39%) of executives receive board fees, contrary to good practice. Finally, most banks and companies typically do not offer their executives with pension or insurance benefits, only 5.4% and 7.2% respectively, both of which are considered long-term incentives that in the case of executives can help tie them to the company.
- *Board working procedures could be improved, in particular with respect to the number of board meetings per year and the development of a professional corporate secretary function.* The majority of banks and companies provide relevant information to their boards one to two weeks before board meetings, in-line with good practice. With respect to banks, 46% answered that their board met an average of three to five times per year, and 21% stated that they met between six and nine times. Only 27% of bank boards meet ten to 12 times per year, in-line with what is arguably considered best practice for banks. With respect to listed companies, 60% responded that they effectively met on a quarterly basis, and only 15% met between six to nine times per year, in-line with what most would conceive as good practice.
- The position of the company secretary needs to be professionalized and generally strengthened in most MENA listed companies and banks. Indeed, 45% stated that the company secretary is a part-time employee, which while appropriate for smaller companies, may not be appropriate for banks and large publicly listed companies due to the lack of time in supporting the chairman to run the board. It should be noted that one-on-one meetings during the interview process revealed that the position of company secretary is generally underdeveloped.
- Board evaluations and director training—both orientation and continuous professional education—should be furthered by banks and listed companies and, if necessary, by regulators. Only 20% of banks and 15% of listed companies conduct board evaluations. Similarly, director training on corporate governance, whether in the form of director orientation or on-going training, remains scarce throughout the MENA region, with only 15.3% of respondents offering such training for their directors.

III. Building a Robust Control Environment and Processes

- Banks and listed companies should strengthen their risk management frameworks and practices, in particular by assigning responsibility for managing risks at the management level, and ensuring that the board has the necessary expertise to establish risk policies and effectively guide and oversee management in managing risks. Central banks in particular should provide the necessary guidance to and oversight over banks to ensure that banks have robust risk frameworks in place. Overall, less than half of those surveyed (43%) had a risk function in place, with 23% of listed companies and 62% of banks stating that they had a risk manager or risk department in place. Those banks and listed companies that do have a risk

management function follow best practice in that the board oversees the risk management system as implemented by management.

- Similarly, the internal control function needs to be strengthened by a majority of banks and listed companies in the MENA region to safeguard assets against unauthorized use or disposal, maintain proper accounting records and ensure for the reliability of financial information. Less than half of the respondents (47%) have an internal control function, i.e., controller or control department. In those banks or listed companies with control functions, a significant majority assigned the board to oversee this function (80.3% for banks, 69% for listed companies); 35% of respondents on the other hand assigned the CEO to oversee the company's internal controls. Best practice calls for management to set, implement and oversee internal controls, and for the board to assure itself that internal controls are robust and defensible.
- *Banks and listed companies should ensure themselves that the chief internal auditor has unfettered access to an independent audit committee.* The internal audit function is well established in MENA, with 88.7% of banks and companies reporting that they have a chief of internal audit (CIA). For 80% of the respondent the CIA reports to the board. Best practice calls for the CIA to report to an independent audit committee. However, although the vast majority of respondents have audit committees, only 25% of these audit committees can be considered independent.
- *Banks should strengthen (and central banks should strongly encourage) the establishment of a compliance function.* Most banks (64%) have a compliance function in place; only 23% of listed companies reported having a compliance function. All banks should strive to hire a chief compliance officer (CCO) and build a strong compliance function.
- On the other hand, external audit practices are mostly in-line with best practice; however, independence needs to be strengthened throughout the region, both among banks and listed companies. Ninety one percent (91%) of those surveyed had an external auditor, of which 77.2% constituted internationally recognized audit firms. A majority of companies do not receive additional services from their external auditors (51%) and are thus safeguarded from conflicts of interest. However, the idea of audit firm or partner rotation to ensure for external auditor independence is not followed by banks and listed companies: of those surveyed, only 32% have an audit firm or partner rotation policy in place.
- *The role of the audit committee is broadly understood, however, the role of the committee in ensuring that all control functions—risk, internal controls, compliance, as well as internal and external audit processes—properly interact needs to be strengthened. Moreover, audit committees need to improve their oversight over the compliance function.* Indeed, only 30.6% of audit committees felt that they were responsible for assuring themselves that the compliance function was operating.

IV. Strengthening Transparency and Disclosure

- *Banks and listed companies in the MENA region generally comply well with good practice and regulations for financial disclosures.* A vast majority (92.3%) of respondents provided financial statements to shareholders, either through the local press (94.7%), general assembly (93.4%), annual report (88%) or company's website (85.9%), in-line with good practice.
- *Non-financial disclosure on the other hand remains weak, and banks and listed companies should take steps to improve upon their disclosure in this area, in particular with respect to corporate governance related information.* While 68% of respondents disclose their corporate

objectives, disclosure in other areas remains lackluster, in particular the disclosure of corporate governance related information, which is particularly weak among banks and listed companies. Indeed, 53.8% of respondents cite that they do not make corporate governance related information available to shareholders.

- *Web-based disclosure needs to be improved. Listed companies, and to a lesser degree banks, should publish their annual reports and other relevant information, for example regarding beneficial ownership, on their websites. With respect to the annual report, 82% of banks but only 61% of listed companies stated that their annual report was published on their website, which typically (but not always) contains a full set of financial information. Only 22.7% disclose their articles of association or company charter, 28.7% the company's beneficial owners, and 24.7% the company's dividend policy on the company's website.*
- *While financial disclosure in the annual report remains relatively strong at 88%, non-financial disclosure, again, remains weak and should be an area for urgent reform given the importance of the annual report for shareholders and investors.* The survey shows that few respondents included a section on 'management's discussion and analysis' (28%), or indeed the bank's or company's policies towards corporate social responsibility (33%) or corporate governance (32%).
- *MENA law- and rule-makers should continue to push for the full adoption of internationally recognized financial reporting standards.* Sixty seven percent (67%) of respondents stated that they disclose information based on International Financial Reporting Standards (IFRS); only 4.6% report according to US GAAP. Because most central banks in MENA require the banking sector to report in accordance with IFRS, in contrast to the market regulators, 77% of banks indicate that their financial reporting is done in accordance with IFRS, in comparison to 58% of listed companies. This information should be carefully scrutinized as the majority of countries that have adopted IFRS have not done so completely, or have out-dated versions of the IFRS framework, and so investors should take care to understand which specific standards have been omitted or are outdated.
- *Although the large majority of banks and listed companies that are a part of a group produce consolidated financial reports, the regulator should ensure for full compliance with this best practice.* Listed companies are less likely to produce consolidated reports than banks, 73% vs. 84%.
- *Most respondents continue to view disclosure from a compliance point of view, rather than an effective tool for managing stakeholder relations and adding value to their business; thus, stakeholders should organize awareness-raising events on the role of disclosure in strengthening corporate governance.* The main barrier cited by banks and listed companies as to why they do not fully implement best practice in the area of disclosure is a lack of legislation, in particular in the area of non-financial disclosure, again confirming the compliance-driven understanding of corporate governance.

V. Protecting Shareholder Rights

- *Regulators should strengthen the ability of shareholders to vote during the general assembly.* The vast majority of banks and listed companies, 75.4%, confirmed relatively high attendance levels at general assemblies, demonstrating that shareholders are interested and willing to engage with their companies. Voting at the majority of general assemblies is still conducted by a show-of-hands (66.2%), and only slightly more than half of respondents (54.3%) cited proxy voting as an alternative. At 1.3%, electronic voting is virtually non-existent in the

region. A basic shareholder right is the right to elect board members. In the MENA region, board members are elected by shareholders in the vast majority (81%) of banks and listed companies surveyed. Only 17.7% of respondents allow for cumulative voting. Finally, best practice calls for shareholders to be furnished with sufficient and timely information concerning the date, location, and agenda of the general assembly, as well as full and timely information regarding the issues to be decided at the meeting. It is generally thought that such information should be provided to shareholders at least 20 days in advance of the assembly, however, the survey shows that while slightly over half of banks (55%) follow this best practice, only 22% of listed companies do so.

- *The regulators should safeguard shareholder rights to share in the profits of the organization, focusing on the effective enforcement of existing legal provisions.* There are many ways in which this fundamental shareholder right to share in the profits of the organization can be evaded or eroded, primarily through insider dealing, conflicts of interest, and/or related party transactions undertaken by company insiders, and regulators should be vigilant in enforcing violations against this best practice. Eighty two percent (82%) of respondents cited that country-laws or internal documents require them to disclose related party transactions. Moreover, a great majority number of banks (80%) and listed companies (71%) have established policies on conflicts of interest and related party transactions; of those that had not, only 34.7% of respondents showed interest in developing such policies in the future. However, such policies are only effective when respected by managers and directors. Unfortunately, 54.7% of respondents thought that directors failed to avoid conflict of interest situations, and that 62.7% used inside information for their benefit, demonstrating an important gap between the law on the books vs. actual practice.
- *Shareholders should have a say on extraordinary transactions, and banks and companies should adopt specific processes regulating when and how shareholders approve extraordinary transactions in their articles of association.* A significant majority of the respondents, approximately 70%, stated that their board is generally responsible for approving extraordinary transactions, regardless of their value. An important minority stated that the competence to approve extraordinary transactions above a certain threshold, e.g., over 50% of book value, is assigned to the shareholders (40.8%). And while there is much debate in the corporate governance community as to whether shareholders are best placed to vote on such transactions, or whether instead directors working with management and their detailed knowledge of the situation should do so for the sake of timely decision-making, it may well be prudent to allow shareholders a final vote on such matters.
- *Banks and listed companies should provide for tag-along rights to their shareholders, while regulators should ensure that effective provisions on pre-emptive rights are enshrined in relevant laws or regulations. Both pre-emptive and tag-along rights are key elements of an effective framework to protect the interests of minority shareholders.* The survey shows that while approximately half of banks protect their minority shareholders through tag-along rights (51%), only a minority of listed companies (31%) do so.

VI. Corporate Governance Issues for Banks, Family-, and State-owned Enterprises

i. Corporate governance issues related to banks

- *Bank regulators and other stakeholders have done well to raise awareness of good corporate governance for banks, and should continue to do so.* Seventy three percent (73%) of bank managers and directors reported their familiarity with the Basel Committee for Banking Supervision Guidelines for Enhancing the Corporate Governance of Banking

Organizations (BCBS Guidelines). On the other hand, much of this awareness must now be translated into practice, for example, via specific corporate governance workshops or consultations.

- **Bank boards should review their current committee structure, in particular with respect to which committees are best placed to support the board vis-à-vis management.** Eighty one percent (81%) of banks have audit committees. Only 19% of banks have board-level risk committees, while 31% of boards have credit committees. Best practice calls for the board to set policies on risk and credit, ideally through a board-level risk committee, while the implementation of these matters should be left to the management team and management level risk and credit committees. Banks do have a number of committees at the management level, in-line with best practice, including committees on assets and liabilities (90.3%), information technology (88.2%), risk management (81.4%), and credit (69%).
- **Reporting lines for key control functions need to be reviewed and re-aligned to avoid potential conflicts of interest.**
 - *The chief risk officer (CRO) should be independent of any business line, so as to avoid any conflicts of interest, and best practice calls for the CRO to report to the CEO or a management-level risk committee, with a “dotted line” reporting relationship to the board and relevant committee, in particular to the audit or risk committee. And while the CRO does indeed report to the CEO in 72% of the cases, there is little to demonstrate that there is any reporting line, full or dotted, to the board (13%) or its audit committee (18%).*
 - *The chief compliance officer (CCO) should be independent of any business line as well and, at a minimum, report to a senior level manager, with unrestricted access to the CEO and chief financial officer (CFO), as well as have a dotted reporting line to the board’s audit committee. The survey demonstrates that the CCO reports to the CEO in the great majority of cases (70%), but not to the board (11%) or its audit committee (20%).*
 - *Best practice indicates that the CIA should report to the board through its audit committee on a functional basis and to the CEO on an administrative basis. The survey provides evidence that the CIA’s reporting lines remain muddled, with 34.7% CIA’s reporting to the CEO and only 40.3% reporting to the board’s audit committee, which, given its lack of independence, may well undermine that reporting relationship.*
- **Banks should consider incorporating corporate governance into their investment decision-making process, thus reducing their portfolio risk and at the same time adding value to their clients.** Results indicate that a majority of banks (58%) do not include an evaluation of their clients’ corporate governance practices, and those that do typically only do so on a piecemeal and not holistic basis.

ii. Corporate governance issues related to family-owned enterprises

- **Family-owned enterprises (FOEs) and banks (FOBs) should consider adopting family constitutions and family bodies, such as family councils or assemblies, to help them differentiate the family interests from those of the company, and also regulate the policies that will guide the relationship between the family and the company.** While 50% of listed FOEs had adopted a family constitution, not a single FOB had done so. The survey also shows that family councils are not commonly established in the region, neither for FOBs (0%) nor for listed FOEs (25%).

- *Similarly, family-owned banks and listed companies would be well served to adopt family-member employment policies.* Once at the cousin consortium stage, good practice calls for families to formalize their family members' employment policies. Indeed, the survey shows that family membership at the board-level is prevalent in listed FOEs, with 75% of respondents citing that their boards are composed of a majority of family members. FOBs on the other hand show a substantially higher degree of non-family membership, with only 33% of boards being composed of a majority of family members, which is likely due to the strict fit and proper requirements imposed by regulators; in fact, all FOBs cited that family board members were required to comply with qualifications for being a board member. At the same time, the position of CEO is held by a non-family member among 67% of FOBs, while this percentage falls to 50% for listed FOEs.
- *Finally, all banks and companies in the MENA region should adopt succession policies and plans to ensure for business continuity and sustainability.* Unfortunately, family succession plans are not widespread in the region, and results show that only 29% of respondents have prepared a succession plan.

iii. Corporate governance issues related to state-owned enterprises

- *Finally, all banks and companies in the MENA region should adopt succession policies and plans to ensure for business continuity and sustainability. Unfortunately, family succession The public sector and other stakeholders should raise awareness as to the importance of corporate governance for state-owned enterprises (SOEs), in particular the OECD Guidelines on Corporate Governance for SOEs.* These Guidelines are not well known, as just over half of the respondents (56%) declared to be familiar with their content and scope.
- *Regardless of whether the state follows a centralized or decentralized ownership model, it should ensure that there is one body responsible for protecting its assets, exercising its ownership rights and responsibilities, and ensuring for good corporate governance among the country's SOEs.* The survey reveals that the exercise of political rights is usually a competence of a high-profile public officer or delegate (80% of responses in aggregate terms), regardless of the shareholder's identity. Of note is that an overwhelming majority of state-owned banks (SOBs), 90%, declared that property rights are exercised by a high-profile public officer or delegate, while this percentage falls to 62% of respondents for SOEs that are partially listed on an exchange. Most SOEs and SOBs report to the controlling agency on an ad-hoc basis, upon request (45%), and not on a periodic basis, for example annually (25%).
- *All SOEs should have a clear and explicit set of objectives, which are made publicly available.* Most state-owned enterprises separate their social mission from their profit-seeking business objectives, with 67% of SOEs citing an existing difference between these often conflicting priorities.
- *Finally, the state should have its own policy in place, requiring all SOEs and SOBs to adopt good corporate governance policies.* To date, only 33.3% of government ownership entities have a policy or requirement for their SOEs to adopt good corporate governance practices, demonstrating that corporate governance does not appear to be of primary concern for most governments.

- *Moreover, the state should ensure that the boards of its SOEs and SOBs are composed of an appropriate mix-of-skills and director types (executive, non-executive, and independent directors), and that these directors receive an appropriate remuneration.* Unfortunately, being a high-profile public officer is still the primary criteria for nominating a director to the board of a SOE in 62% of cases. Competency and skills are secondary requirements, fortunately still considered as an important criterion by 52% of nominating entities. And with respect to director remuneration, results show that 48% of directors are not remunerated for their board services.

Section B. Introduction

I. The definition of and rationale for improved corporate governance

i. What is corporate governance?

Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the boards, managers, shareholders, and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.¹

A company committed to good corporate governance has well-defined and protected shareholder rights, a solid control environment, high levels of transparency and disclosure, and an empowered board (see also Figure B-1). The interests of the company and those of all shareholders are aligned.

Figure B-1: The five elements of good corporate governance	
<p>Good board practices</p> <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Roles and authorities are clearly defined <input checked="" type="checkbox"/> Duties and responsibilities of directors understood <input checked="" type="checkbox"/> Board is well structured <input checked="" type="checkbox"/> Appropriate composition and mix-of-skills <input checked="" type="checkbox"/> Appropriate board procedures in place <input checked="" type="checkbox"/> Director remuneration in-line with best practice <input checked="" type="checkbox"/> Board self-evaluation and training conducted 	<p>Control environment and processes</p> <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Independent audit committee established <input checked="" type="checkbox"/> Risk management framework/structure present <input checked="" type="checkbox"/> Internal control procedures in place <input checked="" type="checkbox"/> Internal audit function in place <input checked="" type="checkbox"/> Independent external auditor conducts audits <input checked="" type="checkbox"/> Management information systems established <input checked="" type="checkbox"/> Compliance function established
<p>Disclosure and transparency</p> <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Financial information disclosed <input checked="" type="checkbox"/> Non-financial information disclosed <input checked="" type="checkbox"/> Financials prepared according to IFRS <input checked="" type="checkbox"/> High-quality annual report published <input checked="" type="checkbox"/> Web-based disclosure and investor site in place 	<p>Shareholder rights</p> <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Minority shareholder rights are formalized <input checked="" type="checkbox"/> Well organized general assembly conducted <input checked="" type="checkbox"/> Policy on related party transactions in place <input checked="" type="checkbox"/> Policy on extraordinary transactions in place <input checked="" type="checkbox"/> Clearly defined and explicit dividend policy
<p>Commitment</p> <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Board discusses corporate governance issues and has created corporate governance committee <input checked="" type="checkbox"/> Company has nominated a corporate governance champion <input checked="" type="checkbox"/> Corporate governance improvement plan is in place <input checked="" type="checkbox"/> Appropriate resources are committed to corporate governance <input checked="" type="checkbox"/> Policies and procedures have been formalized and distributed to relevant staff <input checked="" type="checkbox"/> Company has developed corporate governance code or guidelines <input checked="" type="checkbox"/> Company is publicly recognized as a corporate governance leader 	

ii. Why does corporate governance matter?

Corporate governance matters to stakeholders for broadly similar reasons.

- *Investors* care about corporate governance since well-governed companies have lower risk and fewer unexpected events. Well-governed companies are better at protecting shareholder rights, and provide better assurance that managers and directors will act in the best interest of the company and all of its shareholders. In terms of financial and

¹ OECD Principles of Corporate Governance, 2004.

operational performance, well-governed companies outperform their peers and provide a higher long-term return on investment.

- *Companies* benefit as the risks associated with the corporation decrease. Since good corporate governance minimizes “rent-seeking”² by managers or controlling shareholders, investors invest with a greater sense of security and confidence. The result for the company is greater access to capital. The cost of capital is effectively reduced and the value of the corporation increases. The reduction in risk is complemented by improved operations, which come from better information flows and more rigorous strategic decision-making, which ultimately contribute to better performance.
- The *public sector* cares about corporate governance as it facilitates the development of stronger capital markets, reduces risk, and improves a country’s ability to mobilize, allocate, and monitor investments—all of which help foster economic growth. The vulnerability to financial crisis, as witnessed in South East Asia in 1997 and today’s U.S.-based mortgage crisis, can also be minimized through better corporate governance.
- *Other stakeholders such as banks, suppliers and employees* benefit from the reduced risk and the increased health of the company. Banks, in particular, will make credit decisions with greater confidence, and can expect that they will be handled fairly should problems arise. Other stakeholders, including suppliers and employees, will prefer to enter into business relationships with well-governed companies, since the resulting relationships are likely to be more prosperous, fairer, and longer-lasting compared to companies where corporate governance practices are deficient.

Did you know that?

- Well-governed UK companies posted 18% higher returns than those with poor governance, after adjusting for risk; worst offenders underperformed the average industry-adjusted return on assets by three to five percentage points a year.³
- Well-governed firms in Korea have been found to trade at a premium of 160 % to poorly governed firms.⁴
- A worst-to-best improvement in corporate governance predicted an astronomical 700-fold increase in firm value among Russian firms.⁵
- A study of S&P 500 firms showed that companies with strong or improving corporate governance practices outperformed those with poor or deteriorating governance practices by about 19% over a two-year period.⁶
- Institutional investors will pay premiums to own well-governed companies. Premiums averaged 30% in Eastern Europe and Africa and 22% in Asia and Latin America.⁷ In the MENA region, premiums ranged from 29% (Egypt) to 30% (Morocco).

² In economics, rent seeking refers to individuals or corporations that seek gains by manipulating the environment rather than through productive behavior.

³ ABI Research Paper 7, “Governance and Performance in Corporate Britain”, the Association of British Insurers (ABI), February 2008. The study also found that it takes two to three years after a company starts breaching until there is an impact on performance.

⁴ Black, B. S.; Jang, H., Kim, W. (2004), ‘Predicting Firms’ Corporate Governance Choices: Evidence from Korea’, University of Texas Law School Working Paper No. 39, August.

⁵ Black, B. (2001), ‘The Corporate Governance Behavior and Market Value of Russian Firms’, *Emerging Markets Review*, vol. 2, March.

⁶ Grandmont, R., Grant, G, and Silva, F. (2004), *Beyond the Numbers – Corporate Governance: Implications for Investors*, (Deutsche Bank, April 1).

II. Recent trends and developments in corporate governance across MENA

In the past seven years there have been major world-wide changes in the area of corporate governance. During this period, there have been more than 90 legislative initiatives in 30 different countries, in addition to countless studies and initiatives to update best practice in corporate governance.

The Middle East and North Africa (MENA) region, too, has seen important changes in the field of corporate governance. Indeed, not seven years ago corporate governance was a nascent, largely unknown concept. Today, hundreds of conferences on corporate governance have been held across the region, a number of MENA countries have adopted new or amended existing corporate governance codes and regulations,⁸ institutes of corporate governance or directors have been established,⁹ and banks and companies themselves are starting to undertake corporate governance improvement plans. A number of events have spurred the emergence of corporate governance as a leading reform initiative, including: (i) a number of domestic reform initiatives in the region, in particular the launch of Hawkamah; (ii) the rise of international, regional, and domestic investment to the region, coupled with stock market booms (and corrections), and the emergence of investor activism; (iii) corporate governance programs and projects implemented by international development institutions,¹⁰ and (iv) updates to the international corporate governance framework.¹¹

III. About this survey

i. Purpose of the survey

The primary objectives of the survey were as follows:

- To allow all stakeholders to gain an understanding of the extent to which banks and listed companies in the MENA region follow good corporate governance practices, in-line with internationally recognized best practice.
- To assist both the private and public sectors to close any gaps between best and current practice, by identifying areas for improvement.
- To provide corporate governance projects with a baseline on which to focus their corporate governance reform activities.

⁷ McKinsey's Global Investor Opinion Survey, 2002.

⁸ The following countries have launched or amended corporate governance codes or regulations: **Egypt**: Corporate Governance Code for Listed Companies (2005) and State-Owned Enterprises (2006); **Jordan**: Corporate Governance Code for Banks; **Lebanon**: Corporate Governance Code for Small and Medium-Sized Companies; **Morocco**: Corporate Governance Code (2008); **Oman**: Corporate Governance Code for Listed Companies (2002, update in process); **Kingdom of Saudi Arabia**: Corporate Governance Regulations (2006); **UAE**: AD5M Corporate Governance Code (2006); AD5M Corporate Governance Listing Rules (2006); ESCA Corporate Governance Regulation (2007). The following countries are in the process of launching codes or regulations: **Algeria**: Corporate Governance Code for Family-Owned Enterprises; **Lebanon**: Corporate Governance Code for Listed Companies and Banks; **Bahrain**: Corporate Governance Code for Listed Companies; **Tunisia**: Corporate Governance Code for Listed Companies; **West Bank & Gaza**: Corporate Governance Code for Small and Medium-Sized Companies; **Jordan**: Corporate Governance Code for Listed Companies; **Yemen**: Corporate Governance Code for Small and Medium-Sized Companies.

⁹ Institutes that have been established in the region are the [Egyptian Institute of Directors](#) (2005), the [Hawkamah Institute of Corporate Governance](#) (2006); and the [Mudara Institute of Directors](#) (2008).

¹⁰ Notably the [Center for International Private Enterprise](#) (CIPE), [Global Corporate Governance Forum](#), [IFC](#), [Organization for Economic Cooperation and Development](#) (OECD) and [World Bank](#).

¹¹ [Revised OECD Principles of Corporate Governance](#) (1997, revised in 2004); [Basel Committee on Banking Supervision's Guidance on Enhancing Corporate Governance for Banking Organizations](#) (1998, revised in 2006); [OECD Guidelines on Corporate Governance of State-owned Enterprises](#) (2005); [the Islamic Financial Services Board's Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services \(Excluding Islamic Insurance \(Takaful\) Institutions and Islamic Mutual Funds\)](#) (2006).

ii. Target countries and organizations

The survey targeted countries with operational stock exchanges in three MENA regions specifically the Maghreb (Morocco, Tunisia), Mashrek (Egypt, Jordan, Lebanon, and West Bank & Gaza) and the Gulf Cooperation Council or GCC (Bahrain, Kuwait, Oman, Saudi Arabia, and the United Arab Emirates). Within these countries, the survey targeted banks, both listed and non-listed, and publicly listed companies.

iii. Survey timeline

The survey was launched in July 2006 and final data collection completed by July 2007.

iv. Survey response rate and sample error

The universe consisted of 1,044 banks and listed companies, specifically 122 banks (of which 65 were listed and 57 non-listed) and 922 listed companies.

Banks	Listed companies	Total
74	81	155

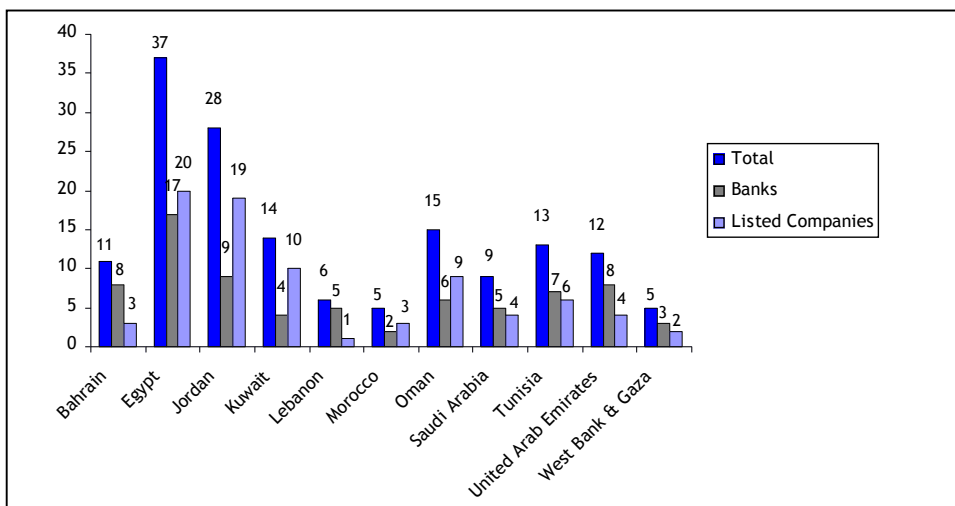
The final response rate to the survey was 155 respondents of which 74 were banks and 81 listed companies (see also Table B-1).

	No. of Responses	Sample Error
Banks	74	7,18%
Listed companies	81	10,41%
TOTAL	155	7,27%

The sample error that resulted for banks and companies' is 7.27%, with a confidence level of 95%. When taken individually, the sample error for banks is 7.18% and for listed companies 10.41% (see also Table B-2).

These sample errors, slightly higher than the 5% usually considered when large universes are estimated, are primarily due to the relatively small size of the universe and, secondarily, to the fact that the survey targeted high-level senior executives and directors, many of which could not find the time to respond. The response rate by country to the survey is shown in Figure B-2.

Figure B-2: Response rate to the questionnaire by country disaggregated by type of entity



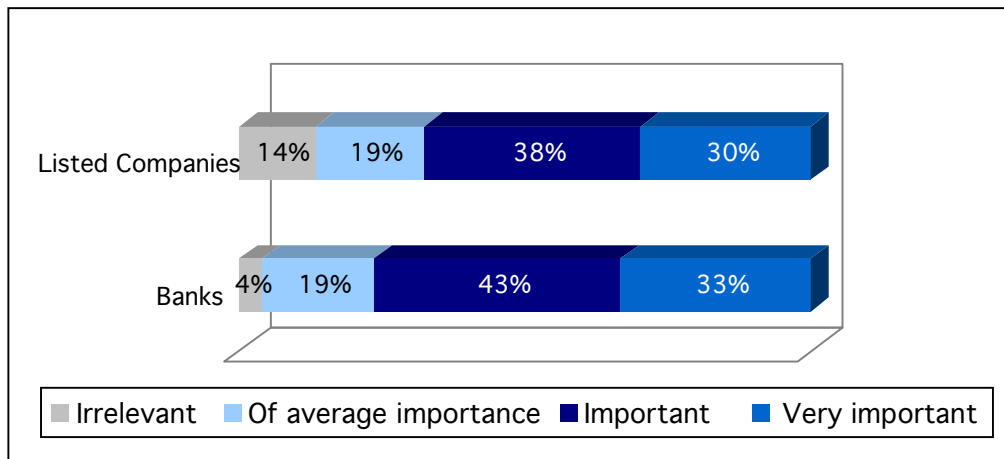
Section C. Main findings

I. Demonstrating commitment to good corporate governance

i. Understanding the definition of and business case for corporate governance

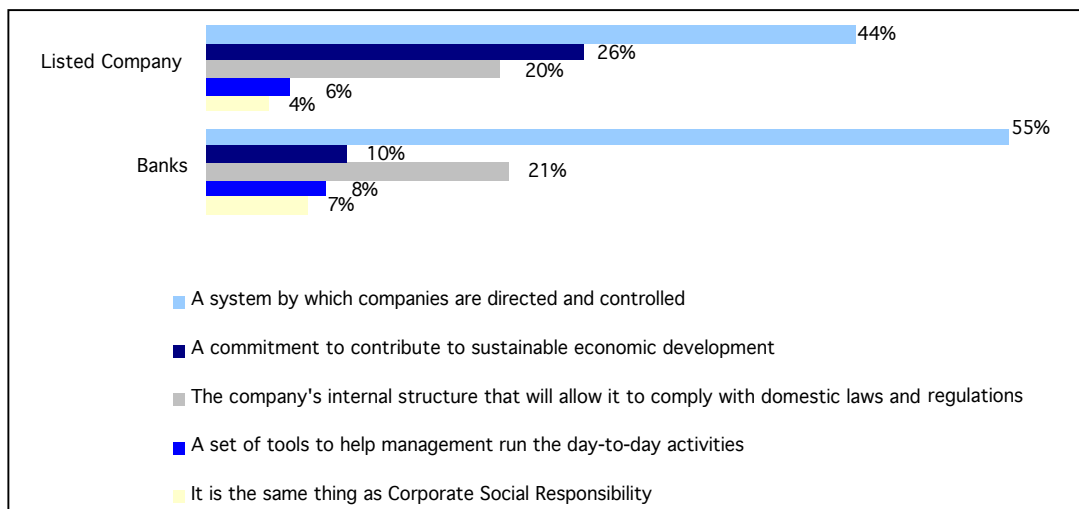
As shown in Figure C-1, the great majority of respondents—76% of banks and 68% of listed companies—cited implementing corporate governance as being important to very important for their businesses.

Figure C-1: The importance of implementing corporate governance



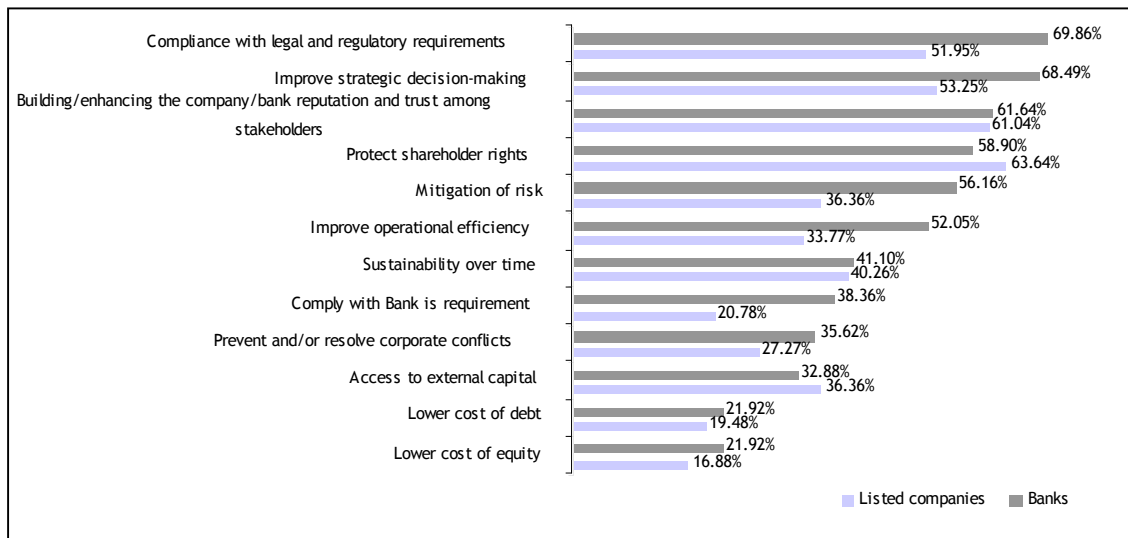
On the other hand, not all respondents were able to properly define the term corporate governance as ‘a system by which companies are directed and controlled.’ Respondents confused the term corporate governance with corporate social responsibility (CSR) or corporate management, or had a narrow, compliance view of corporate governance (see Figure C-2). And while both CSR and corporate management are clearly important issues—and most certainly will reinforce each other—they are two very distinct concepts from corporate governance that merit their own attention and thus need to be considered separately.

Figure C-2: Defining corporate governance



Unsurprisingly, and in-line with the findings in this section, Figure C-3 demonstrates that a great majority of survey respondents associated the benefits of good corporate governance with better compliance and improved reputation; only a small majority cited a lower cost of capital and access to outside capital.

Figure C-3: Understanding the business case for corporate governance



Did you know that the chairs and finance directors of the top 1,000 listed UK firms cited the following three benefits of improved corporate governance: (i) protecting shareholder rights (95%); (ii) improving access to external capital (88%); and (iii) lowering cost of debt and equity (85%)? Only 1% of respondents stated compliance with regulations as a major benefit.¹²

In order to ensure that the benefits from implementing good corporate governance are understood in theory and also translate into practice, all relevant stakeholders should focus on building the business case for good corporate governance by encouraging targeted seminars and workshops for directors and managers on corporate governance. Banks and companies in turn should encourage their directors and senior managers to attend such events.

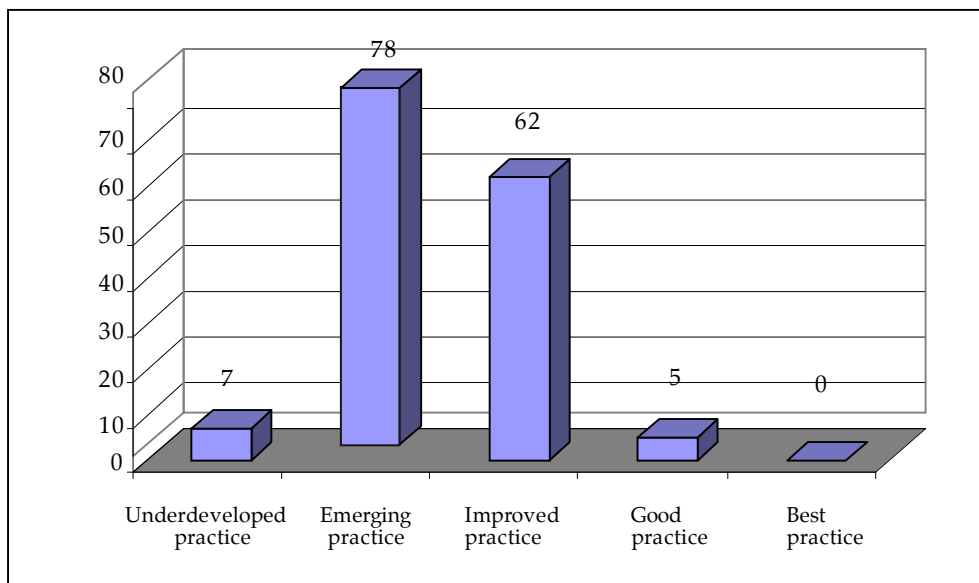
ii. Implementing corporate governance: practice vs. theory

Table C-1 and Figure C-4 highlight that while banks and listed companies state that corporate governance matters to them, few can credibly claim to having implemented broad-scale reforms. In fact, not a single respondent had applied all 32 indicators of what could reasonably qualify a company as a following ‘best practice’ and only five respondents or 3% could be deemed to follow ‘good practice’, having implemented between 16-23 indicators (see Section E.II on page 84 for the complete list of indicators). The great majority of companies, 92% in all, fall under the ‘emerging practice’ or ‘improved practice’ sections.

¹² Moxey, P. (2004), *Corporate Governance and Wealth Creation*, ACCA Occasional Research Paper No. 37.

Table C-1: Corporate governance indicators			
<i>No. of indicators followed</i>	<i>Level of practice</i>	<i>No. of respondents</i>	<i>% of respondents</i>
0-7	<i>Underdeveloped practice</i>	7	5%
8-15	<i>Emerging practice</i>	78	51%
16-23	<i>Improved practice</i>	62	41%
24-31	<i>Good practice</i>	5	3%
32	<i>Best practice</i>	0	0%
	TOTAL SAMPLE	152	100%

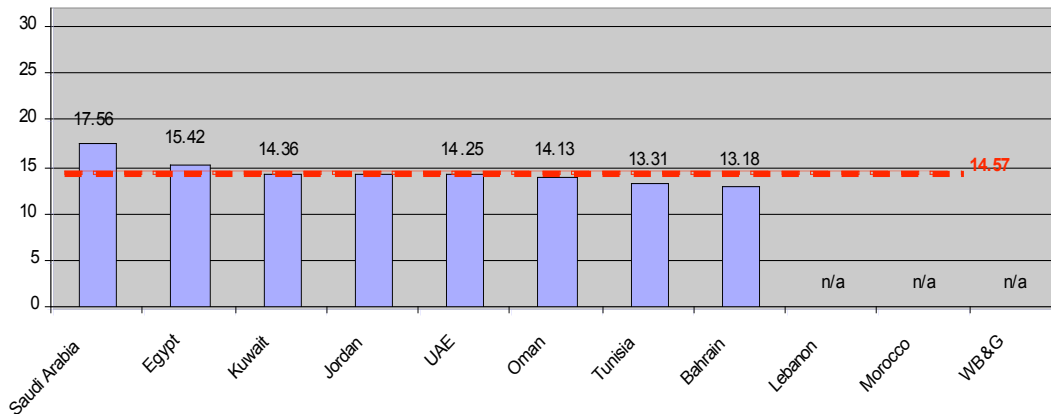
Figure C-4: Best practice indicators and levels



A country-by-country comparison demonstrates that companies in the Kingdom of Saudi Arabia, on average, fall into the ‘improved practice’ category, meeting an average of over 17 best practice indicators (see Figure C-5). Companies in all other MENA countries, again on average, fall into the ‘emerging practice’ category, with the average Egyptian company following 15 best practice indicators, while the remaining countries average between 13 and 14 indicators.¹³

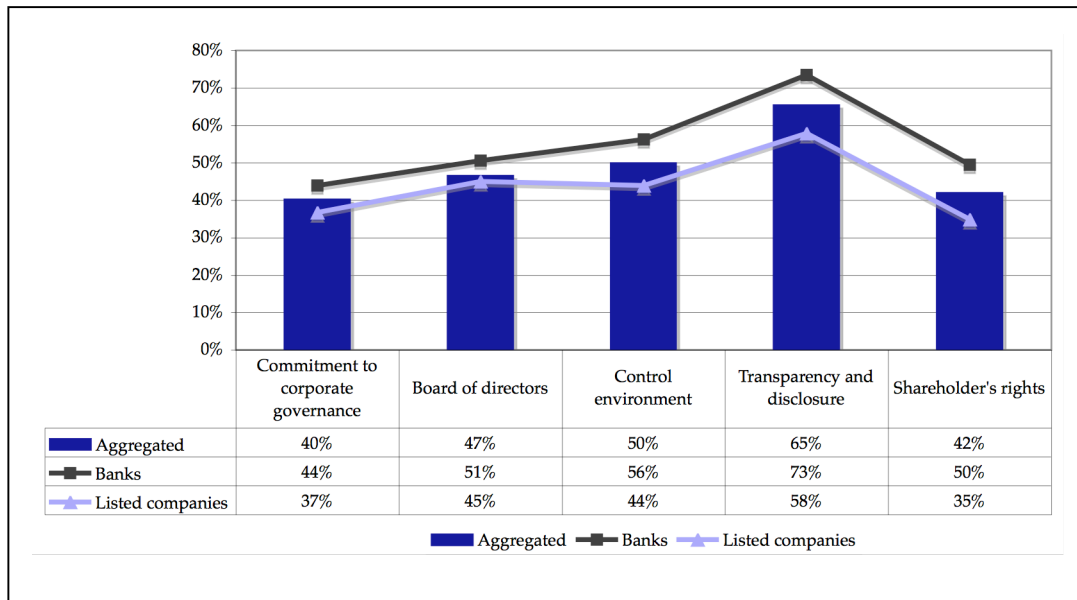
¹³ The following country comparison is based on the average number of corporate governance indicators met by companies in a particular country. Lebanon, Morocco, and the West Bank and Gaza have not been included in this country comparison due to the low level of response from listed companies and banks, and hence high statistical error that could distort the consistency of the surveys findings.

Figure C-5: Corporate governance practices aggregated on a country-by-country level



According to Figure C-6 banks follow better governance practices than listed companies. This is unsurprising, given the fact that banks are typically highly regulated, with specific central bank circulars and regulations on, for example, risk, internal controls, disclosure, and even board composition. Interestingly, results for both banks and listed companies follow a similar trend, with all respondents scoring relatively high (50% and above) on disclosure and transparency, as well as the control environment, both of which are typically codified in laws and regulations, while respondents failed to break the 50% threshold for the other indicators, namely board practices (47%), shareholder rights (42%), and commitment to good corporate governance (40%).

Figure C-6: Implementing the five pillars of good corporate governance

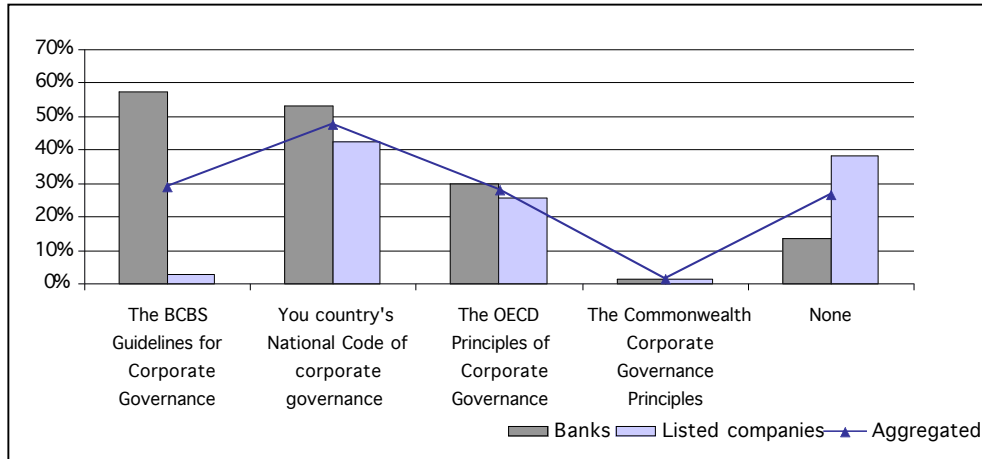


iii. Recognizing international reference points for good practice

It appears from the survey responses shown in Figure C-7 that a great number of respondents, 25.6% of listed companies, did not follow internationally recognized reference points for good corporate governance, such as the OECD Principles of Corporate Governance (OECD Principles), while 57.5% of banks followed the Basel Committee on Banking Supervision’s Guidelines on Enhancing Corporate Governance for Banking Organizations (BCBS Guidelines). Compliance with national codes of corporate governance, insofar as they exist, appears more wide-spread.

Again, awareness raising of the existence of these principles, as well as efforts to adapt these best practices to the local circumstances, may well help improve upon these figures in the years to come.

Figure C-7: Using international best practices as a basis for reforms

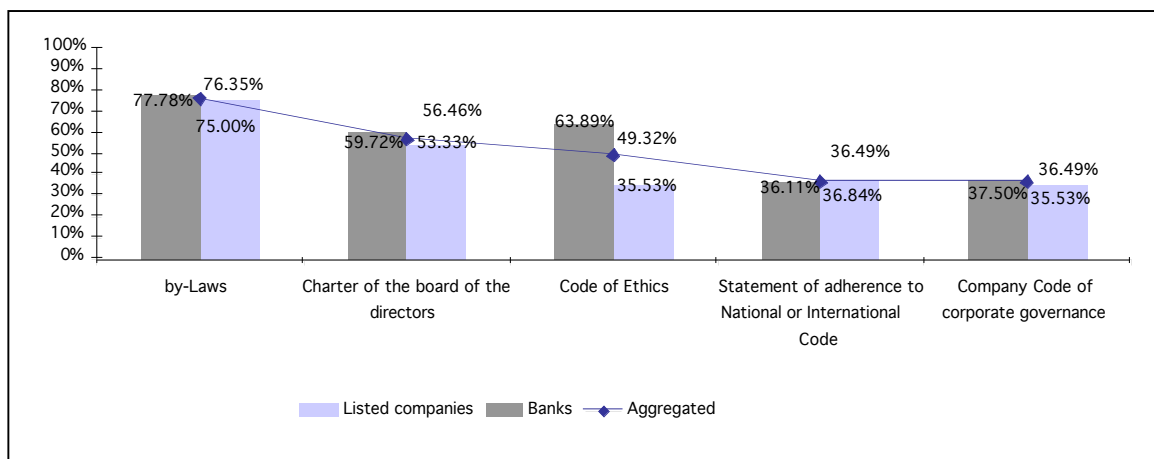


iv. Formalizing corporate governance policies and procedures

Corporate governance reforms are ultimately based on changes in behavior—commitment, integrity, objectivity, courage, and vigilance, to name but a few—notably those of shareholders, directors, and managers. Such behavioral change does not always occur overnight. Culture is process over time.¹⁴ As a result, explicit changes to a company’s governance policies, procedures, and processes can positively affect its culture over time—and with it the behavior of its agents.

Figure C-8 demonstrates that while most companies choose to use by-laws to formalize their corporate governance practices, the use of a company-level code of corporate governance (36.5%) or code of ethics (49.3%) is not wide-spread.

Figure C-8: Formalizing corporate governance



¹⁴ By Peter Drucker.

Did you know that in 2004, 96% of the FORTUNE 1,000 companies in the US stated that their boards had written guidelines on corporate governance (compared with 71% in 2002)? The practice is also gaining broader acceptance in other countries, such as in France where 54% of boards have adopted formal board guidelines in 2004, compared to 36% in 2003.¹⁵

The adoption of new and periodic revisions to existing corporate governance documents constitutes an important time-commitment from the board and senior management. Nevertheless, policies and procedures should be drafted and kept up to date, as they play an important role in the day-to-day conduct of the business and in forming the culture of the business. Indeed, as well as supporting the consistent application of policies, procedures and internal controls, written documentation helps banks and companies allocate responsibilities and authorities; reinforces accountability in the event of performance or compliance failure; and improve upon internal and external communication.

The process of reviewing and updating needs to be integrated into the job description of the designated corporate governance champion. Figure C-9 above contains a comprehensive list of policies and procedures that a company may wish to codify to ensure effective and efficient decision-making and communication across the organization.

Banks and listed companies may find it beneficial to publish their corporate governance code, board and committee charters, and codes of conduct on their website, as well as references to these in the annual report. Institutional investors and ratings agencies are looking increasingly at the state of a bank's corporate governance when making their assessments. Published information is frequently their only source of comfort, short of directly questioning the bank or listed company.

Figure C-9: What to formalize

- Articles of association**
- Company governance code**
- Code of ethics and/or conduct**
- Charters for the:**
 - General assembly
 - Board of directors
 - Board committees
 - Executive board
- Policies and procedures on:**
 - Dividends
 - Information disclosure
 - Risk management & internal controls
 - Internal audit
 - Compliance
- Terms of reference for:**
 - Chief executive officer
 - Chief financial officer
 - Head of internal audit
 - Company secretary
- Other senior managers**

Did you know that ethical breaches by management or employees caused 37% of high-profile business failures in Europe? A recent study of 60 European cases of formal bankruptcy or stock price free fall shows this remarkable impact of ethical lapses.¹⁶ In a large number of these cases, a dominant shareholder or manager with big ambitions acted unethically, and his/her actions went unchallenged by the company and by the board. Formal corporate governance codes and codes of ethics can help guard against unethical behavior in companies. A formal performance review of the CEO by the board of directors can also help root out ethical problems before they lead to business failures.

¹⁵ 31st Annual Board of Directors Study, Korn/Ferry International, 2004.

¹⁶ "Classification and Analysis of Major European Business Failures", Maastricht Accounting, Auditing & Information Management Research Center, RSM Erasmus University. October 2005

Finally, it is important not to confuse substance with form. Directors and senior managers do not simply go through the motions and follow the form of good corporate governance; they need to understand their proper roles and responsibilities, and act in accordance with the precepts of good corporate governance. In the end, corporate governance is as much about behavior as it is about processes and procedures.

v. Assigning responsibility for corporate governance

Just under half of surveyed banks (47%) and listed companies (49%) assign the responsibility for corporate governance policies to the board—in-line with good practice.

The board’s responsibility does not, however, end just by drafting the general corporate governance policy but also in monitoring its compliance. Indeed, best practice calls for boards to create corporate governance committees and task them with evaluating, planning and overseeing the implementation of corporate governance reforms. Only 13% of listed companies and 10% of banks have such corporate governance committees; 18% of listed companies and 16% of banks do not assign this responsibility to any corporate body or person.

Figure C-10: Assigning responsibility for corporate governance

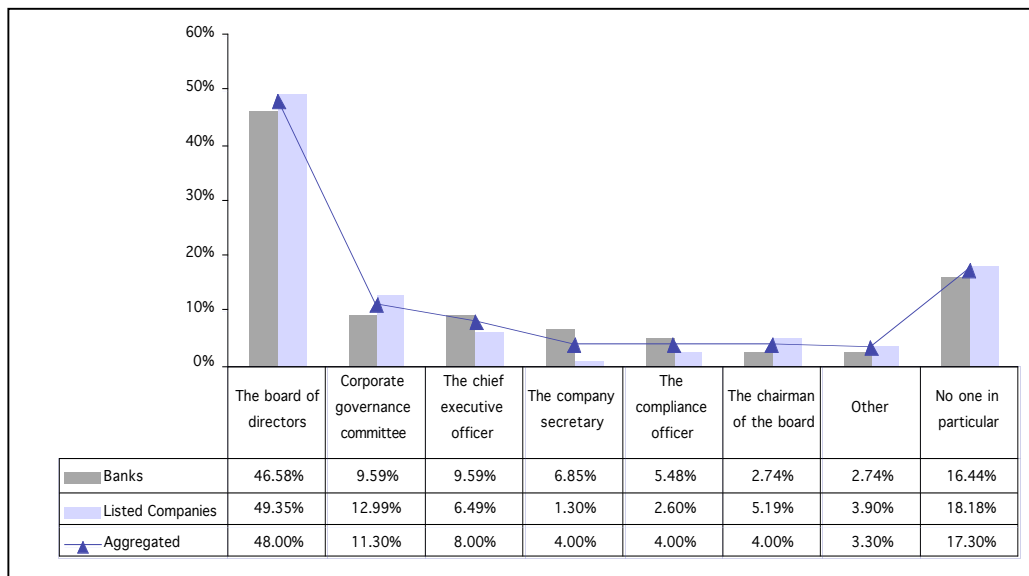


Figure C-10 reveals that three important figures do not appear to play a role in developing, implementing, and monitoring corporate governance improvements. Indeed, only a small minority of banks and companies involve the CEO, board chairman, and company secretary in developing corporate governance frameworks. All do, however, have an important role to play.

- **Role of CEO and chairman:** The CEO and board chairman generate the leadership and drive essential for corporate governance reforms to succeed. This is sometimes referred to as “the tone at the top”. Best practice is for the chairman and CEO to put corporate governance issues on the board’s agenda, and encourage a frank and open discussion. The chairman and CEO should seek to educate board members on the importance of corporate governance, on its benefits, and the respective roles of various parties. They should start a process of evaluation, assessment, and improvement. This process should become iterative so that good corporate governance processes and procedures become ingrained. It is imperative that both lead by example, as corporate governance reforms initiated by one without the support of the other are likely to fail.

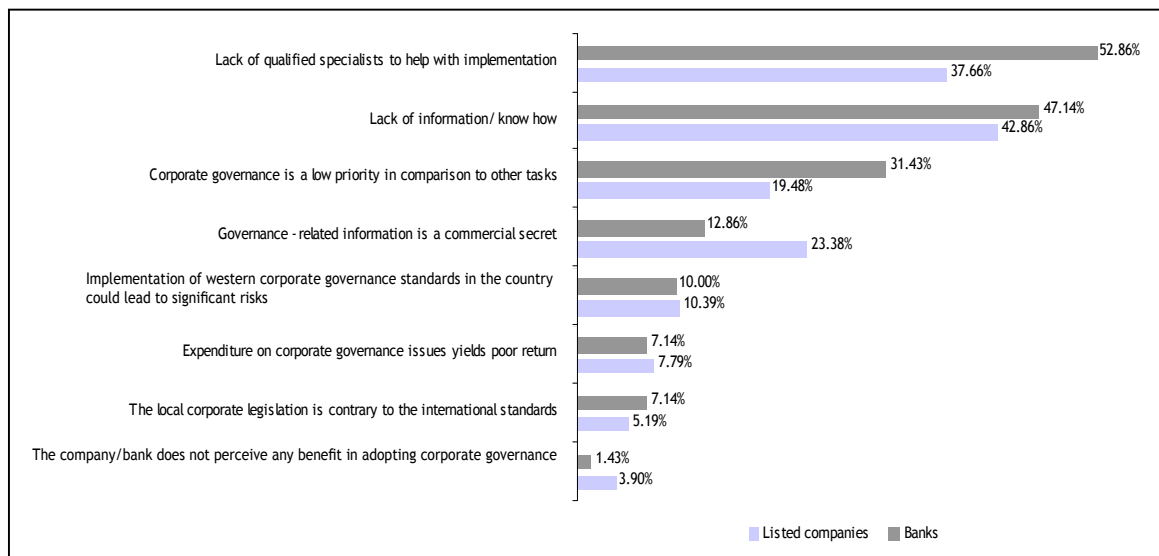
- **Role of company secretary:** Best practice is to provide resources and assign responsibility to a corporate governance champion, ideally to a professional company secretary (or for smaller firms the legal counsel who may double as company secretary), who should be made responsible for developing, implementing, and periodically reviewing corporate governance related documentation, under the supervision board through its chairman or corporate governance committee. The company secretary serves as the focal point for communications with and between the board, senior management, and the bank’s shareholders, and acts as the chief advisor to the board on all corporate governance matters. (More information on the role of the company secretary can be found in Section II.iv.c on page 36).

Did you know that a survey of 400 companies in the US revealed that the company secretary is responsible for compliance and governance, and that 16% even have created the position of chief governance officer?¹⁷

vi. Understanding barriers to reform

Figure C-11 shows how important it is to train or impart corporate governance know-how to assist companies in implementing corporate governance reforms. Fifty three percent (53%) of banks and 38% of listed companies stated that the main barrier to implementing corporate governance is “a lack of qualified specialists”. Similarly, 47% of banks and 43% of listed companies cited “a lack of information and know-how” as a barrier to implementing corporate governance.

Figure C-11: Barriers to implementing corporate governance



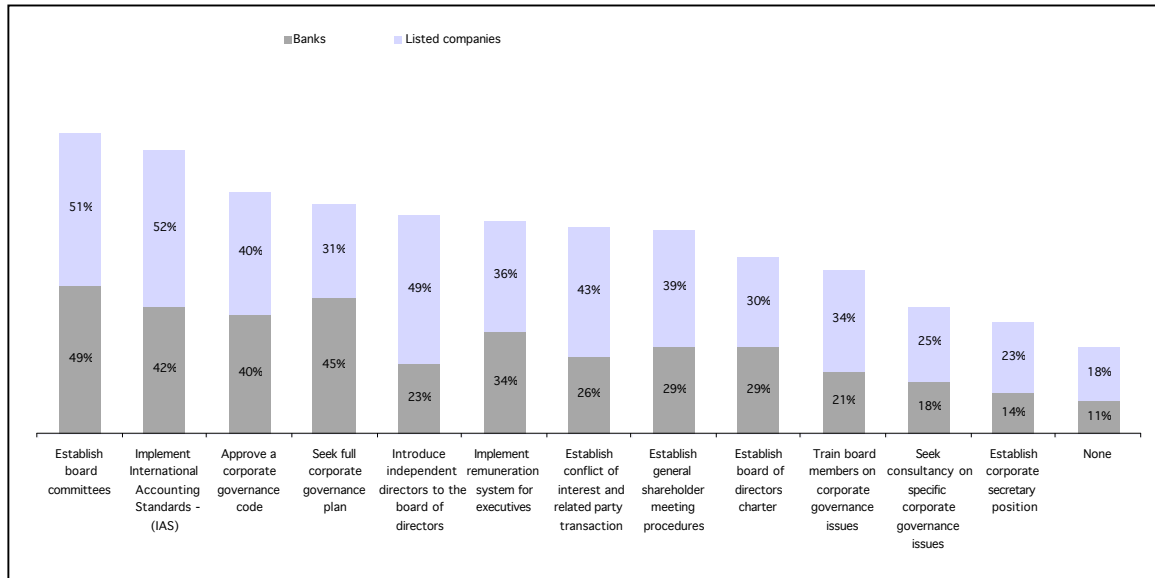
Regulators should consider whether to strongly recommend or mandate corporate governance training for all individuals who serve on a board. To prevent regulatory action in this area, banks and listed companies should encourage their directors and senior managers to undertake training on corporate governance and other related topics, such as for example on finance and accounting or risk management. (Additional information on boardroom training can be found in Section II.vi.b. on page 40).

¹⁷ A survey of 400 corporate secretaries, general counsels and other governance professionals conducted in 2005 by the Society of Corporate Secretaries and Governance Professionals.

vii. Looking ahead: priorities for corporate governance reforms

Figure C-12 depicts three priority reform areas that banks and companies intend to implement in the future: (i) to establish board committees; (ii) to implement IFRS; and (iii) to draft a company-level corporate governance code. The corporate governance code is an excellent starting point for corporate governance reforms, as it allows the company to define its own unique set of corporate governance principles.

Figure C-12: Corporate governance reform priorities



Of note is that an important percentage of listed companies are interested in nominating independent directors to the board (49%), as well as introducing procedures on conflicts of interest and related party transactions (43%), both of which are key elements to an effective corporate governance framework, whereas only 23% respectively 26% of banks plan on doing so.

II. Implementing good board practices

*When you sweep the stairs, you always start from the top.*¹⁸

The board is where key corporate governance issues converge. The board is responsible for strategic guidance and oversight of management, and functions as a trustee for shareholders. These are important responsibilities, and the means by which the board organizes itself are an important factor in determining how well it fulfils its responsibilities. A professional, independent, and vigilant board is essential for good corporate governance. Ultimately, the board can neither substitute for talented professional managers, nor can it change the economic environment in which a company operates. It can, however, influence the company’s performance and sustainability through its guidance to, and oversight of management.

i. The role of the board

Although specific board authorities will vary by country based on legal traditions, virtually all international and national codes of corporate governance agree that the overarching role of the board is to strategically guide and oversee management, as well as to ensure that a robust corporate governance framework is in place.

¹⁸ A German proverb.

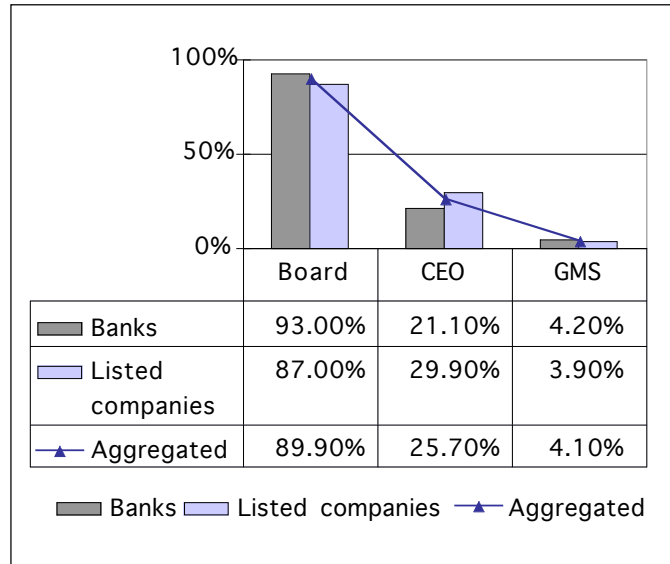
a. The board’s role in reviewing and approving company strategy

An overwhelming majority of respondents (93% of banks and 87% of listed companies, see Figure C-13) stated that the board was responsible for setting company strategy. The process of setting strategy is also assumed by the CEO in almost a quarter of the banks and listed companies surveyed (21% and 30%, respectively).

Managers with their industry knowledge and resources are, however, best placed to develop and then implement strategies, while directors with their experience and objectivity in turn are best positioned to review, challenge, and ultimately approve these strategies, in particular objectives and corresponding key performance indicators.

The development of strategy is a complex, difficult, and time-consuming exercise that is rightly the primary responsibility of the executive, although some boards have done well to formulate high-level strategies to effectively guide management in strategic decision-making. Directors and managers would be well served to openly discuss and agree on their respective roles with respect to the strategic decision-making process.

Figure C-13: Setting corporate strategy

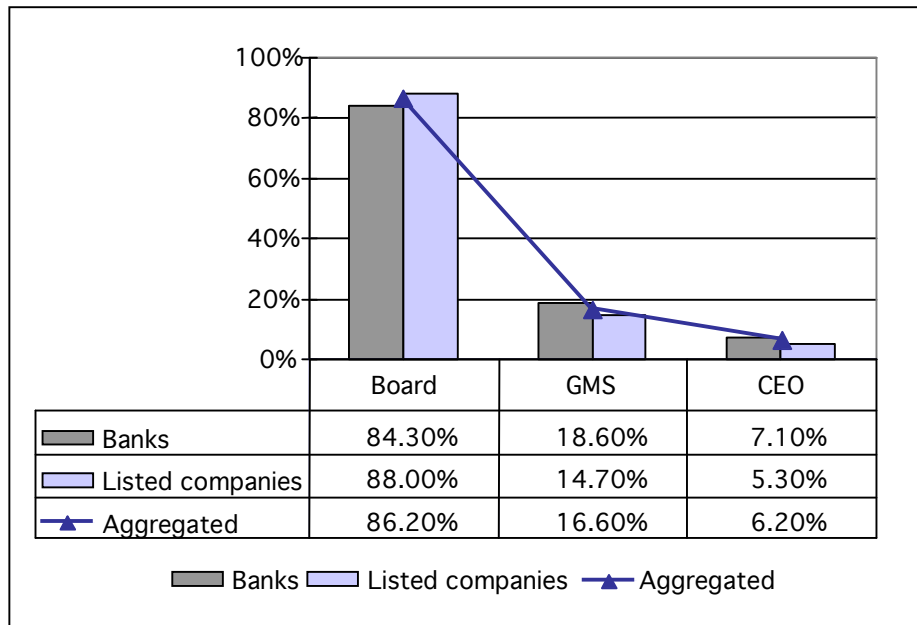


b. The board’s role in overseeing management

The second principle role of the board is to oversee management. The primary means of doing so is to request management to report back to the board on its implementation of strategy and a defined set of key performance indicators. In addition, selecting and, when necessary, replacing the CEO constitutes an important first step in defining the relationship between the board and CEO.

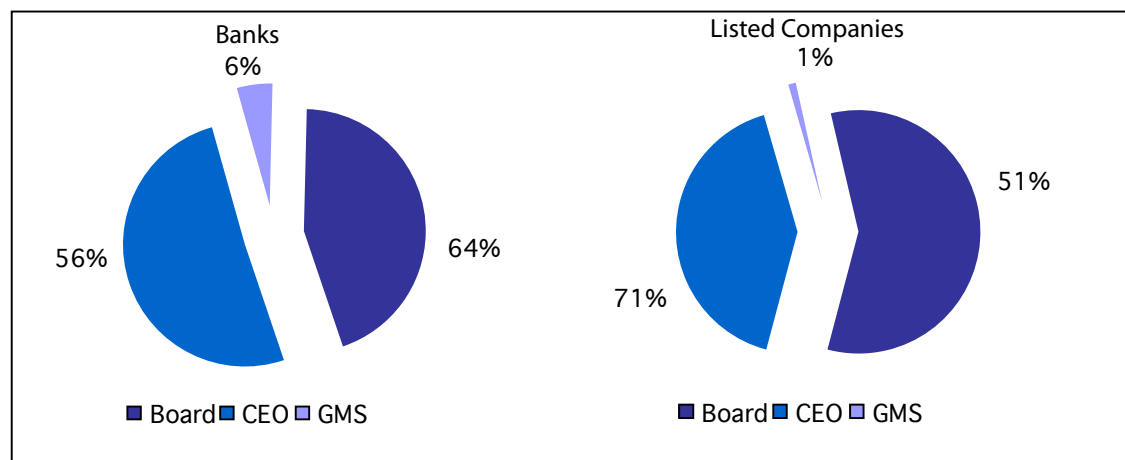
Figure C-14 shows that a vast majority of boards in MENA do select and dismiss the CEO. Sixteen percent (16%) of respondents cited that the general assembly elected and dismissed the CEO, which arguably runs counter to good corporate governance as it may well undermine the authority of the board.

Figure C-14: Electing and dismissing the CEO



As for the other key executives and managers, results show that their selection is entitled *ceteris paribus* a responsibility either of the board or the CEO (see Figure C-15). Best practice calls for the CEO to select his or her management team, however, for the board to establish appropriate parameters *ex ante*—for example on qualification requirements and remuneration levels—and *ex post*—for example in approving final candidates.

Figure C-15: Electing and dismissing other key executives

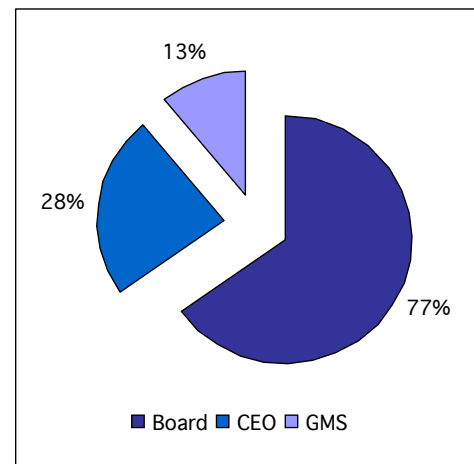


Setting a succession policy and overseeing succession planning by management is an important function of the board, as it allows a company to develop and change leadership in a systemic, progressive, and non-disruptive manner. Simply nominating a deputy does not constitute best practice in succession planning, as it fails to capture the systematic development of talent

within the company. Succession plans should be in place for all key executives, in particular the CEO and CFO, but also for directors and the board chairman.

Results shown in Figure C-16 offer a positive picture in that 77% of boards feel responsible for approving succession plans of key executives. However, these results should not be misinterpreted to mean that succession plans beyond naming a deputy are actually in place in most companies in the region. Indeed, as can be seen in Section D.II.ii below (see page 69), only 29% of family-owned enterprises have succession plans in place, and qualitative data from the interview process suggest that most respondents have simply named deputies as successors.

Figure C-16: Approving succession plans



a. The board’s role in implementing corporate governance structures, policies, and practices

The third and final key role of the board is to implement appropriate corporate governance structures, policies and procedures, and practices by:

- (i) ensuring for company-wide commitment to good corporate governance;
- (ii) implementing good board practices;
- (iii) establishing a robust control environment;
- (iv) strengthening transparency and disclosure; and
- (v) protecting shareholder rights, in particular those of minorities.

However, while boards state that corporate governance matters to them, few can credibly claim to having implemented broad-scale reforms (see Figure C-1 on page 15 and Table C-1 on page 17 above). As such, not a single respondent had applied all 32 indicators of what could reasonably qualify a company as following ‘best practice’ in the area of corporate governance.

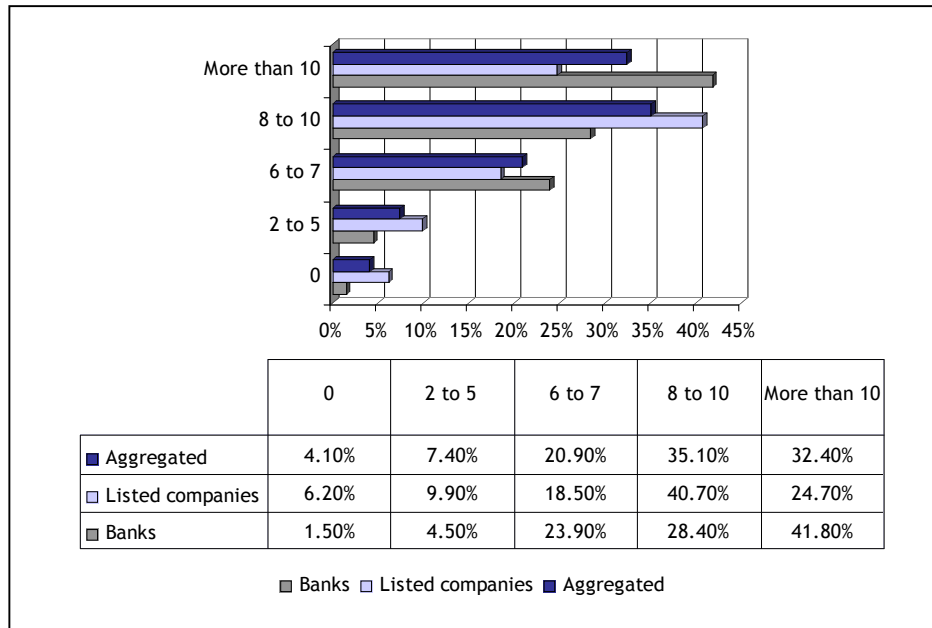
ii. Board composition

In order to effectively fulfill the board’s role, directors should be qualified, have a clear understanding of their duty to the company and all shareholders, and be able to exercise sound, objective, and independent judgment. This can be achieved by different means and approaches to the board’s size and composition.

a. Board size

Having either too few or too many directors can be a problem for effective decision-making. A board with too few members may not allow the company to benefit from an appropriate mix-of-skills and breadth of experience. A larger board, on the other hand, is typically difficult to manage, and can make consensus-building time consuming and difficult. The challenge in selecting the correct board size is striking an appropriate balance within the framework mandated by law. The size of the board should thus enable a company to hold productive and constructive discussions and make prompt and real decisions.

Figure C-17: Board size



The majority of boards in MENA have eight or more members (see Figure C-18). Bank boards are usually composed of ten or more members, while the boards of listed companies typically have eight to ten. These numbers appear to be in-line with best practice, if slightly above the norm.

b. Identifying the right mix of executive, non-executive and independent directors

Companies can benefit from having an appropriate mix of executive, non-executive, and independent directors on their boards. In defining the right mix for the board, it is important to understand the roles executive, non-executive, and independent directors play.

Table C-2 summarizes these roles:

Table C-2: The role of executive, non-executive, and independent directors	
Executive directors	<ul style="list-style-type: none"> ☑ Definition: An executive director holds an operational position in the company. The executives that one typically finds on boards are the CEO and CFO. ☑ Role: Executives are inevitably best informed on the state of the business and the challenges it faces, since they confront the problems every day. They are also ultimately responsible for the operating results of the company and may add tremendous value to the board given their understanding of the bank or company and industry expertise.
Non-executive directors	<ul style="list-style-type: none"> ☑ Definition: Non-executive directors are board members that do not hold an executive position in the company. A non-executive director may or may not be independent. ☑ Role: Current thinking is that the talent and skills of non-executive directors who are not technically independent are being overlooked or rejected purely on formal grounds. Non-executive directors may contribute: (i) an outside perspective and greater impartiality in their judgments; (ii) additional external experience and knowledge; and (iii) useful contacts.
Independent directors	<ul style="list-style-type: none"> ☑ Definition: An independent director is a director who has no material relationship with the company beyond his or her directorship. An independent director should be independent in character and judgment, and there should be no relationships or circumstances which could affect, or might appear to affect, the director’s independent judgment. ☑ Role: The purpose of identifying and electing independent directors is to ensure that the board includes individuals who can effectively exercise best judgment for the exclusive benefit of the company and all shareholders, whose judgment is not clouded by personal interest or loyalties and either real or perceived conflicts of interest. Independent directors are best able to assess situations openly, and bring an objective and unbiased view to discussions, without the fear of possible retribution.

As may be inferred from Figures C-18 through C-20, boards in the MENA region appear to be relatively well-balanced, with most boards consisting of a healthy mix of executive and non-executive directors, complemented with a few independent directors. However, experience on the ground and qualitative results from the one-on-one interview process appears to tell a different tale, with boards in some MENA countries (in particular the Mashrek region) being dominated by executives, with boards in other countries (in particular the GCC region) being exclusively composed of non-executive directors (and, in aggregate, portraying a balanced mix of director types that may not exist in practice).

Figure C-18: Number of non-executive directors

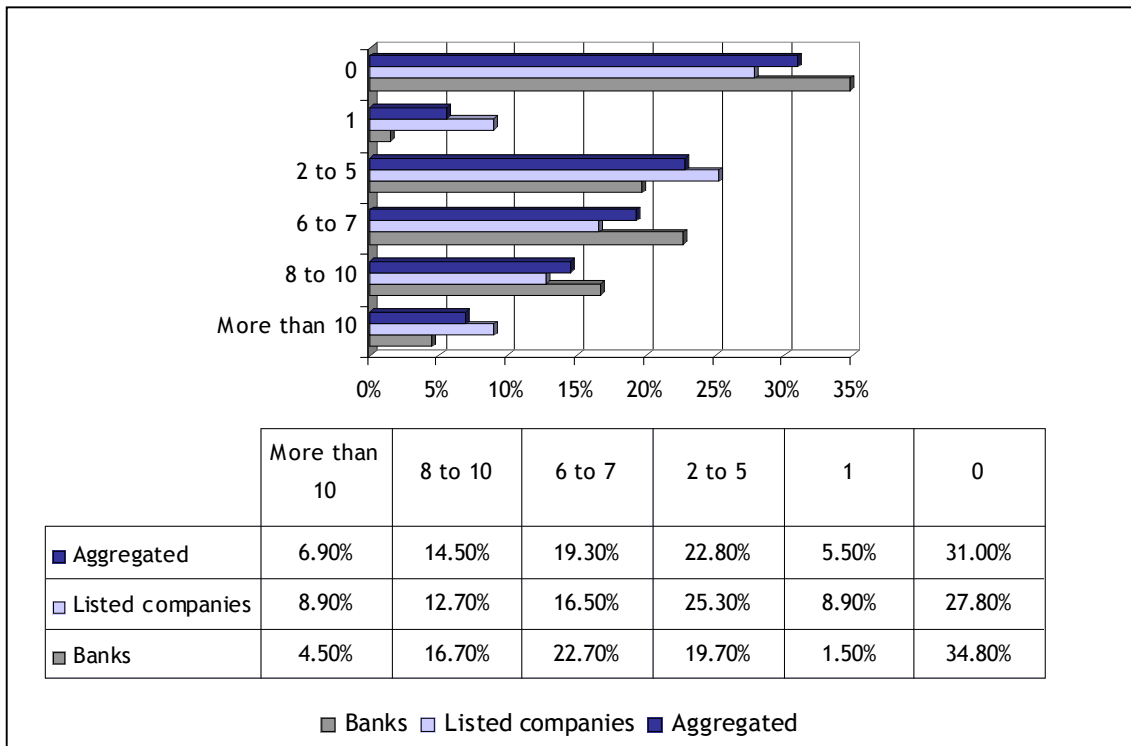


Figure C-19: Number of executive directors

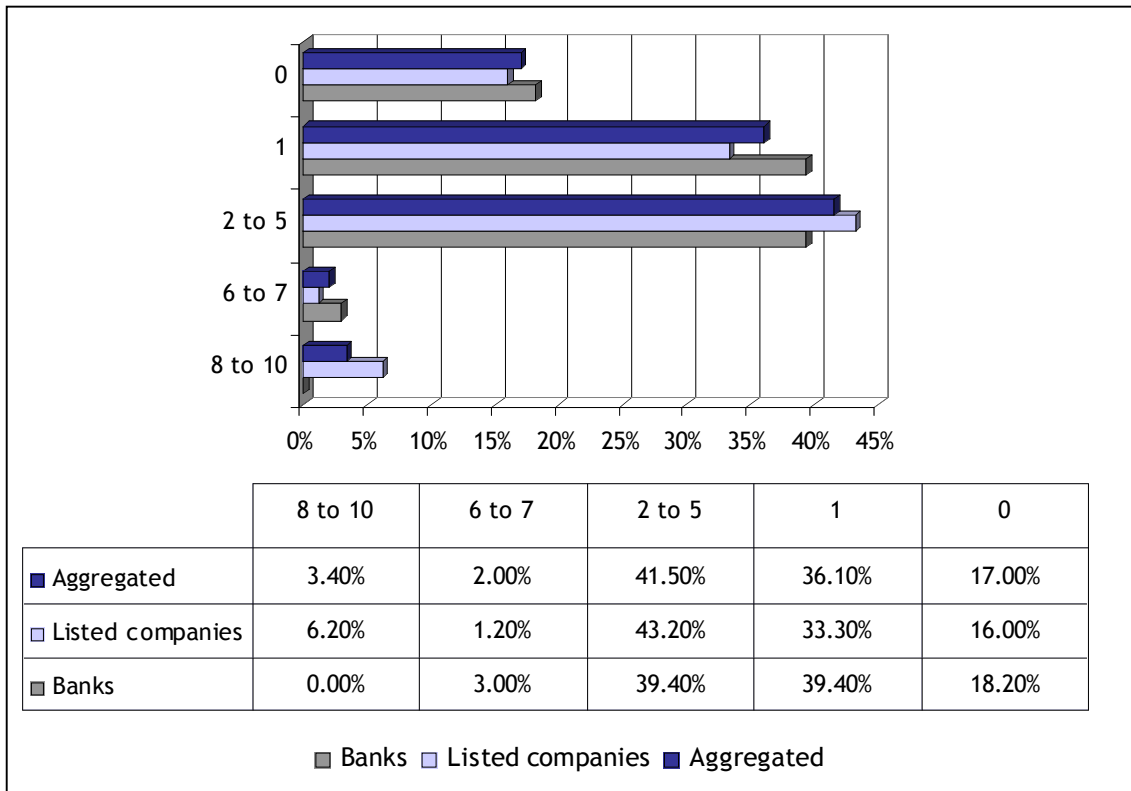
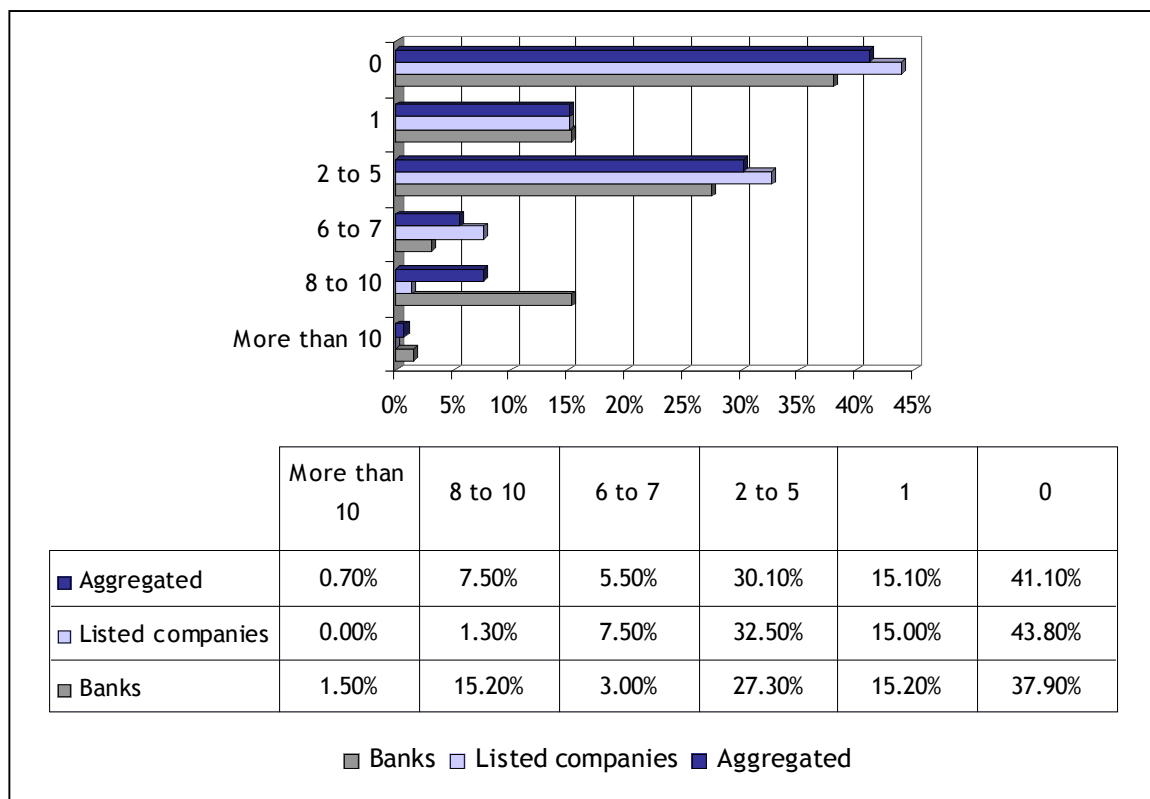


Figure C-20: Number of independent directors



However, the survey is clear on the subject of independence: 57.6% of all listed companies and 54.3% of banks only have a single, or no independent director on their board, although the presence of independent directors has become a *condition sine qua non* for good corporate governance.

Did you know that an average of ten independent directors—constituting 80% of the board—sit on the boards of S&P 500 companies operating in the financial industry in the US.¹⁹ This is partly the result of the listing rules of the NYSE and NASDAQ that a majority of directors be “independent”.

Though greater independence is highly desirable, especially for listed firms, this requirement may be unrealistic in MENA. It is essential to have some independent directors, but a majority might not be feasible, at least in the short to medium term. Any similar requirement imposed by the regulator should take into account, amongst other things, the ownership structure, the local culture, and the pool of qualified independent directors. A minimum of three independent directors to chair key board committees—the audit, nominations and remuneration committees—might be an appropriate benchmark for regulators to strive for.

c. Identifying the right mix-of-skills for the board

Independence is not a panacea. Other skills such as expertise and experience, and characteristics such as integrity and loyalty, are just as important to complete the board—qualities that help the board collectively act as a valuable advisor to the executive.

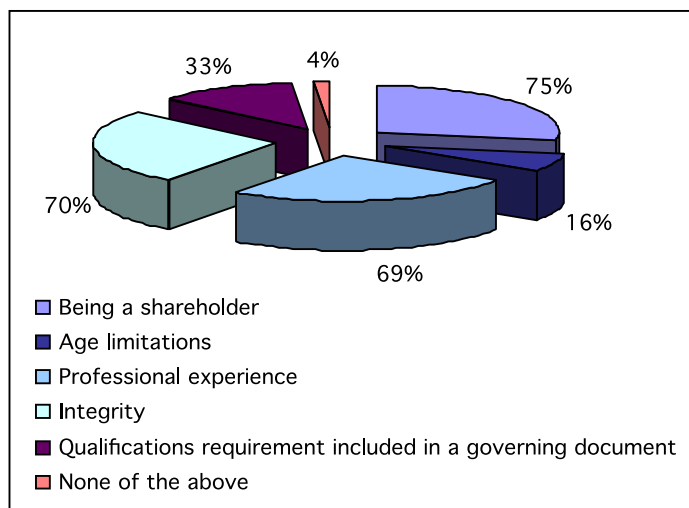
¹⁹ The Spenser Stuart Board Index, 2005.

- Some basic skills such as finance and accounting, as well as audit are universally useful to boards. Boards should ensure that they have directors with relevant industry experience, which is useful in identifying industry trends and developments, and in guiding management in setting strategy. Boards may also find it useful to have directors who are legal experts; experienced in mergers and acquisitions or re-organizations; or perhaps knowledgeable in taking companies public. At times, it could be beneficial to include the representatives of key stakeholders on the board. Experience of operating in a foreign country can also be of great benefit, for example in case of opening offices or launching products abroad.
- Characteristics and qualities such as leadership, honesty, loyalty, and integrity are of course not to be underestimated and are of fundamental importance when the board takes important decisions. For example, the ability of a non-executive or independent director to constructively challenge the traditional means of doing business or the company’s strategy developed by the CEO, who is often simultaneously the majority owner, may at first seem a nuisance but likely prove invaluable over the long run.

At a minimum, all directors should have the necessary time to properly fulfill their board duties, which can be substantial.

An overwhelming majority of responding banks and listed companies require the combination of integrity (70%) and professional experience (69%), which is very much in-line with good corporate governance (see Figure C-21). However, respondents chose “being a shareholder” as the most relevant requirement for being a director (75%), which typically leads to the creation of insider or shareholder board that may not always act in the interest of the company and all of its shareholders. Qualitative data and the authors’ experience confirm that most boards in the region are in fact ‘shareholder boards’, i.e., dominated by majority shareholders or their representatives.

Figure C-21: Requirements for being a director

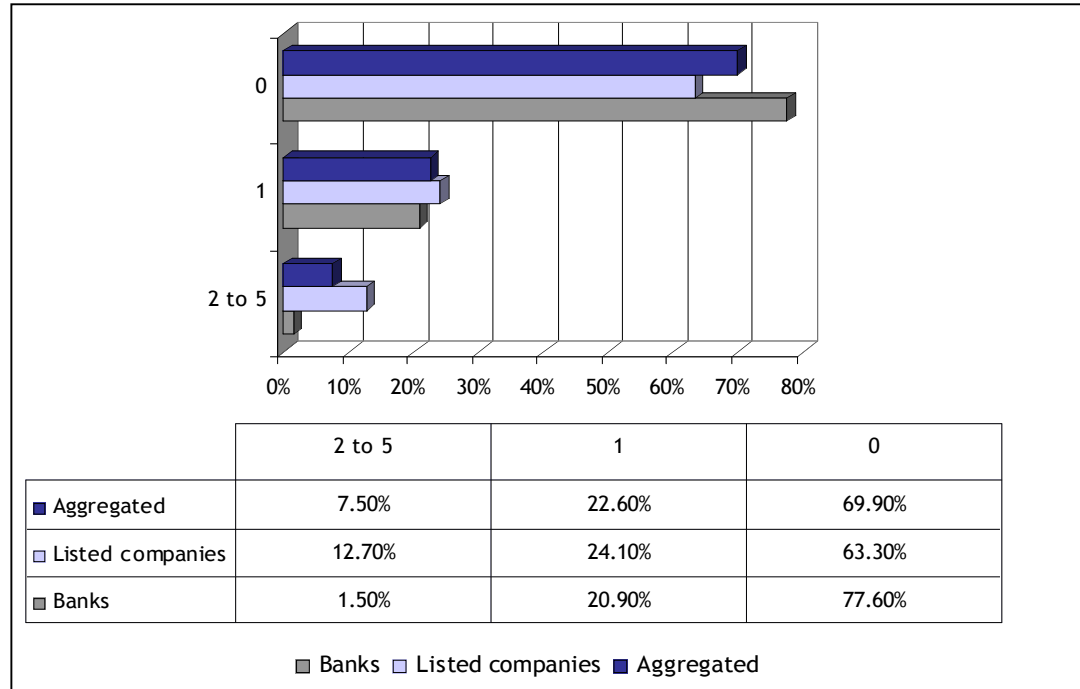


d. Balancing the boardroom: the value added of women on the board

As can be clearly seen from Figure C-22, female board members are but a small minority on most MENA boards, if they exist at all. An important majority of banks (78%) state that they do not have a single female board member, while only 1% answered that they had more than one

female director. On the other hand, one third of listed companies had at least one or more female board members, a small but important step in balancing the boardroom.

Figure C-22: Number of women on the board



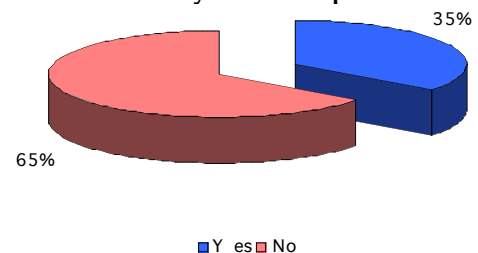
Did you know that empirical evidence shows that UK-based companies with female directors scored significantly higher in corporate governance (and hence in long-term performance) than companies with all-male boards.²⁰

iii. Board structure

a. Separating the position of board chairman and CEO

Companies operating in some countries, in particular the US and France have traditionally combined the positions of board chairman and CEO, citing improved leadership and efficiency as the main rationale for doing so. Combining these two roles is, however, not considered best practice. Indeed, most leading corporate governance codes call for a separation of the role of chairman and CEO, citing the need for effective board oversight over management, which is next-to-impossible due to the inherent conflict when combining the two positions. A non-executive chairman is also likely to be more inquisitive in guiding the board in fulfilling its main functions, in particular strategic oversight, and is ideally placed to counter the (potential) short-term focus of the CEO with an outside and long-term perspective. The main argument for separating these two functions is that the roles of the chairman and the CEO are fundamentally different, requiring different skills and

Figure C-23: Is the position of CEO and chairman held by the same person?



²⁰ The Female FTSE Report 2004, Canfield University School of Management. The study used 13 indicators to measure corporate governance in relation to gender diversity.

characteristics: while the CEO runs the business, the chairman runs the board.

A significant majority of respondents (65%) state that both positions are held by different individuals, in-line with best practice (see Figure C-23). In particular banks (72.2%) follow best practice, presumably due to central bank regulations to this effect. In contrast, 42.3% of listed companies continue to combine these two functions.

b. Companies operating in some countries, in Establishing board committees

The demands on a board continue to increase as markets globalize, regulation becomes more complex and as companies grow. Board committees can be an effective method of dealing with these challenges, and appropriate committees should permit the board to: (i) handle a greater number of issues in a more efficient manner by allowing experts to focus on specific areas and develop recommendations for the board as a whole; (ii) develop subject-specific expertise on the company’s operations, for example on financial reporting, risk management, and internal controls; and (iii) enhance the objectivity and independence of the board’s judgment, insulating it from potential undue influence of managers and controlling shareholders, in such key areas as remuneration, director nomination, and managerial oversight.

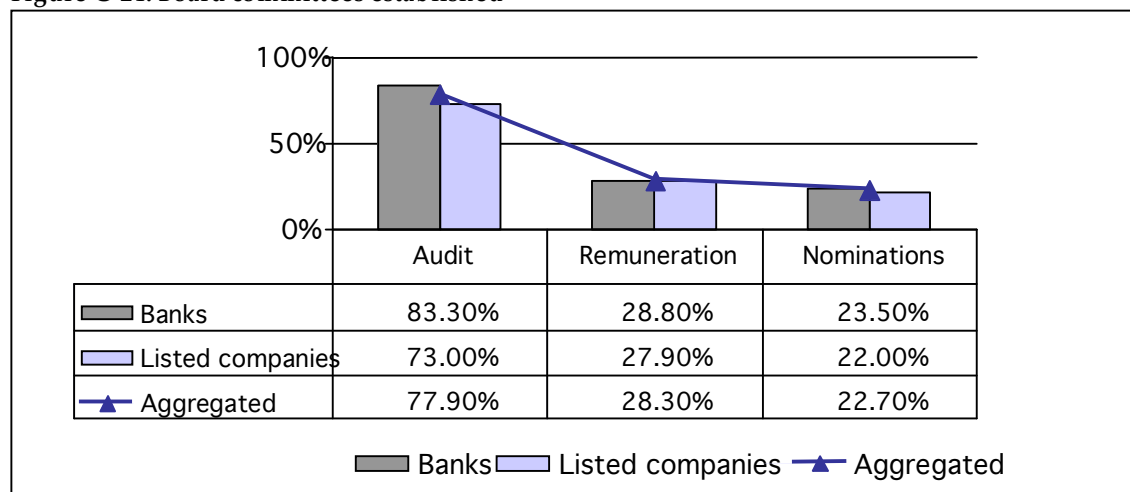
There is a great variety of committees a board may adopt. The three principal committees for the purpose of corporate governance are the audit, nomination (often called the nominations and corporate governance committee), and remuneration committees. Each of these committees should ideally be entirely composed of independent directors. At a minimum, these committees should be chaired by an independent director with the remaining members being non-executives.

It is important to note that even if the board delegates some of its authorities to a committee, the board remains the ultimate decision-making authority, and retains responsibility for all board decisions. Should committees require outside advice, they should be in a position to hire outside expertise to advise them on specific issues, such as studies on remuneration levels for executives. External advisors should not however become full members of board committees as they are not board members.

When board committees are established, their mandate, composition and working procedures should be well defined and disclosed by the board.

Figure C-24 below summarizes the percentage of boards that have put these three core committees in place. The high presence of audit committees (77.9%) is a positive sign; however, we find that only 26.4% of these committees are composed of a majority of independent directors, in-line with good corporate governance. Nominations (22.7%) and remuneration (28.3%) committees are less prevalent in the region.

Figure C-24: Board committees established



Did you know that 100% of SAP 500 boards now have an audit committee composed entirely of independent directors; that 100% also have a remuneration committee, nearly all of which are composed of independent directors; and that 98.5% of boards have a nominating/corporate governance committee, and nearly all committee members are independent directors?²¹

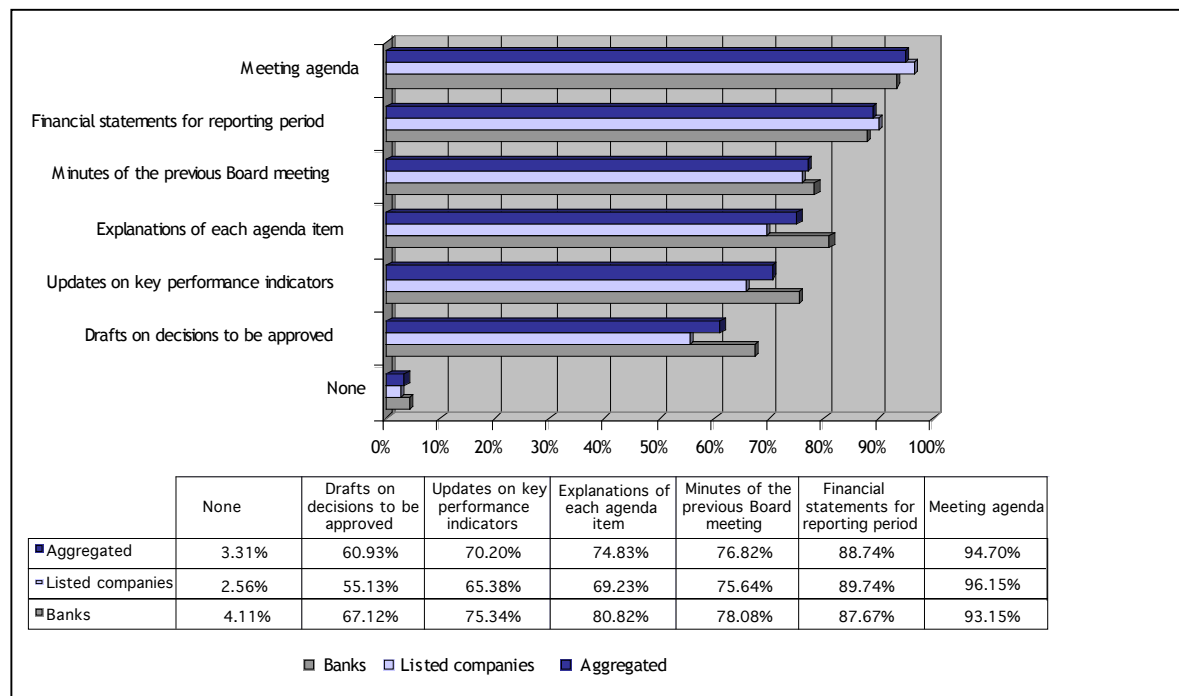
iv. Working procedures

a. The board agenda and briefing materials

The board agenda determines the issues under discussion during board meetings. It is generally put together under the leadership of the chairman by the company secretary, with input from other directors and the CEO. It is the chairman’s duty to offer directors and the CEO the opportunity to suggest items, within reason, and any director can and should request that the chairman includes a matter on the board agenda. The board agenda should strike a balance between reviews of past performance (e.g., financial statements) and forward-looking issues (e.g., strategy).

The board agenda, along with other key materials, should be combined in a board briefing book and forwarded to all board members at least five business days in advance of the board meeting. As can be seen from Figure C-25, the materials that are included in the board briefing book and then forwarded to board members appear to be complete in the majority of cases.

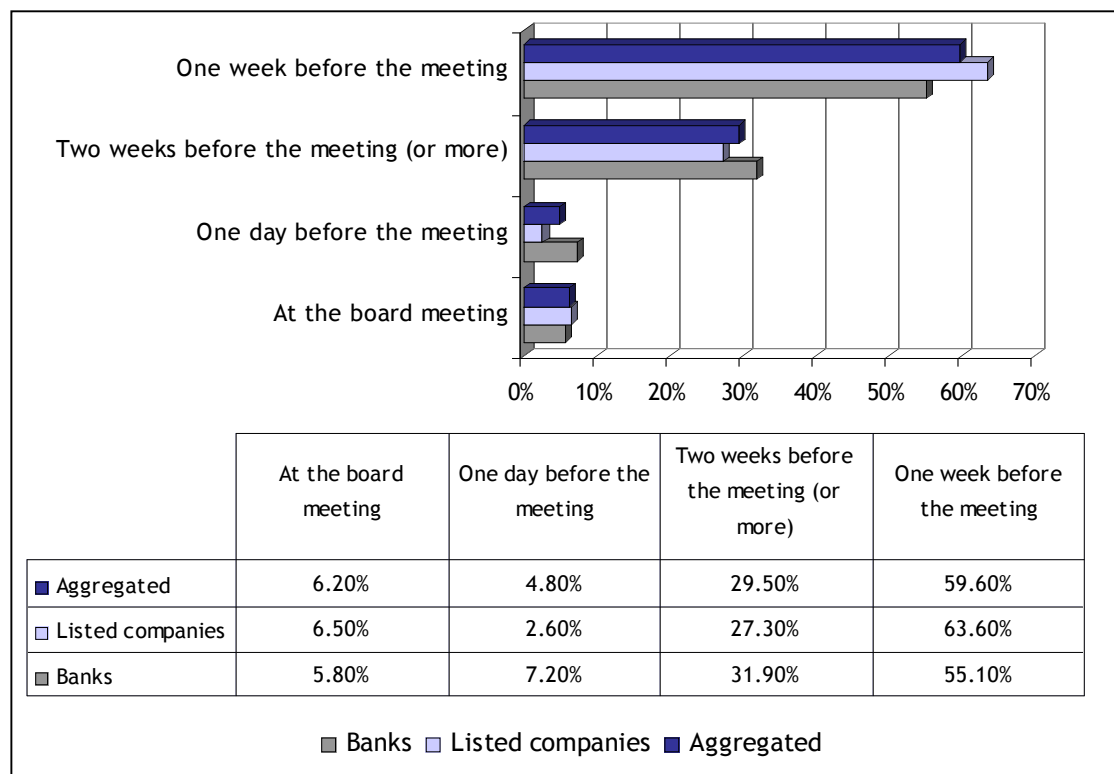
Figure C-25: Board briefing materials distributed to directors



²¹ The Spencer Stuart Board Index, 2005.

Figure C-26 shows that the majority of banks and companies provide such information one to two weeks before the board meeting, in-line with good practice.

Figure C-26: Timeliness of distributing board briefing materials



b. Meeting frequency

Board meetings should be held regularly, at least four times in a year. As a rule of thumb and in-line with best practice, six to ten meetings are likely to constitute an appropriate number of board meetings in a year, in particular when committees meet between board sessions.

Figure C-27 and Figure C-28 show that significant differences between banks and listed companies exist. On the one hand, 46% of banks answered that the board met an average of three to five times per year, and 21% stated that they met between six and nine times. Only 27% of banks’ boards meet ten to 12 times per year, in-line with best practice. Sixty percent (60%) of listed companies responded that they met on a quarterly basis and only 15% met between six to nine times per year (see Figure C-27).

Figure C-27: Meeting frequency – listed companies

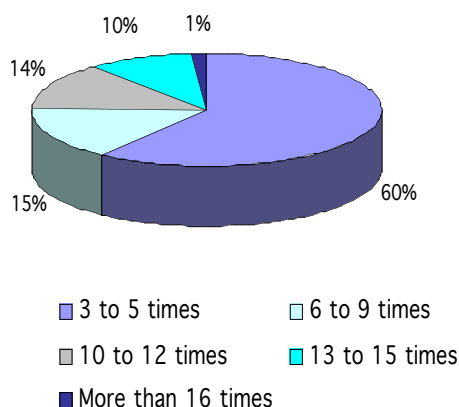
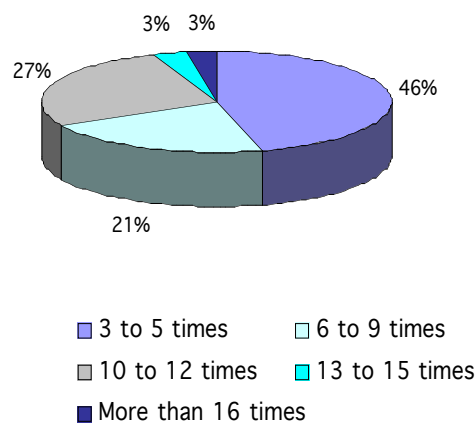


Figure C-28: Meeting frequency – banks



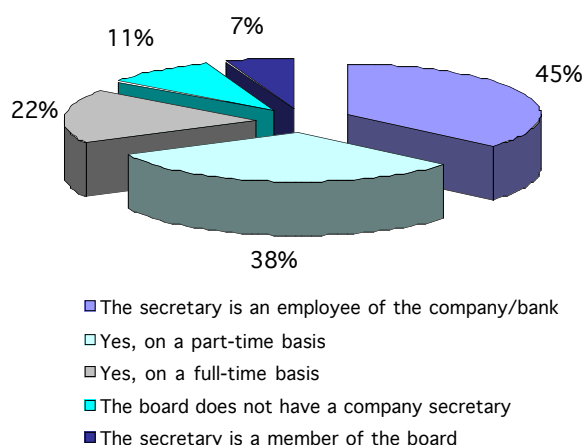
c. The role of the company secretary

Many companies have a secretary to the board; few have professional company secretaries. The company secretary can play a significant role in professionalizing the work of the board and in improving corporate governance practices. Indeed, professional company secretaries usually have legal backgrounds, understand corporate and securities law, have sufficient business knowledge to understand the company's business, and have strong interpersonal skills that allow them to help the chairman steer boards.

The company secretary is accountable to and supervised by the board to shield him or her from undue influence from management.

The majority of respondents stated that the company secretary is an employee (45%), or a part-time employee (38%), which while appropriate for smaller companies, may not be appropriate for banks and larger publicly listed companies due to the lack of time they can allocate to board and governance matters (see also Figure C-29). The company secretary should not also be a board member.

Figure C-29: The function of the company secretary



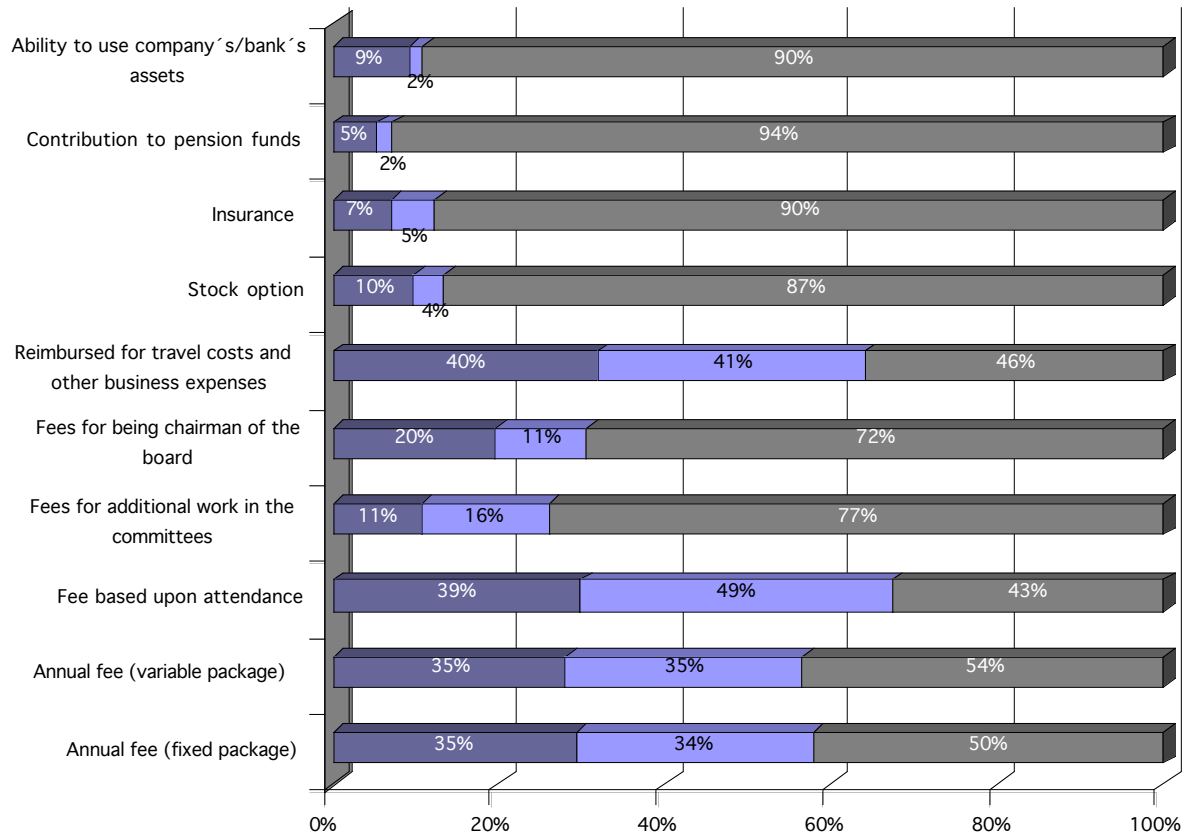
v. Remuneration policy

a. Non-executive and independent director remuneration

Non-executive and independent directors should be remunerated for their board duties. The most common form of remuneration for non-executive and independent directors is an annual fee, part or all of which should be linked to meeting attendance. The annual or meeting fee payable to directors should be the same for all non-executive and independent directors. Additional fees should be paid for additional responsibilities, such as committee membership or for chairing the board or board committees.

Setting an appropriate level of remuneration is important to safeguard the status of independent directors in that their judgment could be clouded if they receive a significant percentage of their total income in the form of a director's fee. As can be seen from Figure C-30, 42.9% of companies do not pay their directors an attendance fee. Only 16.1% of non-executives receive additional remuneration for serving on committees and only 11.3% receive fees for chairing the board.

Figure C-30: Board remuneration structure and practices



	Annual fee (fixed package)	Annual fee (variable package)	Fee based upon attendance	Fees for additional work in the	Fees for being chairman of the board	Reimbursed for travel costs and other	Stock option	Insurance	Contribution to pension funds	Ability to use company's/bank's assets
None of the above	50.00%	53.80%	42.90%	77.10%	71.80%	45.50%	86.60%	90.10%	93.70%	89.90%
Non-executive directors	33.90%	35.30%	48.90%	16.10%	11.30%	40.90%	3.60%	5.40%	1.80%	1.80%
Executives	34.70%	34.50%	39.10%	11.00%	20.20%	40.20%	9.80%	7.20%	5.40%	9.20%

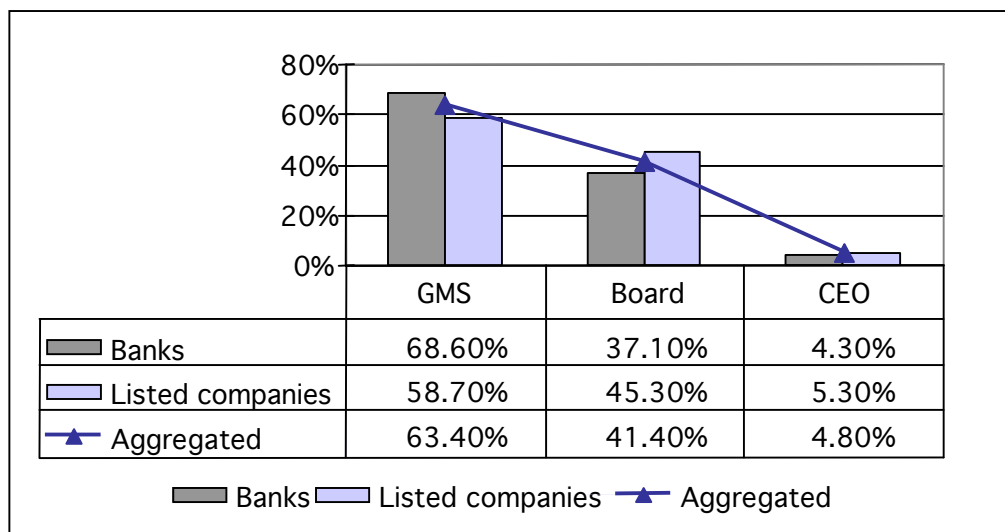
■ Executives ■ Non-executive directors ■ None of the above

Only 3.6% of banks and companies offer their non-executive directors stock options.

Did you know that performance and stock-based remuneration is typically not offered to non-executive directors? Linking non-executives remuneration to company performance can be difficult, as non-executives are not directly responsible for the day-to-day management—and hence performance—of the company.

Of particular importance is the question of who approves non-executive remuneration. As shown in Figure C-31, a significant majority of respondents (63%) assign this responsibility to shareholders, with a slight difference between banks (69%) and listed companies (59%). Best practice would call for the board's independent remuneration committee to set a policy and appropriate remuneration levels, and then to disclose both the policy and remuneration levels to shareholders.

Figure C-31: Approving non-executive remuneration



b. Executive director remuneration

The remuneration of executives should be aligned with the long-term interests of the company and its shareholders. In order to do so, best practice calls for the board to develop a remuneration policy that specifies the relationship between remuneration and performance, and also includes measurable standards that are based on the company’s objectives and key performance indicators.

When considering key performance indicators, the board and its remuneration committee may wish to consider financial indicators—for example return of equity or economic value added—as well as non-financial indicators—which for example may focus on: (i) customer satisfaction levels or retention rates; (ii) operational processes and quality measures; and (iii) internal growth, knowledge management, and training programs, as well as employee satisfaction rates.

As can be seen from Figure C-30 , the use of variable remuneration packages is, surprisingly, limited in the MENA region, with 53.8% of respondents citing that they do not offer their executives variable packages. Stock options, too, are not commonly used and only 9.8% of executives and 3.6% of non-executives have such plans. And while the fact that banks and companies do not offer their non-executives stock options is in-line with best practice, there is an argument to be made for compensating executives with such options, so-long as they are restricted over time, are not structured to induce short-term behavior, and do not dilute ownership.

As a rule, executive directors do not receive additional remuneration for their work on the board. In MENA, 39% of executives do, however, receive board fees.

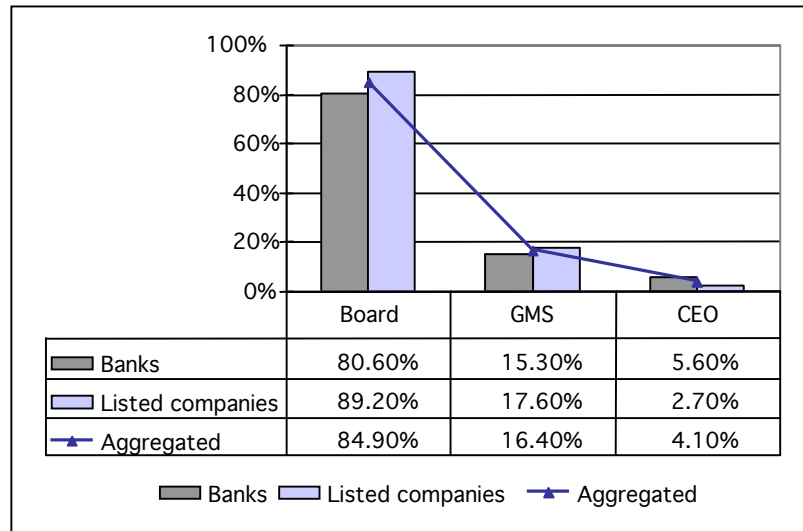
Finally, banks and companies typically do not offer their executives with pension or insurance benefits, both of which are considered long-term incentives that may help tie key executives to the company.

Setting executive remuneration policies falls under the board’s—and not management’s—authority, with the board ideally acting on the recommendations of an independent remuneration committee.

The great majority of respondents cited that the board is indeed responsible for executive remuneration (85%), with a slight difference between banks (81 %) and listed companies (89%), as depicted in Figure C-32.

As previously mentioned, only 29.3% have remuneration committees, and only 10.3% are composed of a majority of independent directors. Overall, 16% of general meetings appear to either directly vote on pay levels or policies, or have a ‘say on pay’, which is a UK-style annual advisory (non-binding) vote on compensation; and although it may not be desirable to have shareholders setting, or even approving executive remuneration, offering them a non-binding vote may send a powerful message to executives. When stock options are offered, shareholders should, however, have a binding vote due to the possibility of dilution.

Figure C-32: Approving executive remuneration

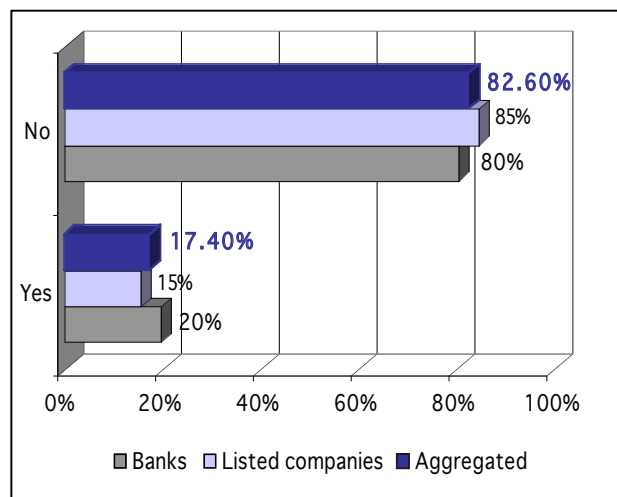


vi. Board evaluation and training

a. Board evaluation

Board evaluations can play an important role in improving the effectiveness and efficiency of the board’s work. Moreover, it demonstrates that the board itself is not above evaluation and sets the appropriate “tone at the top”. And in the same manner that executives benefit from an annual evaluation against performance objectives, boards too can benefit from an evaluation process.

Figure C-33: Conducting board evaluations



Indeed, evaluations highlight the weaknesses and strengths of the board, and action can be taken to improve the board’s effectiveness.

Did you know that in 2003, board evaluation for listed UK companies was introduced by the Combined Code on Corporate Governance? Similar rules were introduced in 2004 for companies listed on the New York Stock Exchange (NYSE), as well as across Europe through various national corporate governance codes. The result has been impressive: According to a recent survey,²² 86% of UK boards are instituting formal full board performance evaluations, as have 75% of responding German directors. Just over half (52%) of those respondents who sit on the boards of French companies state they undergo a formal review.

In comparison, and as indicated in Figure C-33, only 20% of banks and 15% of listed companies conduct evaluations.

b. Board induction training on corporate governance

In a global and increasingly complex economy, the range of issues that directors need to be informed about is daunting and ever-growing. For this reason it is increasingly viewed as a necessity to provide induction training to new board members, but also to provide opportunities to update knowledge and refresh skills through continuous professional education.

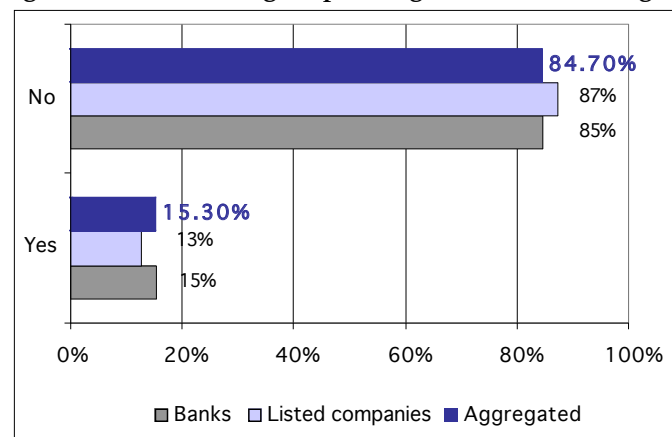
A well thought out induction process is important for all new directors and, particularly, for non-executive directors. A hallmark of a company committed to good corporate governance and a feature of most corporate governance codes (e.g., the UK Combined Code, Dutch, French, Swedish, and NYSE listing rules) is a process of induction to the board for new directors. Induction programs are typically offered by the company and focus on the company’s strategy, operations, and governance. The task of organizing the induction training is frequently assigned to the corporate secretary.

c. Board training on corporate governance

In addition to induction training, it is increasingly common for companies to offer on-going training that may be provided in-house or externally. Nobody is too senior or experienced not to benefit from continuing professional development.

Results show that director training, whether in the form of orientation or on-going training, remains scarce throughout the MENA region in that only 15.3% of respondents offer corporate governance related training to their directors (see Figure C-34).

Figure C-34: Providing corporate governance training



22

Korn/Ferry International, 32nd Annual Board of Directors Study.

Did you know that two-thirds of surveyed boards in the United States do have formal programs for director training within their companies? Fifty percent (50%) of board members are either encouraged or required to participate in director education outside the boardroom.²³

III. Building a robust control environment and processes

A strong control environment is needed to complement independent, professional and vigilant boards, thus providing companies and their shareholders with a reasonable level of assurance that the likelihood of misstatements, mismanagement, fraud, or other abuses are minimized. One of the key duties of the board is to set policies with respect to and oversee management’s implementation of the company’s control environment, in particular as regards risk management, internal controls, and the external and internal audit. The principal means by which the board oversees the control environment is through the audit committee. While management is responsible for establishing and implementing effective risk and control procedures, it is the board that remains accountable to shareholders for the effectiveness of the company’s control environment.

i. Risk management

Companies that effectively manage risk are likelier to see profits over the long run while companies that are overly cautious in their risk taking may well miss opportunities and are unlikely to succeed over the longer term. Those that do not manage risk at all or pursue risks recklessly should expect failure sooner rather than later. The challenge, therefore, is for risk to be managed effectively but not eliminated altogether, be it in the area of strategic, operational, financial, or compliance risk.

Overall, less than half of those surveyed (43%) had a risk function in place. More specifically, and as shown in Figure C-35, only 23% of listed companies had a risk manager or department in place, in sharp contrast to banks, of which 62% responded that they had a CRO, risk manager or risk department. This is to be expected, as bank regulation frequently covers specific issues related to specific risks.

As shown in Figure C-36, 82.2% of respondents that have a risk

Figure C-35: Presence of a risk function

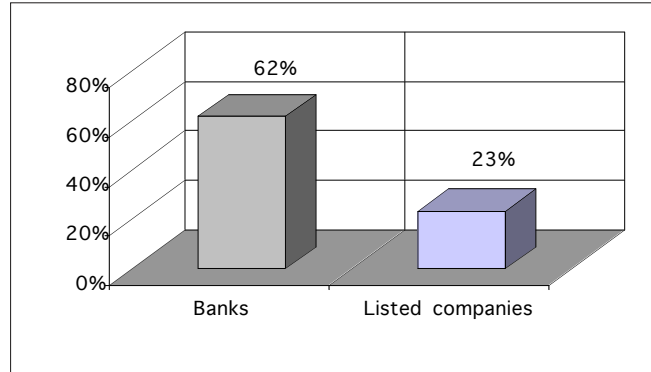
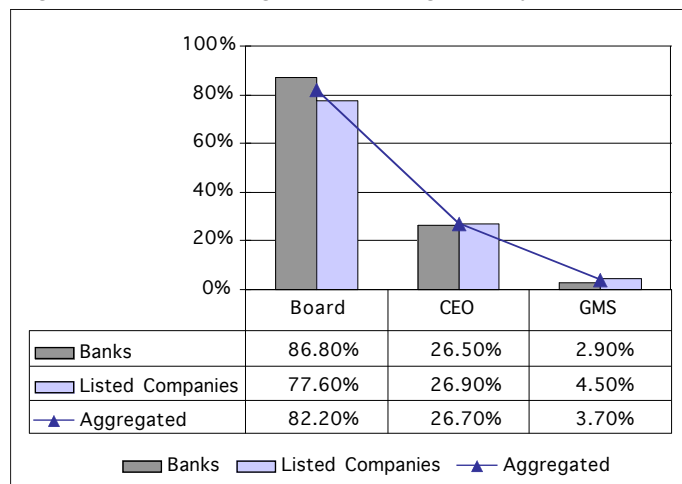


Figure C-36: Overseeing the risk management system



²³ Ibid.

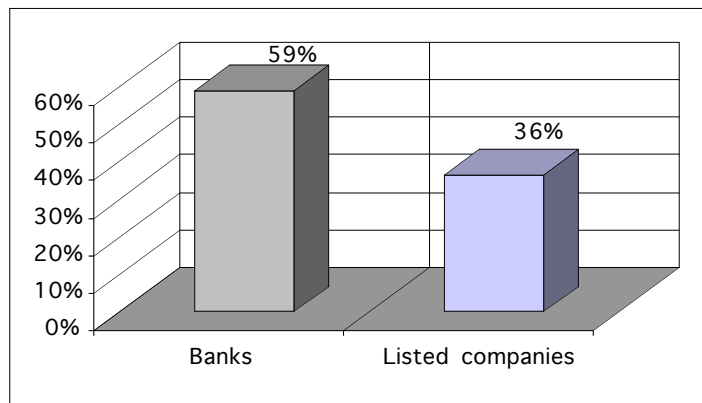
management function follow best practice in that the board oversees risk management as implemented by management. Indeed, directors are responsible for setting the risk appetite and policies, and managers for ensuring that all risks are identified, evaluated, and suitably managed.

ii. Internal controls

Directors are also responsible for overseeing the adequacy of the internal control environment and processes, as set by management, and for reviewing their effectiveness. Procedures should have been designed by management for the purpose of: (i) safeguarding assets against unauthorized use or disposition; (ii) maintaining proper accounting records; and (iii) ensuring for the reliability of financial information.

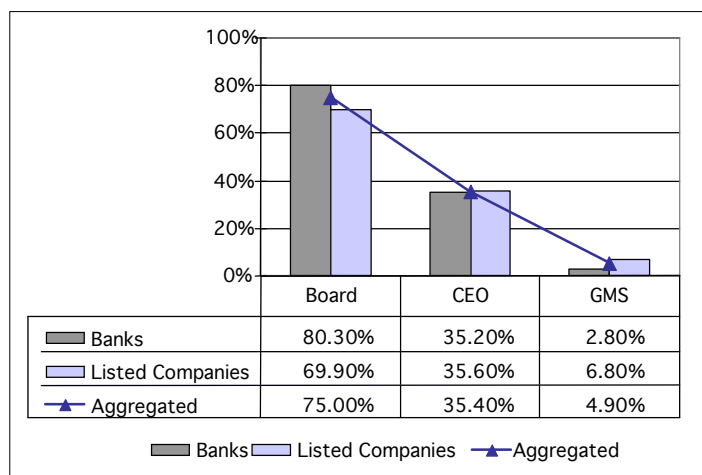
Did you know that fraud costs U.S. organizations more than \$400 billion annually, or an average organization loss of 6% of revenues? A study²⁴ found that fraud and abuse costs employers an average of \$9 a day per employee and that small businesses are the most vulnerable. Of interest is that most fraud is not discovered during routine audits, but instead most cases are exposed by whistleblowers. The study found that prevention, i.e., a robust control framework, is in fact the most cost effective defense.

Figure C-37: Presence of an internal control function



As shown in Figure C 37, less than half of the surveyed (47%) have an internal control function, i.e., controller or control department. For those with control functions, a significant majority of boards claim responsibility for overseeing this function (80.3% for banks, 69% for listed companies); however, a significant majority of CEOs (35%) are also deemed with oversight duties (Figure C 38). Best practice calls for management to set and implement, and the board to oversee the control function.

Figure C-38: Overseeing the internal control function



²⁴ The Association of Certified Fraud Examiners, report on the status of fraud and white-collar crime in the U.S., 1996.

Did you know that many directors do not request a copy of the external auditor’s ‘management letter’? This could be because they confuse the management letter with the auditor’s opinion.

A director’s first glimpse of what goes on in the internal controls of a company can be found in the management letter. The auditor’s opinion expresses the view of the independent external auditors on whether the financial statements have been prepared in accordance with applicable standards and accurately reflects the financial condition of the company. The management letter is intended to let the company know what possible weaknesses in the company’s internal controls and systems came to the attention of the auditors in the course of their work, and what steps the auditors recommend be taken. It is most likely within the audit committee’s duty of care to read management letters and to follow-up the implementation of their recommendations by management.

iii. Compliance

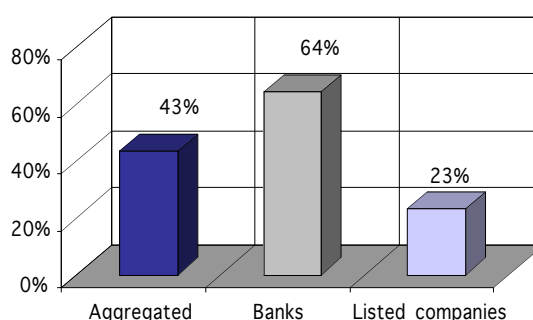
Compliance means compliance with the conduct of business rules imposed by laws and regulations, as well as internal rules and procedures.

Most banks (64%) have a compliance function in place; unsurprisingly, only 23% of listed companies reported having a compliance function (see Figure C-39). And while compliance can play an important role for all businesses, it plays a particularly important role for banks, as banks rely on staff following a detailed set of policies and procedures, requiring full compliance to protect against mismanagement or fraud. Most central bank regulations require banks to have a compliance function, and banks and their regulators should strive towards full compliance.

The internal audit’s role is to evaluate and assess the effectiveness and adequacy of the company’s risk management, internal control, and corporate governance processes and procedures. Internal audit is not responsible for ensuring that the company is compliant with internal or external requirements. This is management’s responsibility, which typically appoints a compliance officer.

Unlike internal audit, compliance is not generally an independent function. It typically reports to the company’s senior executive management, though best practice calls for compliance officers to increasingly report directly to the board and its audit committee as well. The audit committee has a responsibility to understand and oversee the compliance process. Thus, many compliance officers also have a dual reporting line to a senior manager or the CEO and the board’s audit committee. From a legal and reputational risk perspective, it is very important that the board receives regular updates from the compliance officer as to the state of affairs.

Figure C-39: Presence of a compliance function

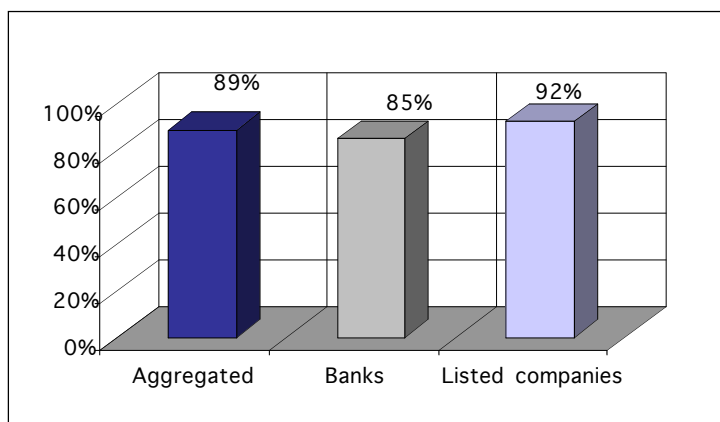


iv. The internal audit

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and corporate governance processes.²⁵ A progressive internal audit function plays a critical role in providing executive management and the board with an objective and comprehensive view of the business processes, identifying risk and controls, and validating that the controls are effective in mitigating risk.

Figure C-40 shows that the great majority of banks (85%) and listed companies (92%) have an internal audit function.

Figure C-40: Presence of an internal audit function

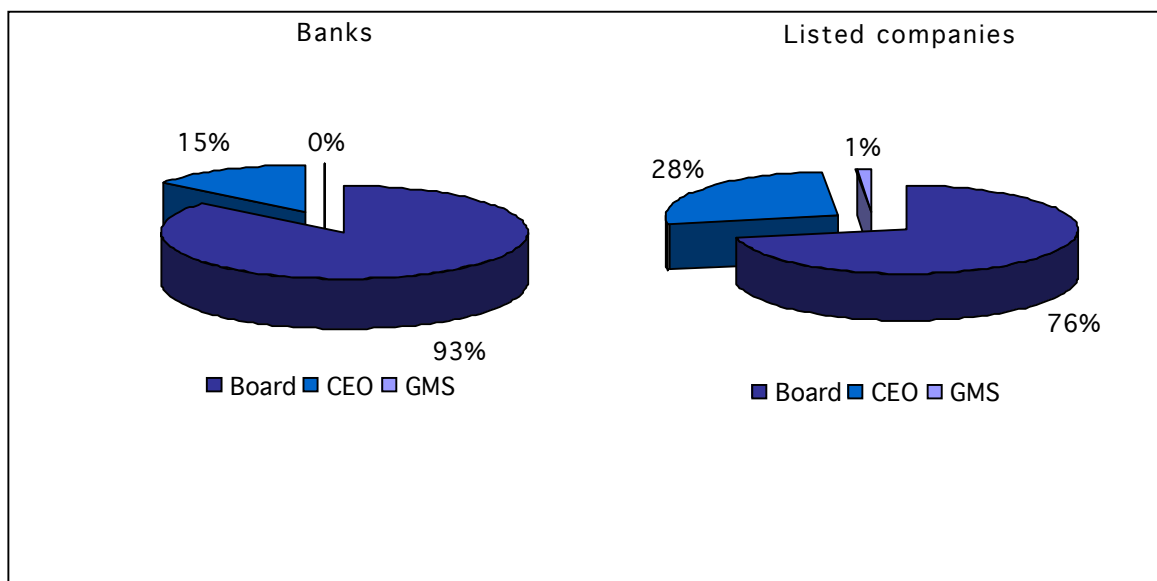


On the other hand, for this internal audit function to be effective, it is important that the CIA carries out his or her activities independently. Best practice thus calls for dual reporting responsibilities, with the internal auditor reporting to management administratively and to the board functionally.

Figure C- 41 shows that the majority of banks (93%) and listed companies

(76%) follow best practice, with the board overseeing the internal audit function. However, because few audit committees in the region are composed of a majority of independent directors, the CIA’s independence may be jeopardized in practice.

Figure C-41: Overseeing the internal audit function

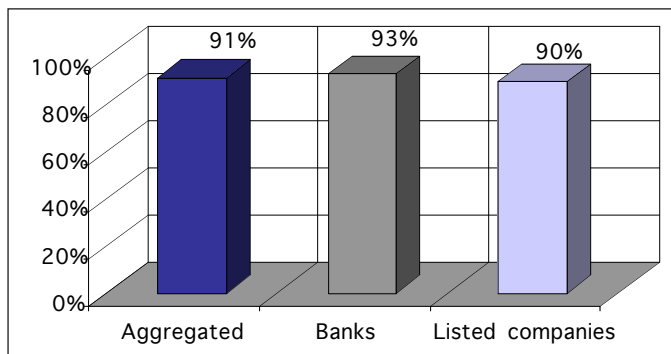


²⁵ www.theiia.org

Did you know that a useful starting point for identifying leading internal audit practices and for benchmarking the organization’s audit function against these is the guidance and standards issued by the Institute of Internal Auditors (IIA)? The audit committee should ensure that internal audit function has sufficient resources to meet the standards required by the IIA and (as recommended by the IIA), subject the internal audit function to an independent assessment every five years. Companies may further wish to consider allowing their internal auditors to receive a certificate from the IIA.

v. The external audit

Figure C-42: Presence of an external auditor

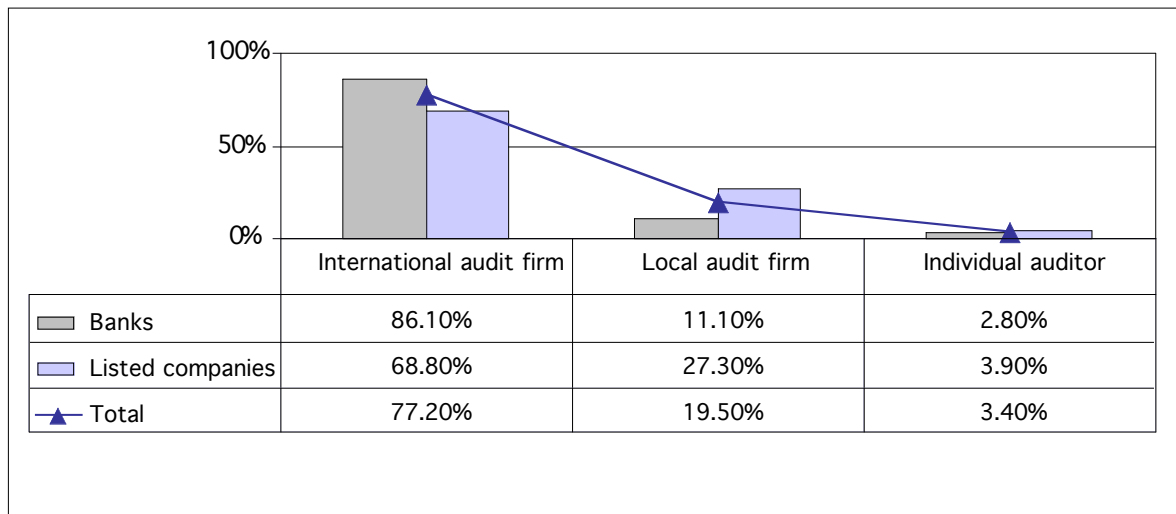


An annual external audit should be conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects. External auditors should be

accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.

Professional standards require the external auditor to state whether, in their opinion, the financial statements are presented in conformity with an underlying accounting principle or standard, and to identify those circumstances in which such standards have not been consistently observed in the preparation of the financial statements. As can be seen from Figure C-42 above, 91% of those surveyed had an external auditor. Figure C-43 shows that the great majority of these constituted international audit firms.

Figure C-43: Nature of the external auditor



Did you know that the independence of the external auditor has become a central corporate governance concern in the wake of a number of European and US scandals? To deal with the skewed incentives which may arise with a conflicted external auditor, a number of countries now call for disclosure of payments to external auditors for non-audit services. Examples of other provisions to underpin auditor independence include, a total ban or severe limitation on the nature of non-audit work, which can be undertaken by an auditor for their audit client, mandatory rotation of auditors (either partners or in some cases the audit partnership), a temporary ban on the employment of an ex-auditor by the audited company, and prohibiting auditors or their dependents from having a financial stake or management role in the companies they audit. Some countries take a more direct regulatory approach and limit the percentage of non-audit income that the auditor can receive from a particular client or limit the total percentage of auditor income that can come from one client.

a. Rotating audit firms or partners

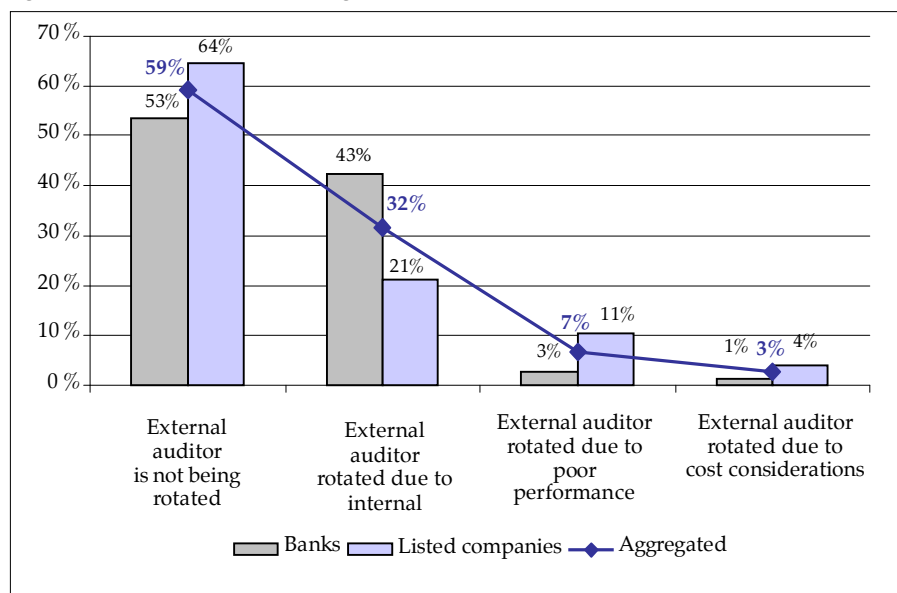
Suggestions to improve auditor independence often include the rotation of either the audit partner or the firm itself after a certain period, typically between five and seven years. Rotation is important because it prevents the external auditor from developing an excessively close relationship with the client, which may eventually compromise the auditors' necessary independence.

However, some critics of auditor rotation suggest that it can also cause audit failure. An auditor that has taken a new assignment is typically unfamiliar with the business and most likely to commit errors during the first year of the audit. Moreover, many will argue that audit firm rotation may actually be counter productive in some emerging markets, where there may be a limited number of qualified audit firms, in particular for audits of financial institutions; and rotating these firms would run counter to the interests of shareholders.

The idea of audit firm or partner rotation is not practiced by banks and listed companies: of those surveyed, only 32% have an audit-rotation policy in place and 53% of respondents had not changed their external auditor in the previous five years (see Figure C-44).

Most international audit firms have their own audit partner rotations in place; the board will, however, wish to assure itself that its auditor follows this best practice.

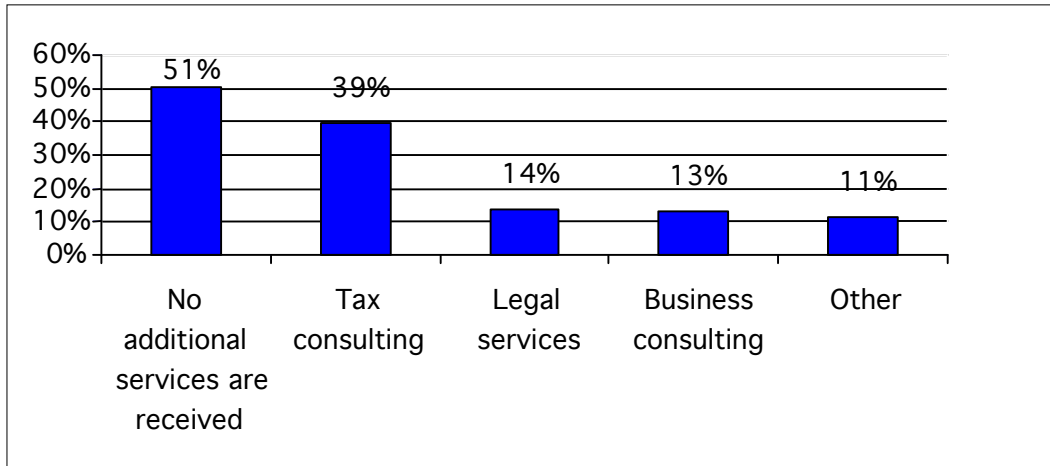
Figure C-44: Reasons for rotating the external auditor



b. Suggestions to improve Providing other, non-audit services

Figure C-45 shows that a slight majority of external auditors (51%) do not provide their clients with any other services that may jeopardize their independence, in-line with best practice. Only a small minority provide legal services (14%) or business consulting (13%), which could run counter to the notion of auditor independence should the fees generated from such services be material in relation to the audit fee. Tax consulting, provided by 39% of auditors, is typically not considered a major source of business income for the external auditor.

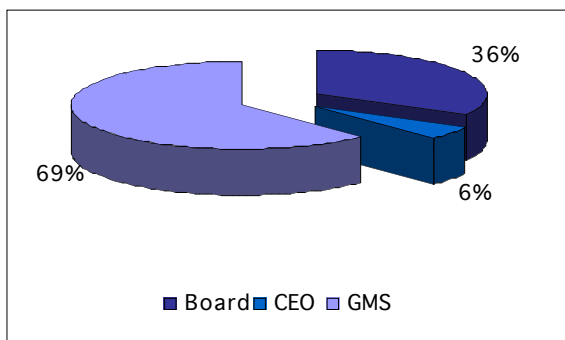
Figure C-45: Additional services provided by the external auditor



c. Nominating the external auditor

Best practice calls for the board’s audit committee to conduct a competitive bidding process for the external auditor, the board to then nominate and shareholders to finally approve the appointment of the external auditor. And while 69% of banks and listed companies allow their shareholders to appoint the external auditor, 36% of respondents stated that the appointment of the external audit firm is a competence of the board (see also Figure C-46).

Figure C-46: Appointing the external auditors

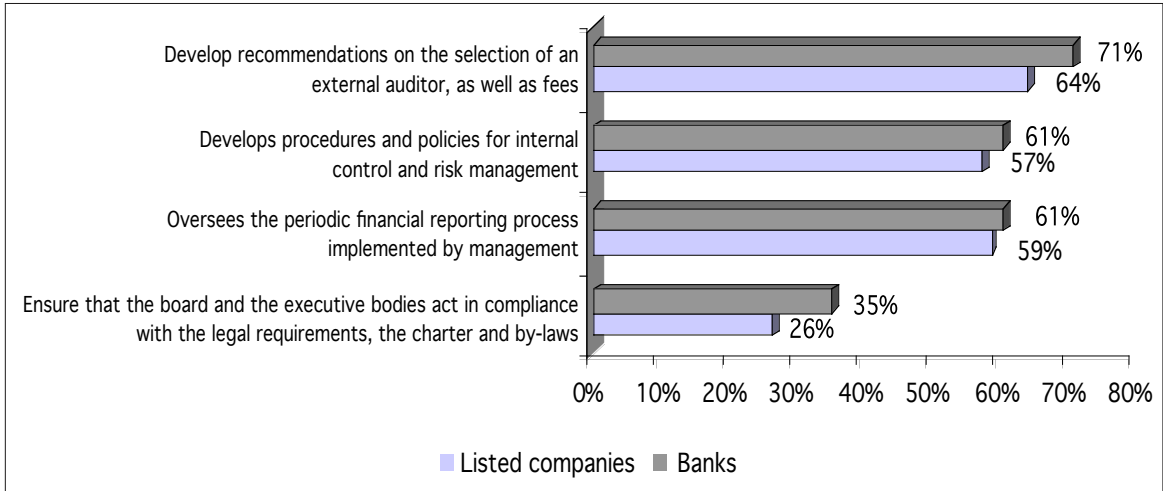


vi. The audit committee

The audit committee’s primary responsibilities are to: (i) review and report to the board the most critical accounting policies, which are the basis for financial reports; (ii) help the board establish internal control policies; (iii) oversee the company’s internal audit function; (iv) ensure for an effective compliance function; as well as (v) oversee the overall relationship with the external auditor. Some boards request that their audit committees support the board in establishing an appropriate risk management framework, although banks are increasingly

establishing separate board-level risk committees for this purpose. As can be seen from Figure C-47, the role of the audit committee is broadly understood, however, the role of the committee in overseeing the compliance function needs to be strengthened, as only 30.6% of audit committees feel responsible for this area.

Figure C-47: The role of the audit committee



IV. Strengthening transparency and disclosure

Disclosure is considered to be one of the most important elements of sound corporate governance. It is difficult for shareholders, other stakeholders and market participants to effectively monitor and properly hold the board and management accountable when there is a lack of transparency. Companies that are transparent are thus more highly regarded and ultimately valued by investors.

Disclosure and transparency is important within the bank or listed company as well, ensuring that there is proper accountability and responsibility, oversight and guidance, between shareholders, directors, and managers.

Timely and accurate public disclosure should be proportionate to the size, complexity, ownership structure, economic significance, and risk profile of the bank or listed company, as well as whether the entity is publicly traded or not.

Did you know that 69% of 137 institutional investors in charge of some of the world's largest portfolios in 16 countries identified transparency as a top priority when considering an initial investment?²⁶ Banks and listed companies would be well served to develop a clear communications strategy, possibly a disclosure policy or investor communications function, to ensure that they are providing investors the information they seek in the most effective manner.

i. What information is being disclosed?

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation.

a. Financial disclosure

Financial disclosure encompasses the bank's or company's balance sheet, income statement, statement of cash-flows, statement of equity, and notes to the financial statements.

As can be determined from Figure C-48 and Figure C-49, financial information is generally disclosed by both banks and listed companies, which is likely due to the fact that regulation in this area is typically specific, detailed, and enforced. Most of those surveyed provided financial information to shareholders through the local press (94.7%), general assembly (93.4%), annual report (88%), and company's website (85.9%), in-line with good practice.

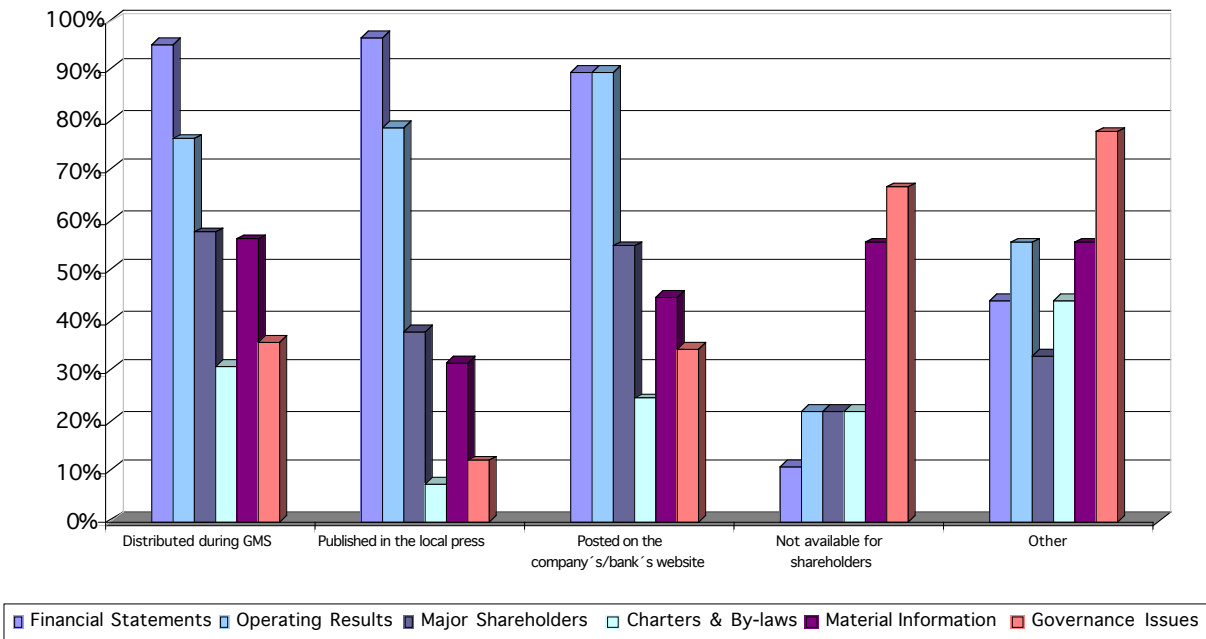
b. Non-financial disclosure

In addition, best practice calls for the disclosure of non-financial information, in particular: (i) operating results; (ii) ownership and voting rights; (iii) key corporate documents, including articles of association, relevant charters and by-laws, and policies; (iv) material events; and (v) corporate governance related information, for example, information on the board's composition and structure.

Disclosure in this area—where legal and regulatory requirements are typically insufficient or altogether absent—is much weaker. Results show that the disclosure of corporate governance related information, as well as charters and by-laws, is particularly weak among banks and listed companies (see Figure C-48 and Figure C-49). However, it is worth noting that a relevant majority of companies provide this information upon a shareholder's request.

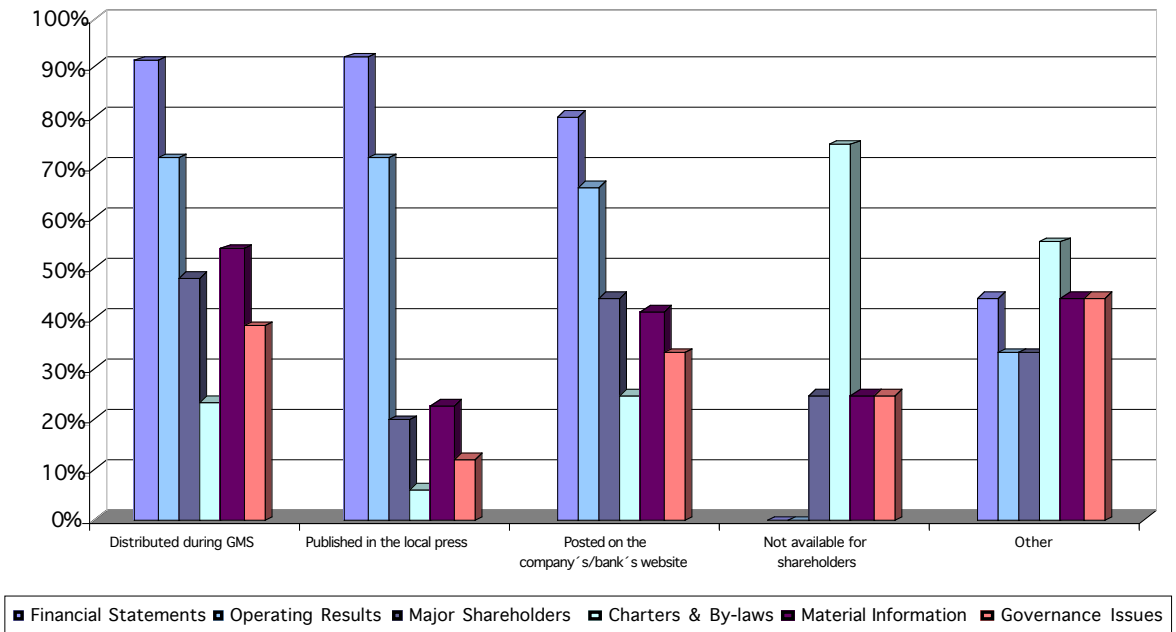
²⁶ "Investors on Risk. The Need for Transparency", Ernst & Young, 2005.

Figure C-48: Information disclosure by banks



As for listed companies, results are quite similar to those of banks except for the use of electronic communication (e-mail and corporate website), which are more frequently used by banks than listed companies.

Figure C-49: Information disclosure by listed companies



ii. Where to disclose information: the use of the annual report and internet

a. Web-based disclosure

There is an increasing trend internationally to use corporate websites to disclose financial and non-financial information.

With respect to financial information, as can be seen from Figure C-50 and Figure C-51, 82% of banks but only 61% of listed companies stated that their annual report was published on their website, which typically (but not always) contains a full set of financial information.

However, information disclosure on specific financial statements could be improved upon, in particular for listed companies where web-based disclosure is weak.

Figure C-50: Internet-based financial disclosed by banks

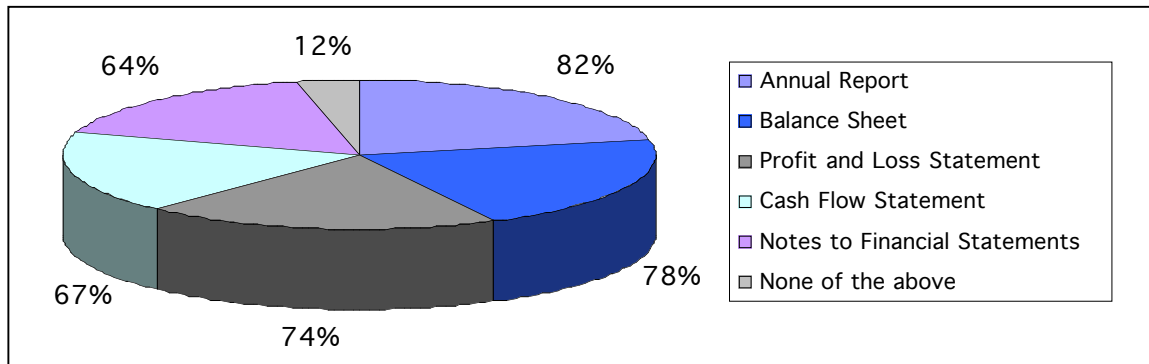
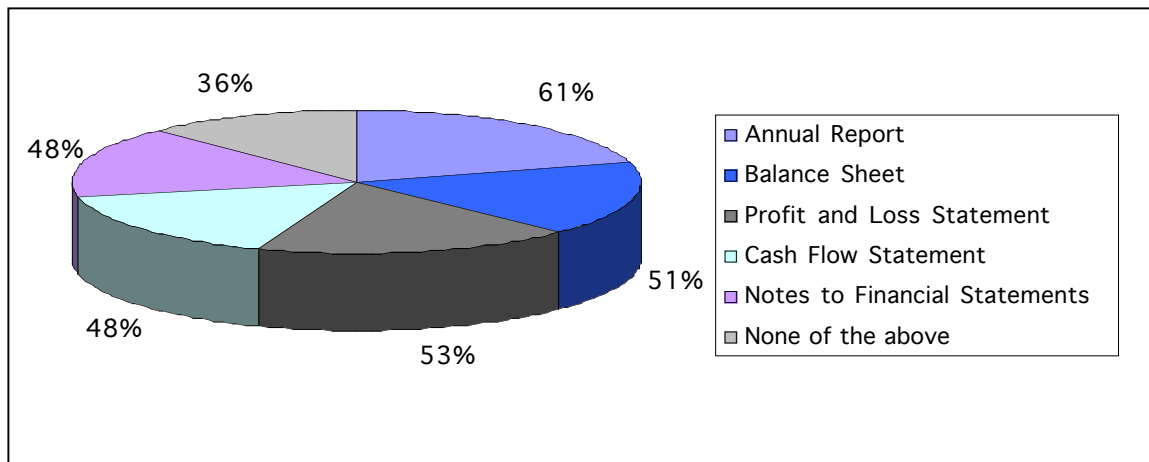
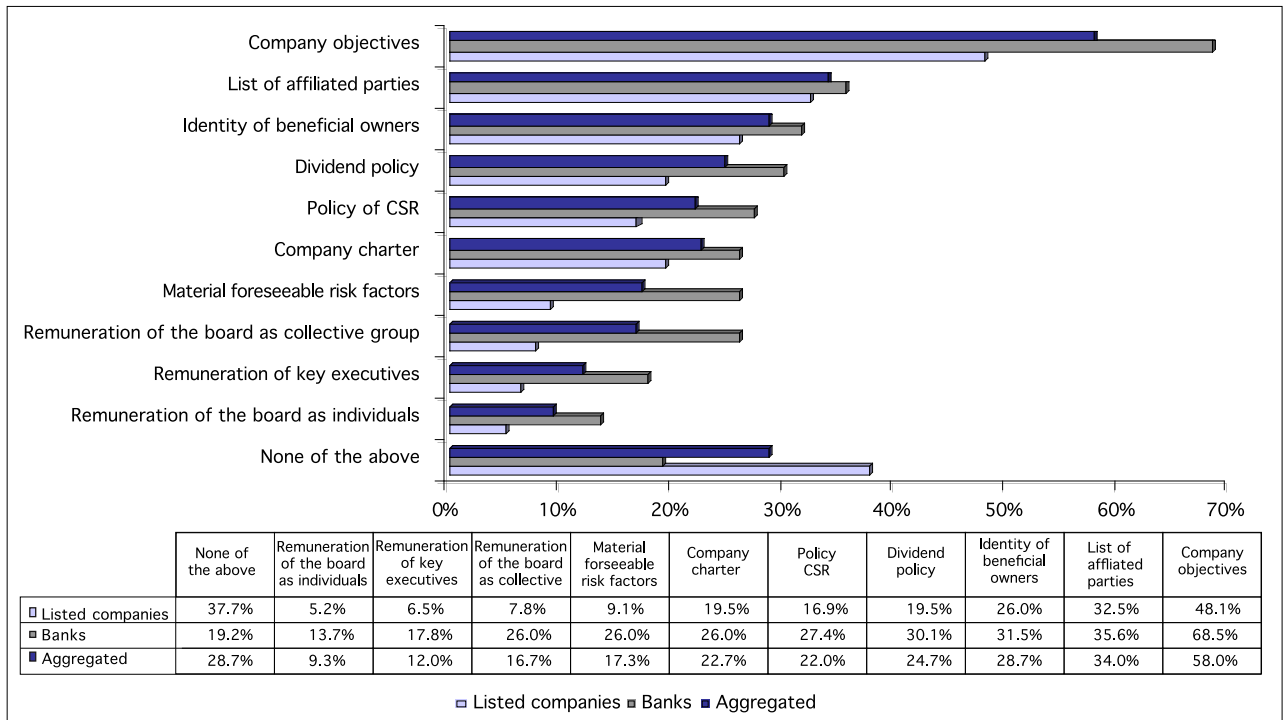


Figure C-51: Internet-based financial disclosed by listed companies



As for non-financial information, an important majority, 68%, do publish their objectives, however, disclosure in other areas remains lackluster, with few banks and listed companies publishing their beneficial owners (28.7%), dividend policies (24.7%), charters (22.7%) or remuneration (9.3%). Banks appear to be more transparent in disclosing non-financial information than listed companies, as can be observed from Figure C-52 .

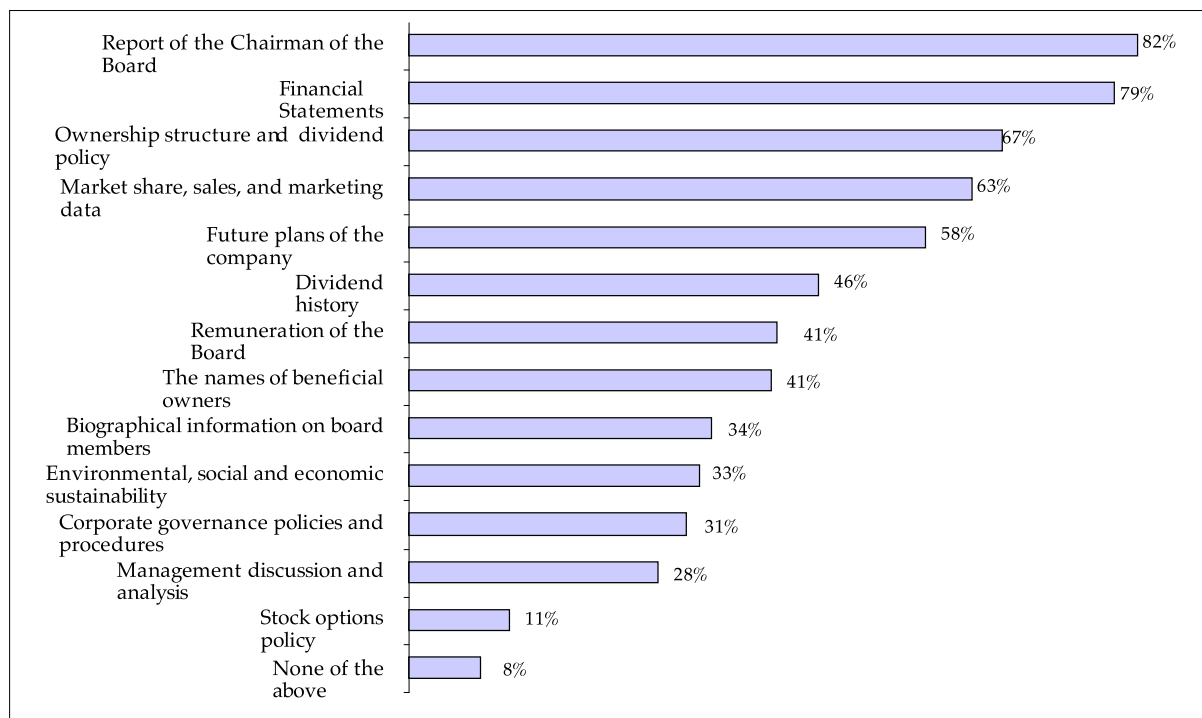
Figure C-52: Internet-based non-financial disclosed information



b. Disclosure in the annual report

A vast majority of banks and listed companies comply with those disclosure requirements typically mandated by law, such as the chairman’s report, financial information, and the external auditor’s report. Non-financial disclosure in the annual report, again, remains weak, and Figure C-53 shows that few respondents included a section on management’s discussion and analysis (28%), or indeed the bank’s or company’s policies towards corporate social responsibility (33%), or corporate governance (32%).

Figure C-53: Information disclosed in the annual report



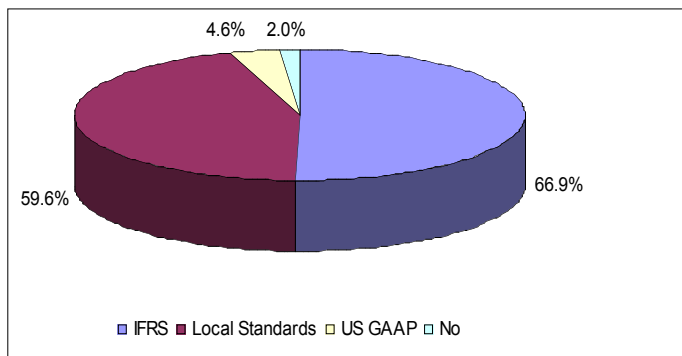
Of note is that listed companies show a slightly higher degree of information disclosure than banks, with the exception of disclosure in the area of “environmental, social, and economic sustainability” as well as “corporate governance policies and procedures”, where banks rank slightly higher. This may be due to the secretive nature of the banking industry as a whole, as well as the difficulty of quantifying and qualifying financial information for banks, which in contrast to companies is forward looking.

iii. How best to disclose information?

The corporate governance framework should not only ensure that timely and accurate disclosure is made on all material matters regarding the corporation, but that information is prepared and disclosed in accordance with high quality standards of financial (and non-financial) disclosure.

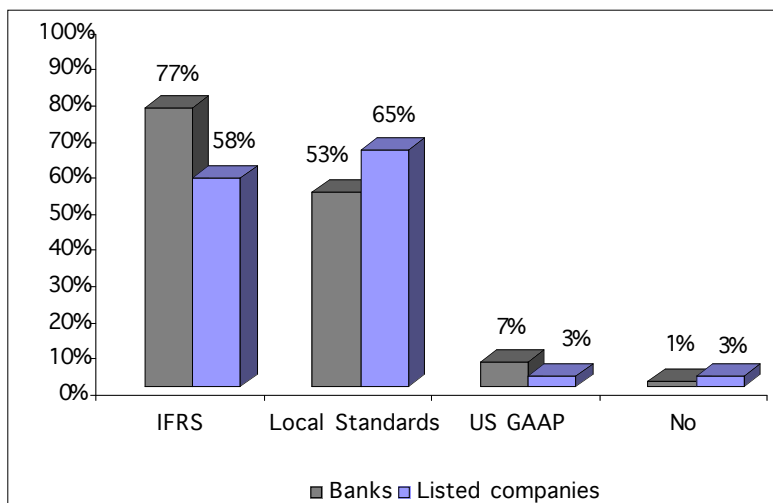
It is increasingly considered best practice to adopt IFRS, which today are viewed as the accepted international standard for financial reporting, and which improves the quality, reliability, transparency, and comparability of financial information, and thus improves insight into company performance comparable across countries. As seen in Figure C-54 below, 67% of respondents stated that they disclose information based on IFRS, along with the 59.6% also reporting according to local reporting standards; only 4.6% report according to US GAAP.

Figure C-54: Reporting according to International Financial Reporting Standards



Because most central banks in MENA require the banking sector to report in accordance with IFRS, in contrast to the market regulators, 77% of banks indicate that their financial reporting is done in accordance with IFRS, compared to 58% of listed companies (see Figure C- 55).

Figure C-55: Reporting according to International Financial Reporting Standards



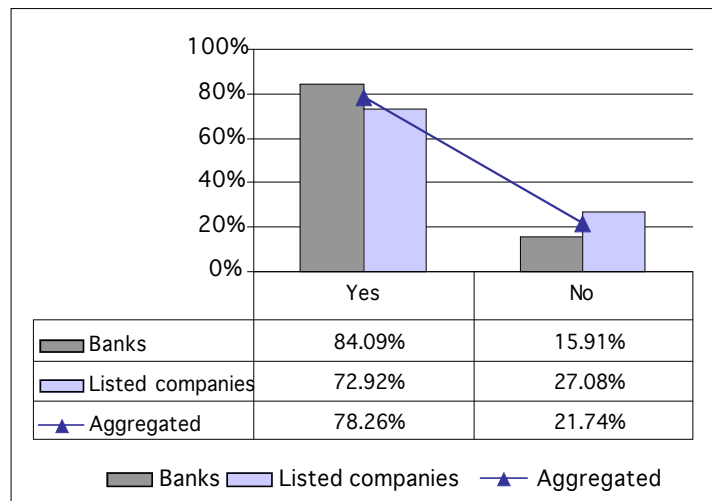
However, this data should be treated with caution, as most countries in the MENA region have not fully adopted IFRS—by issuing a law or regulation referring to IFRS as developed by the International Accounting Standards Board (IASB)—but have either opted out of individual IFRS or have translated IFRS but have not updated these translations. As a consequence, not all respondents that stated their compliance with IFRS may be actually doing so in practice.

iv. Special focus: consolidation of financial information

Complete disclosure of intra-group relations, transactions and their financial terms, and consolidated accounts is a crucial pre-requisite to make the group’s functioning transparent. When preparing consolidated accounts, companies should follow uniform accounting policies for the parent and its subsidiaries or, if this is not practicable, the company must disclose this fact and the proportion of items in the consolidated financial statements to which different policies have been applied.

Figure C-56 demonstrates that financial consolidation is widespread among banks and listed companies that are part of a group and consequently might consolidate their financial statements. However, that listed companies are less likely to do so than banks, 73% vs. 84%.

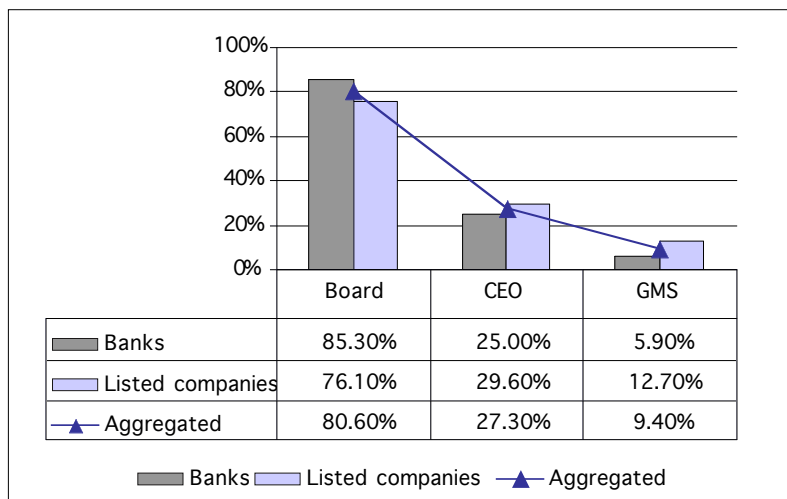
Figure C-56: Financial consolidation in groups of companies



v. Who is responsible for disclosure?

Establishing the disclosure policy should be the responsibility of the board; management in turn is responsible for implementing that plan and communicating with stakeholders under the framework of that policy. As shown in Figure C-57, 80.6% of respondents comply with this best practice, however, there is a significant difference when considering banks (85.3%) and listed companies (76.1%).

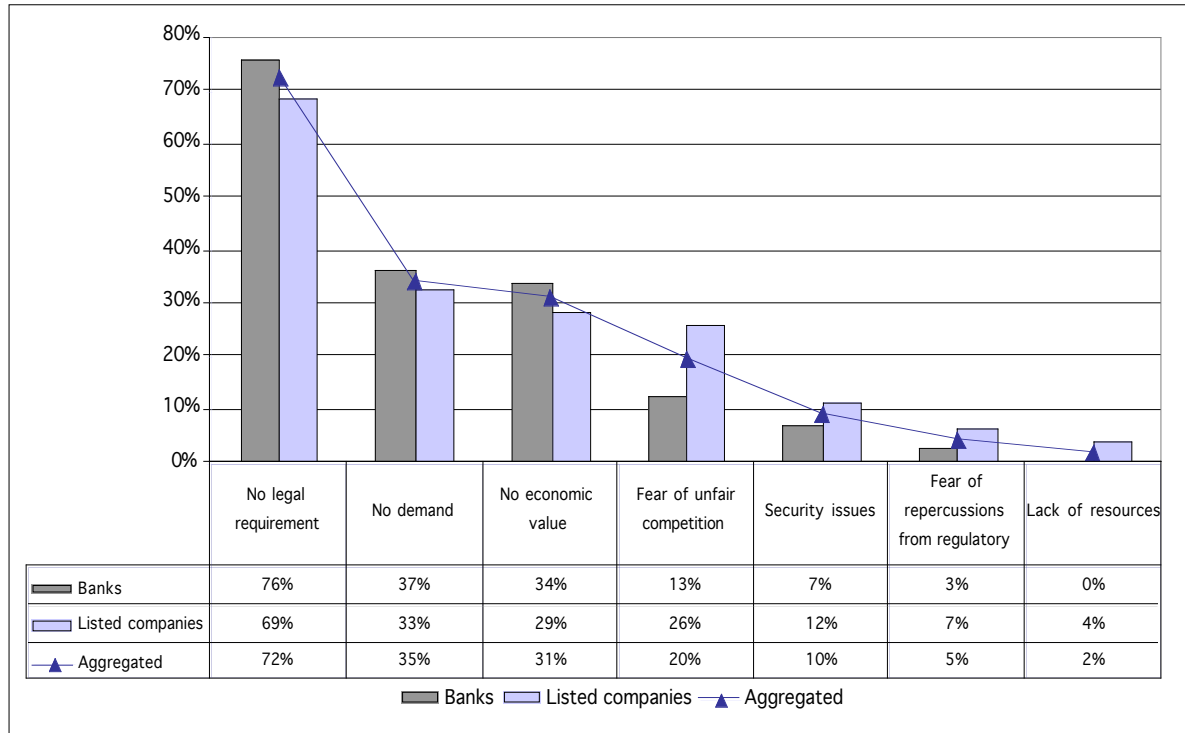
Figure C 57: Approving disclosure policies



vi. Factors preventing disclosure

The main barriers cited by banks and listed companies as to why they do not fully implement best practice in the area of disclosure are shown in Figure C-58. Accordingly, most respondents continue to view disclosure from a compliance point of view, rather than an effective tool for managing stakeholder relations and adding value to their business.

Figure C-58: Main reasons preventing disclosure



V. Protecting shareholder rights

Shareholders are the owners of the corporation—it is their property—and it is in their interests that the corporation operates and directors and managers must exercise their duties and responsibilities. The most basic rights that shareholders should enjoy include the right to: (i) secure methods of ownership registration; (ii) convey or transfer shares; (iii) obtain relevant and material information on a timely and regular basis; (iv) participate and vote in general assemblies; (v) share in the profits of the corporation; and (vi) participate in, and be sufficiently informed on, fundamental decisions such as amendments to the articles of association, issuing additional shares and conducting extraordinary transactions.²⁷

The quality of shareholder protection will affect the depth of capital markets, ownership patterns, and the efficiency of allocating resources. Where laws and corporate action are protective of shareholders and well enforced, shareholders tend to be willing to invest their capital and financial markets tend to be broader and more valuable.

Shareholder rights are generally provided by law and directors and managers do not have the right to abridge them. However, following laws and regulations by “the letter or book” rather than “in spirit” are two different matters, and directors and managers can influence *whether* and *how* legal requirements are complied with in practice.

²⁷ From the OECD Principles of Corporate Governance, 2004.

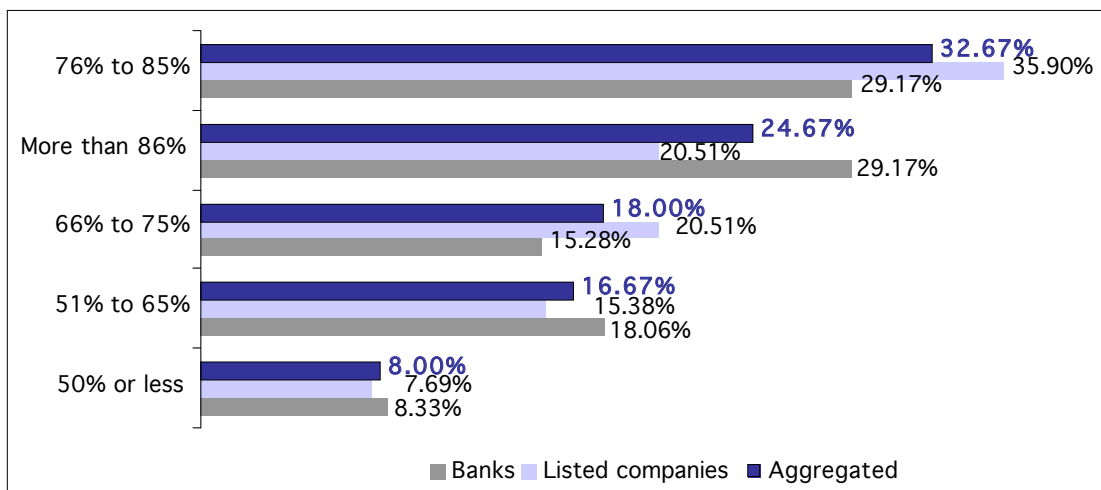
Did you know that director should have the interests of the company and all of its shareholders at heart? In some cases, a director nominated by a certain shareholder might find that their position conflicts with that of other directors (and the shareholders they represent). Equitable treatment may not mean that all shareholders are treated equally; some shareholders enjoy different rights according to their level of shareholding and may have different goals. It does, however, imply that shareholders are treated fairly and with equal regard and respect. This precept conforms to the requirement that directors act in the best interests of all shareholders and not just the company or shareholder that may have nominated and/or elected them to the board.

i. Participating in general assembly meetings

Shareholders should have the right to participate and vote in general assemblies.

Figure C-59 shows that shareholders in the region attend general assemblies.

Figure C-59: Percentage of shareholders attending the general assembly

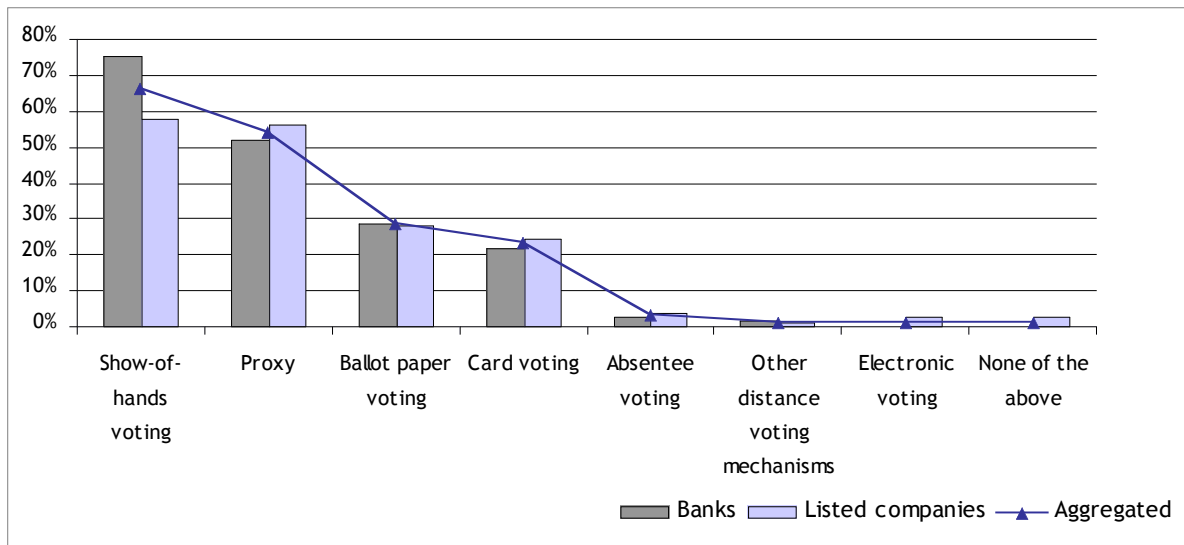


The vast majority of banks and listed companies confirmed relatively high attendance levels during their previous general assemblies, demonstrating that shareholders are interested and willing to engage with their companies.

It is one thing to attend, another to actively participate in and be able to exercise basic shareholder rights during these general assemblies, such as nominating, and then electing or dismissing board members.

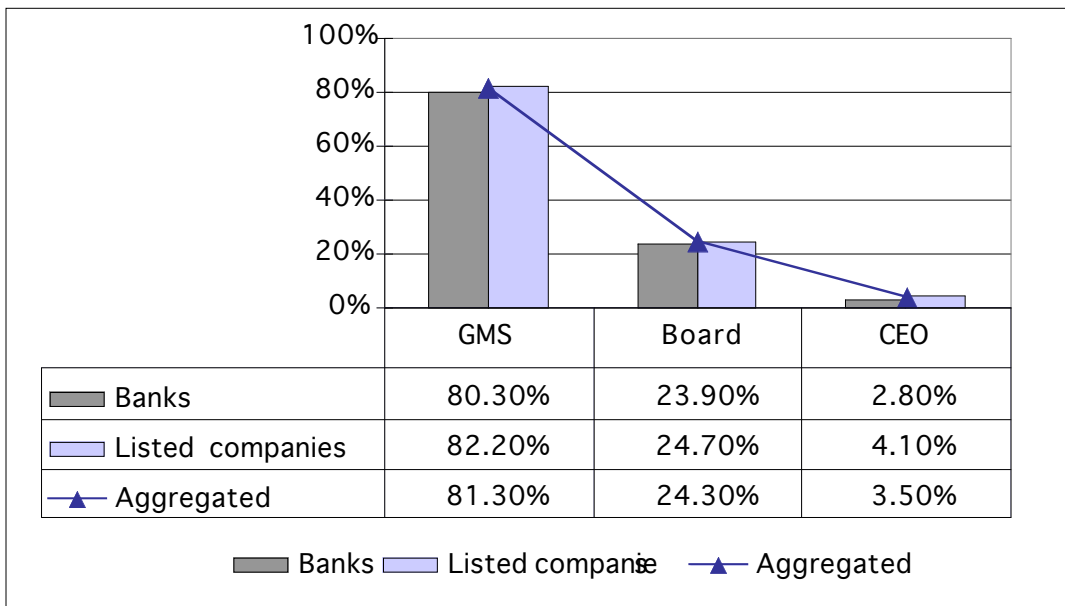
One such right is the right to vote, either in person or in absentia. The following Figure C-60 shows the mechanisms in place and available to shareholders. As can be seen, voting at the majority of general assemblies is still conducted by show-of-hands (66.2%), and only slightly more than half of respondents (54.3%) cited proxy voting as an alternative. At 1.3%, electronic voting is virtually non-existent.

Figure C-60: Voting mechanisms in place and available to shareholders



Another basic right is the right for shareholders to elect board members. In the MENA region, Figure C-61 demonstrates that board members are elected by shareholders in the vast majority (81%) of banks and listed companies surveyed.

Figure C-61: Electing and dismissing board members



However, while it is good practice to allow shareholders to vote on directorships, it is also considered good practice to establish a proper nominations process, allowing for shareholder and the board itself, through an independent nominations committee, to nominate directors for shareholder approval. Of note is that an independent nominations committee is best placed to build a board with an appropriate balance of executive, non-executive and independent directors, as well as an appropriate mix-of-skills.

ii. Safeguarding the right to share in the profits of the organization

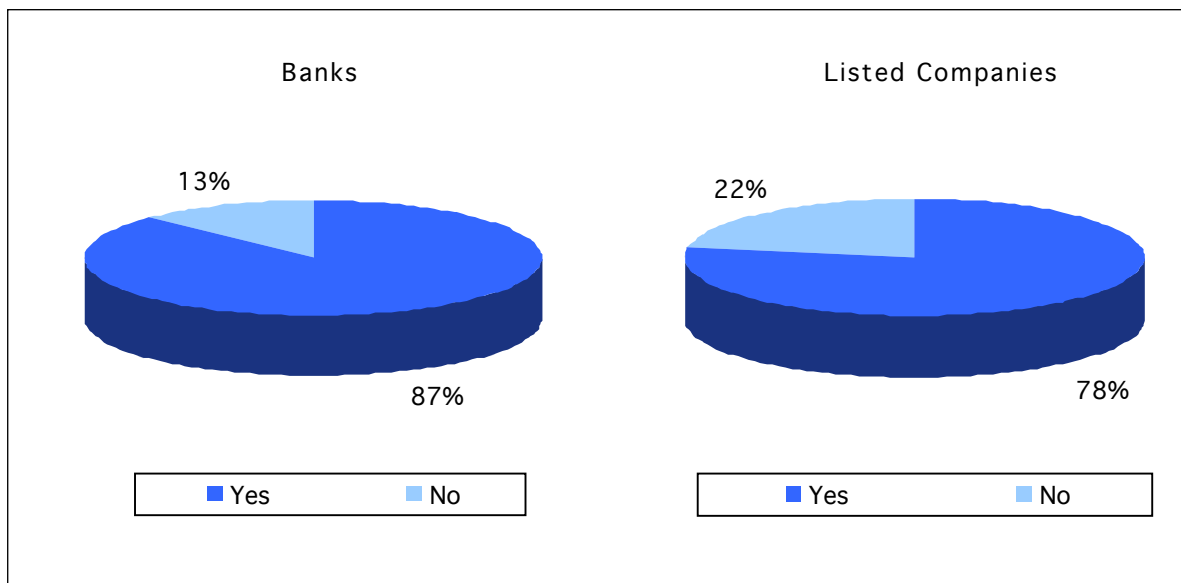
Shareholders invest in companies to receive a return, and as such they hold an exclusive claim on the residual profits of the corporation. There are two ways in which shareholders can share in the profits of the organization: they may benefit from capital gains and/or receive dividends, i.e., if the bank or company declares dividends (there is as such no right to receive dividends). Unfortunately, there are many ways in which this fundamental right can be evaded or eroded, primarily through insider dealing, conflicts of interest, and/or related party transactions undertaken by company insiders.

Related party transactions are not necessarily contrary to good corporate governance. Nevertheless, related party transactions are particularly vulnerable to abuse and thus require special supervision. Best practice in this area calls for related party transactions to be evaluated by non-conflicted directors to the transactions, and that the transaction is conducted at “arm’s length”. Material related party transactions may be approved by shareholders. Proper internal disclosure of personal interests by managers and directors *ex ante*, as well as *ex-post* disclosure to shareholders, also constitutes good practice. Finally, the conflicted directors should abstain from voting on the issue at hand; best practice would further call for conflicted directors to excuse themselves from the deliberations on that particular agenda item.

In order for the board to exercise proper oversight, it should assure itself that there: (i) is a clear written policy with respect to related party transactions; and (ii) are sufficient systems and internal controls in place that will signal these transactions to the board.

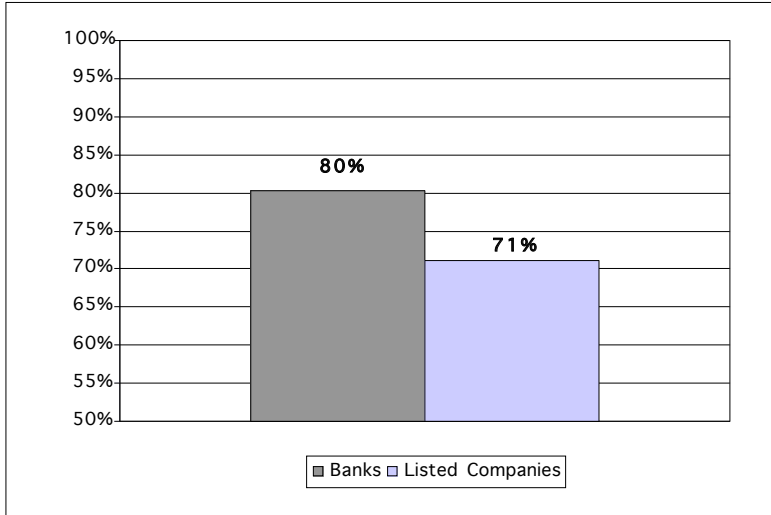
As can be seen from Figure C-62, most laws or internal document require banks and listed companies to disclose related party transactions.

Figure C-62: Mandatory disclosure of related party transactions



As shown in Figure C-63, a number of banks (80%) and listed companies (71%) have established policies on conflicts of interest and related party transactions; of those that had not, only 34.7% of respondents showed interest in developing such policies in the future.

Figure C-63: Establishing policies on conflicts of interest and related party transactions



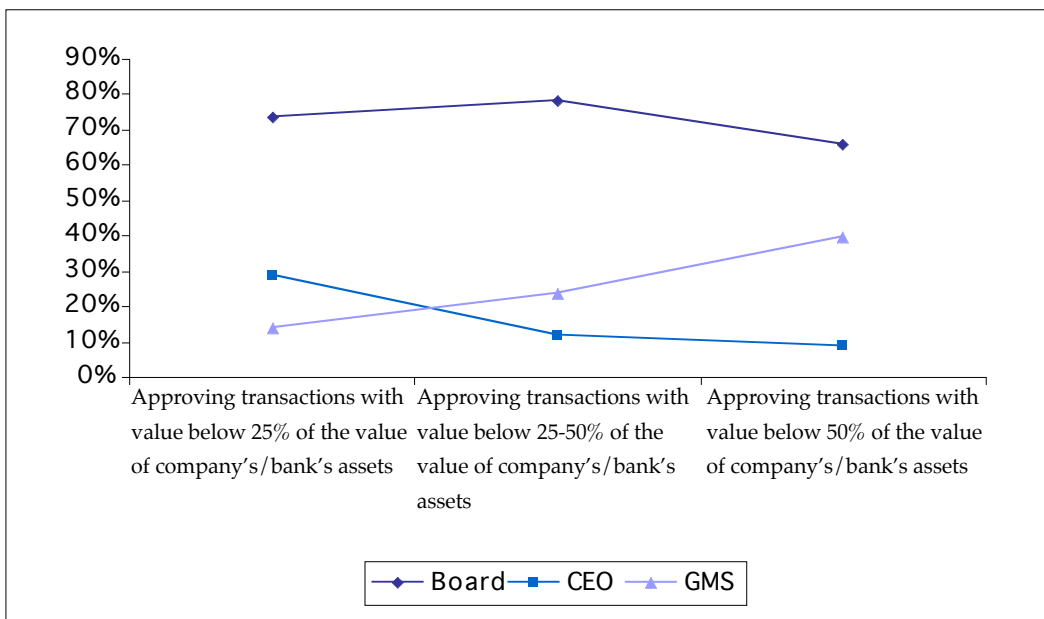
However, such policies are only effective when respected by managers and directors. Unfortunately, 54.7% of respondents thought that directors failed to avoid conflict of interest situations, and that 62.7% used inside information for their benefit.

iii. Participating in and being sufficiently informed on fundamental decisions

One of the main functions usually assigned to the board is to control and supervise extraordinary transactions, including major capital expenditures, mergers and acquisitions, and divestitures.

The following Figure C-64 illustrates who has competence over the approval of major transactions taking into consideration the book value of company’s or banks’ assets.

Figure C-64: Approving extraordinary transactions



A significant majority of the respondents, approximately 70%, stated that their board is generally responsible for approving extraordinary transactions, regardless of their value. An important minority stated that the competence to approve extraordinary transactions above a certain threshold, e.g., over 50% of book value, is assigned to the shareholders (40.8%).

And while there is much debate in the corporate governance community as to whether shareholders are best placed to vote on such transactions, or whether instead directors working with management and their detailed knowledge of the situation should do so, it may well be prudent to allow shareholders a final say on such matters.

iv. Protecting minority shareholder through pre-emptive and tag-along rights

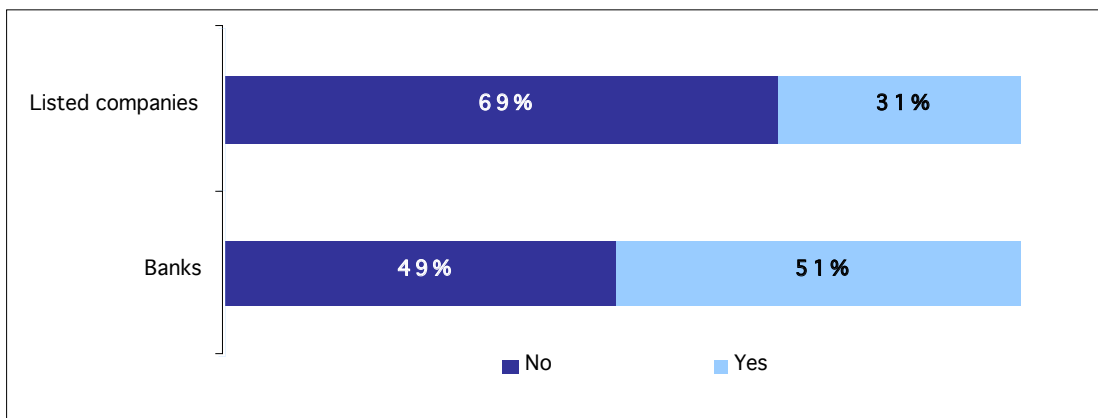
Both pre-emptive and tag-along rights are means of promoting equitable treatment among shareholders.

Pre-emptive rights allow a shareholder to maintain a proportionate share of the ownership of a corporation when it issues new shares. Otherwise, their relative percentage of share ownership would be diluted. In most MENA jurisdictions, an existing shareholder has the right to buy additional shares of a new issue to preserve equity before others have a right to purchase shares of the new issue.

Tag-along rights on the other hand are a contractual obligation used to protect minority shareholders. When a majority shareholder sells his or her stake, then the minority shareholders have the right to join the transaction and sell their minority stake in the company at the same price. This means that all shareholders can effectively sell their shares for the same price rather than having tiered pricing.

The following Figure C-65 shows that while approximately half of banks protect their minority shareholders through tag-along rights (51%), only a minority of listed companies (31%) do so.

Figure C-65: The use of tag-along rights

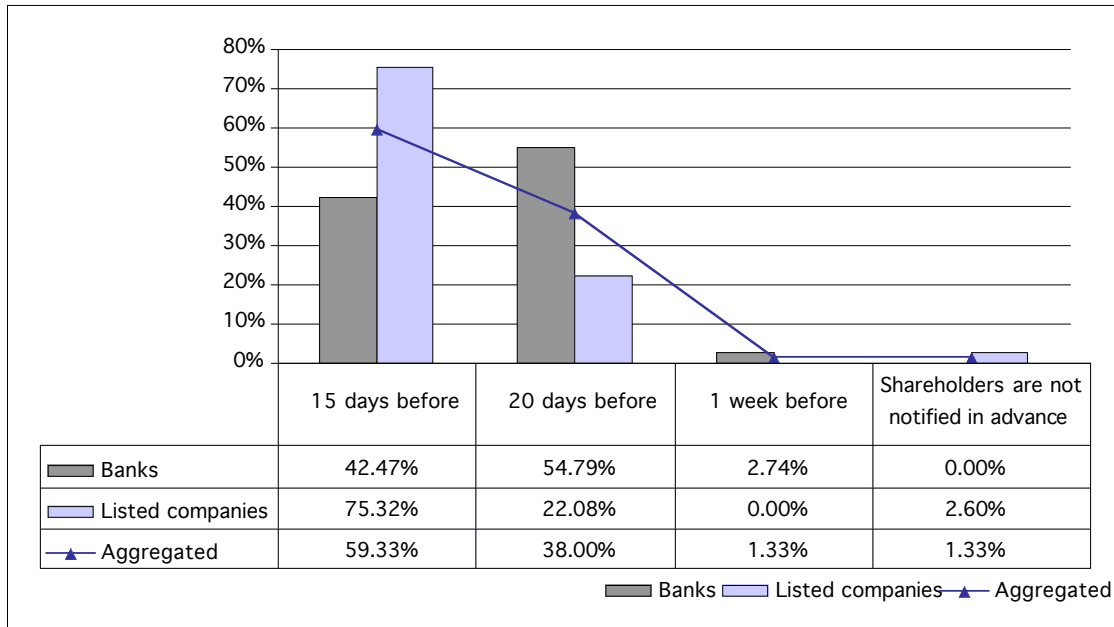


v. Obtaining relevant and material information on a timely and regular basis

The majority of disclosure and transparency issues are covered in the previous section. In addition, best practice calls for shareholders to be furnished with sufficient and timely information concerning the date, location, and agenda of the general assembly, as well as full and timely information regarding the issues to be decided at the assembly. General assembly notices should provide shareholders reasonable time to receive agendas, consider voting items, make arrangements to attend the meeting, and vote in time. It is generally thought that such information should be provided to shareholders at least 20 days in advance of the assembly.

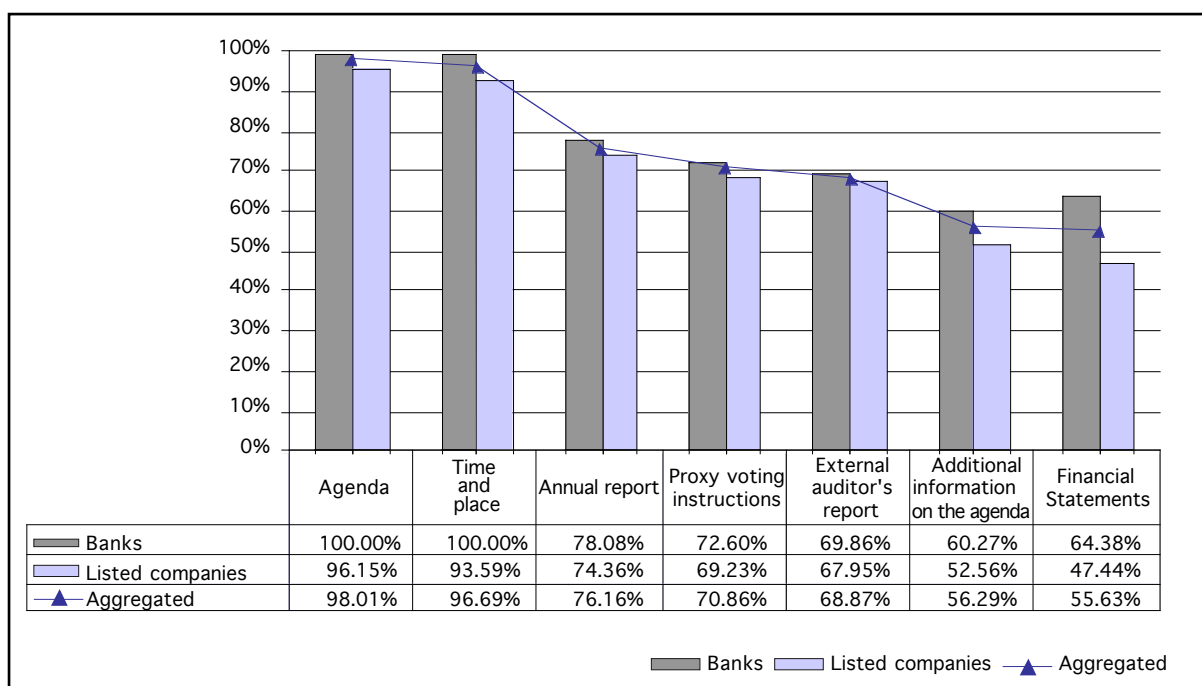
Figure C-66 shows that most banks (55%) followed this best practice, however, that only 22% of listed companies did so.

Figure C-66: Notification period to distribute information prior to the general assembly



The following Figure C-67 shows the information provided to shareholders prior to the meeting. In summary, all banks and the vast majority of listed companies provide an agenda, and information on the assembly time and place. On the other hand, less than half of listed companies (47%) provide additional information on agenda items, while 64% of banks did so. Proxy voting instructions still require more attention, as just over half (56.3%) disclosed proxy voting instructions.

Figure C-67: Information provided to shareholders prior to the general assembly



Section D. Focus on Banks, Family-, and State-Owned Enterprises

I. Corporate governance issues related to banks

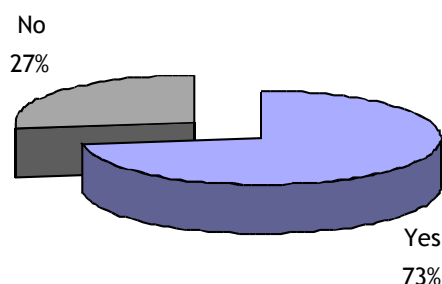
Corporate governance is particularly significant for the banking sector due to the important role they play in an economy. First and foremost, banks accept deposits from and are liable to the general public. These deposits constitute a significant portion of a nation’s wealth, and must therefore be managed appropriately. Should this wealth be managed inadequately, people’s money and livelihoods could be at stake. Another issue that makes bank governance so significant is the fact that banks provide loans. Indeed, banks are the sole source of financing for the great majority of enterprises, in particular in emerging markets. The assessment and selection of customers and the ensuing decisions to extend or refuse credit are important processes that fundamentally influence the growth of the economy. Finally, some banks are expected to make credit and liquidity available in difficult market conditions. The importance of banks to national economies is underscored by the fact that banking is, almost universally, a regulated industry. It is thus of great importance that banks have strong corporate governance practices.

With this in mind it is important to note that commercial banks and other deposit-taking financial institutions have special governance risks and complexities since: (i) banks take large amounts of risk-bearing (and thus forward-looking) obligations on their books, and hence weak internal controls and accountability can cause urgent and rapid crises, as currently witnessed in the wake of the US sub-prime mortgage crisis with its global implications; (ii) the collapse of a bank will usually destroy value for its public depositors, not just shareholders, and may even require a costly bail-out by the fiscal authorities; and (iii) there is the systemic risk that the collapse of a single bank can undermine the entire banking system. Because of these special governance risks, banks are usually required by law or regulation to have certain specific governance structures and reporting standards.

i. Demonstrating commitment to good corporate governance

Seventy three percent (73%) of bank managers and directors reported their familiarity with the BCBS Guidelines,²⁸ as shown in Figure D-1. On the other hand, as can be determined from the below, translating this knowledge into actual practice remains a challenge.

Figure D-1: Are managers and directors familiar with the BSBC Guidelines?



Indeed, an understanding by the survey’s respondents as to the business case for implementing good corporate governance, beyond compliance, appears to be lacking with banks as well.

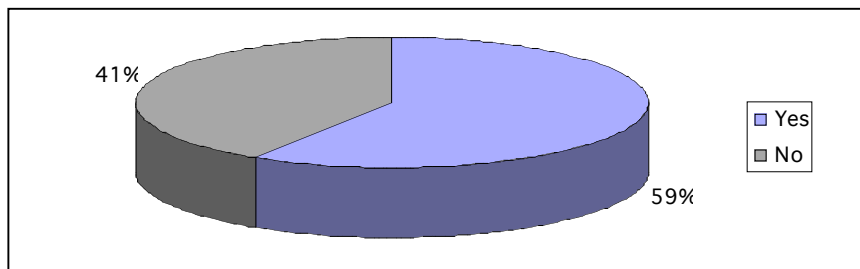
²⁸ Basel Committee for Banking Supervision and its Guidelines for Enhancing Corporate Governance for Banking Organizations, published in 1999 and revised in 2006.

Did you know that Romania’s Banca Comerciala Romana (BCR) was upgraded by Fitch Ratings (individual rating to C/D from D) and S&P (long-term counterparty rating to BB- from B+) due to improvements to its corporate governance? Both agencies cited improvements in corporate governance and risk management as the main reasons for the upgrades.²⁹ This is but one of many case studies that demonstrate that corporate governance can add value.

In addition to their responsibility to shareholders, banks also have a responsibility towards depositors. Sound corporate governance contributes to the protection of depositors of the bank, requiring the board to approve the strategic objectives taking into account and balancing the interests of shareholders and depositors.

Figure D-2 below shows that most banks expressly include in their formal documents the responsibility of assuring levels of liquidity and the protection of depositors. It should be noted that according to best practice depositors’ interests should be considered in conjunction with any applicable deposit insurance systems in place maintaining enough liquidity in the banking system.

Figure D-2: Is the board formally responsible for protecting the interests of depositors



ii. Implementing good board practices

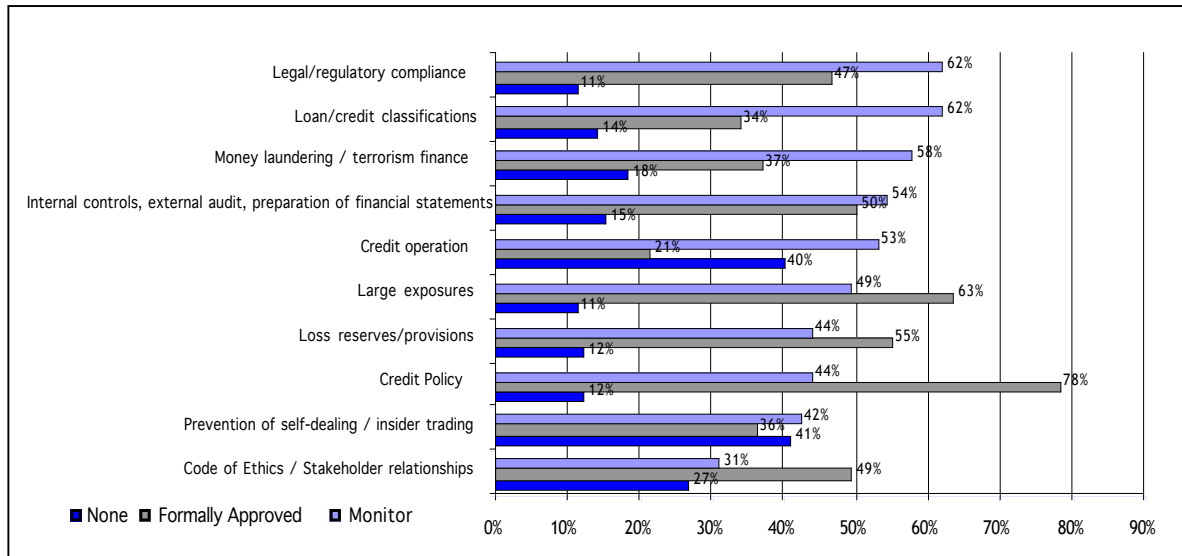
a. Specific functions of the board

A bank’s board is ultimately responsible for the operations and financial soundness of the bank. In carrying-out their responsibility, directors should primarily oversee and guide management. Moreover, directors should, *inter alia*: (i) understand and execute their oversight role, including to understand the bank’s risk profile; (ii) approve the overall business strategy of the bank, including approval of the overall risk policy and risk management procedures; (iii) exercise their duty of loyalty and duty of care to the bank under applicable national laws and supervisory standards; and (iv) avoid conflicts of interest, or the appearance of conflicts, in their activities with, and commitments to, other organizations.

²⁹ The Irresistible Case for Corporate Governance (IFC, March 2006). See www.ifc.org/corporategovernance.

Figure D-3, however, illustrates that bank directors do not always follow these best practices.

Figure D-3: Functions bank boards approve and oversee



b. Board structure

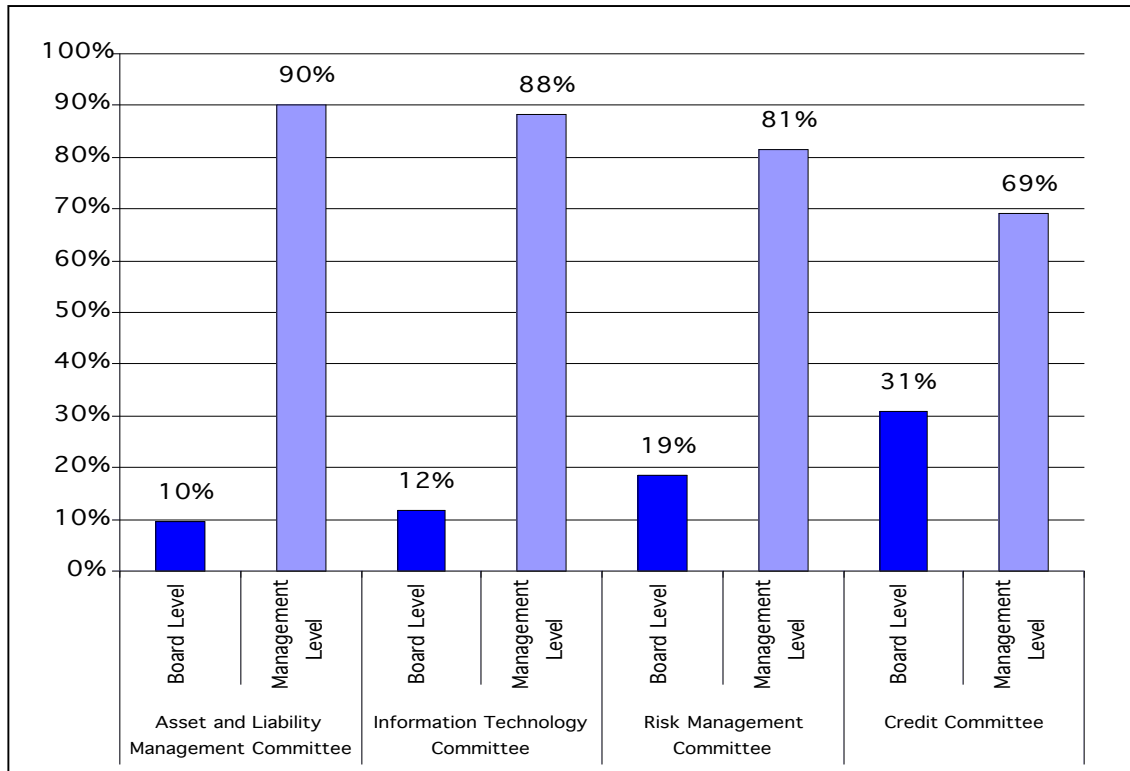
As already established above, board-level committees can help make the board’s work more efficient and effective. The same holds true for management-level committees.

All surveyed banks indicated that they have one or more committees, at both the management and board levels, however, as Figure D-4 demonstrates, there is confusion as to which issues the board should focus its attention on, vs. those under the exclusive purview of management.

Typical board-level committees as previously mentioned include the audit, remuneration, and nominations and corporate governance committees. Some bank boards chose to establish separate risk committees, while others chose to assign this responsibility to the audit committee. The credit, asset and liability (or ALCO), information technology or product development committees are typically established at the management level. Many banks also choose to establish risk committees at the management level.

Of note is that while only 19% of banks have board-level risk committees, 31% of boards have credit committees. And while the board should be setting policies on risk and credit issues, possibly through a board-level risk committee, the implementation of these matters should be left to the management team and management level risk and credit committees. Credit decisions in particular should be handled by management, with the board establishing the bank’s risk appetite and credit policy under which management operates.

Figure D-4: Board and management committees established

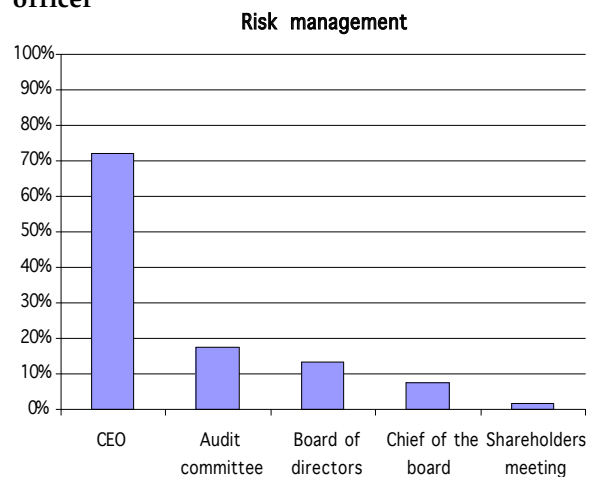


iii. Building a robust control environment through clear reporting structures

a. Reporting lines for the chief risk officer

The CRO should be independent of any business line, so as to avoid any conflicts of interest. Best practice further calls for the CRO to report to the CEO, or to a management-level risk committee and the board; should the CRO report to the CEO, s/he has a “dotted line” reporting relationship to the board or a relevant board committee, such as the audit or risk committees. And while Figure D-5 provides evidence that the CRO does indeed report to the CEO in 72% of the cases, there is little to demonstrate that there is any reporting line, full or dotted, to the board (13%) or its audit committee (18%), let alone a risk committee.

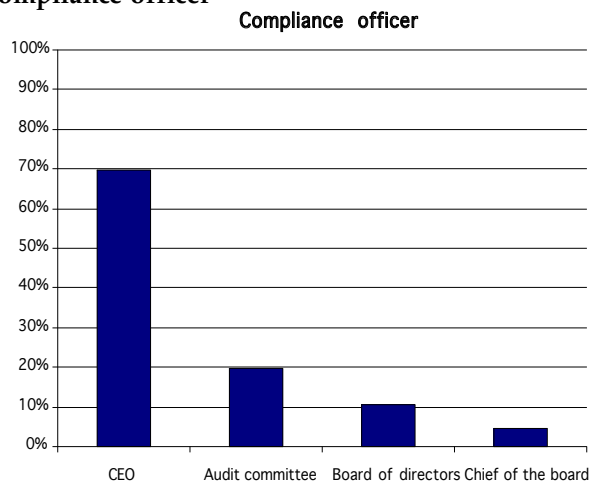
Figure D-5: Reporting lines for the chief risk officer



b. Reporting lines for the chief compliance officer

Compliance means complying with the conduct of business rules imposed by regulators, the law, the capital markets, established market practices and other regulatory requirements and standards, as well as internal processes and procedures. The compliance function plays a particularly important role in banks due to the important number of processes and procedures required to properly operate a bank. The CCO needs to be independent of any business line, so as to avoid conflicts of interest. At a minimum, s/he reports to a senior level manager—but not less than two steps removed from the CEO—and has unrestricted access to the CEO and CFO, or to a relevant management-level committee. Best corporate governance practice is increasingly calling for the CCO to have a dotted reporting line to the board’s audit committee as well. **Figure D-6** demonstrates that the CCO reports to the CEO in the great majority of cases (70%), but that reporting to the board can be improved upon.

Figure D-6: Reporting lines for the chief compliance officer

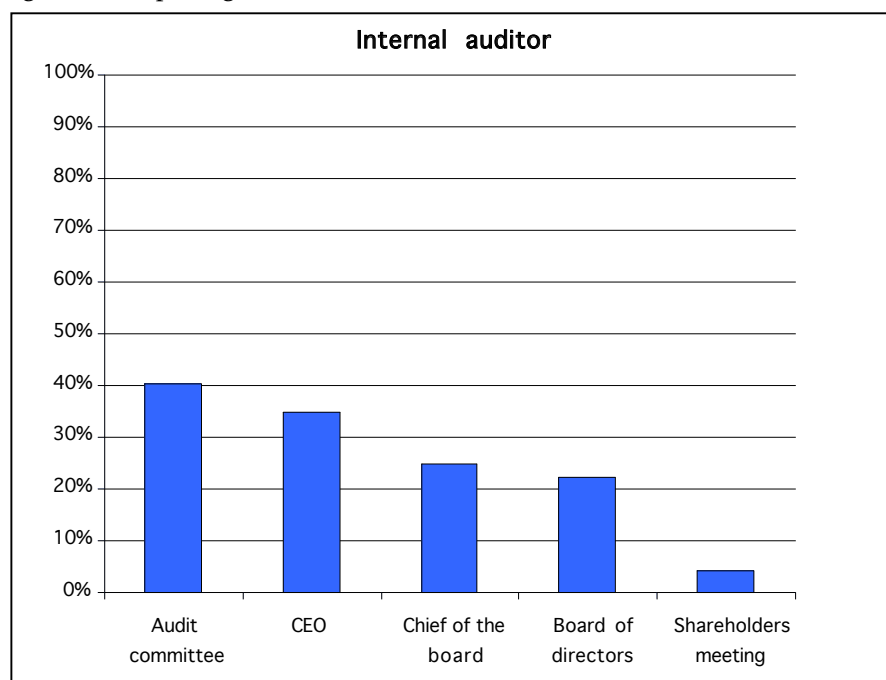


At a minimum, s/he reports to a senior level manager—but not less than two steps removed from the CEO—and has unrestricted access to the CEO and CFO, or to a relevant management-level committee. Best corporate governance practice is increasingly calling for the CCO to have a dotted reporting line to the board’s audit committee as well. **Figure D-6** demonstrates that the CCO reports to the CEO in the great majority of cases (70%), but that reporting to the board can be improved upon.

c. Reporting lines for the chief internal auditor

As previously established, best practice calls for the CIA to report to the board through its audit committee on a functional basis and to the CEO on an administrative basis. Figure D-7 provides evidence that reporting lines for the CIA remain muddled, with only 40% of CIA’s reporting to the board’s audit committee.

Figure D-7: Reporting lines for the chief internal auditor

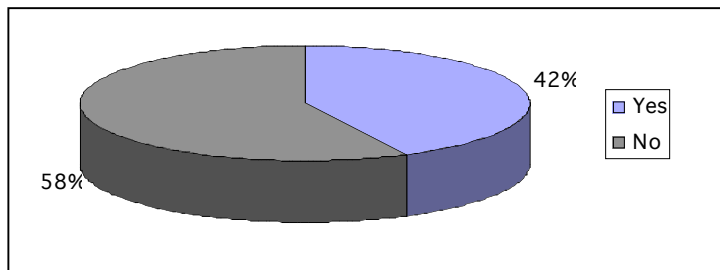


iv. Know your client: assessing the corporate governance of borrowers

As much as banks have traditionally looked after the financial performance of its borrowers, they may also be well served to pay attention to their governance practices. Indeed, assessing, improving, and monitoring the corporate governance practices of their clients may not only help minimize their portfolio risk but also add value to their client’s business.

Results indicate that a significant majority of banks (58%) do not include an evaluation of their clients’ corporate governance practices, as seen on the Figure D-8 below.

Figure D-8: Does the bank evaluate its clients’ corporate governance practices



II. Corporate governance issues related to family-owned enterprises³⁰

Several studies have shown that FOEs outperform their non-family counterparts in terms of sales, profits, and other growth measures.³¹ This high performance is the result of the inherent strengths that FOEs have compared to their counterparts. Some of these strengths include: (i) identification with and strong commitment by the family members to the family business; (ii) knowledge continuity, i.e., families pass their accumulated knowledge, experience, and skills on to the next generations; and (iii) reliability and pride, in particular when the family name is associated with the business.

However, most FOEs have a very short life span beyond their founder’s stage. Indeed, some 95% of family businesses do not survive the third generation of ownership. This high rate of failure among FOEs is attributed to a multitude of reasons. Some of these reasons are the same ones that could make any other business fail, such as poor management, insufficient cash to fund growth, inadequate control of costs, industry life cycles, and other macro conditions. However, FOEs also show some weaknesses that are especially relevant to their nature. Some of these weaknesses are: (i) complexity, i.e., family businesses are usually more complex in terms of governance than their counterparts due to the addition of a new variable: the family; (ii) informality in that because most families manage their businesses themselves during the first and second generations, there is usually very little interest in setting clearly articulated business practices and procedures; and (iii) lack of discipline with respect to financial and operational oversight, succession planning, and attracting and retaining skilled outside managers.

³⁰ For more information on best practices in the area of FOE governance, please visit www.ifc.org/corporategovernance to download a copy of IFC’s recently published Handbook

³¹ Denis Leach and John Leahy, “Ownership Structures, Control and the Performance of Large British Companies”, *Economic Journal*, 1991.

Did you know what steps family-owned enterprises take when they get serious about corporate governance? They:

1. Establish a “family constitution”;
2. Establish a family employment policy—and separate family members’ rights and responsibilities as shareholders and as employees;
3. If the firm will not pay dividends, set up a fund or other mechanism to buy out family shareholders who prefer, for example, annuity income over owning a growth stock;
4. Create a succession plan for the owner/founder/CEO/chairman;
5. Develop transparent systems for financial accounting, management accounting, human resources, and strategy development; and
6. Create a board which can seriously add value to the business itself.

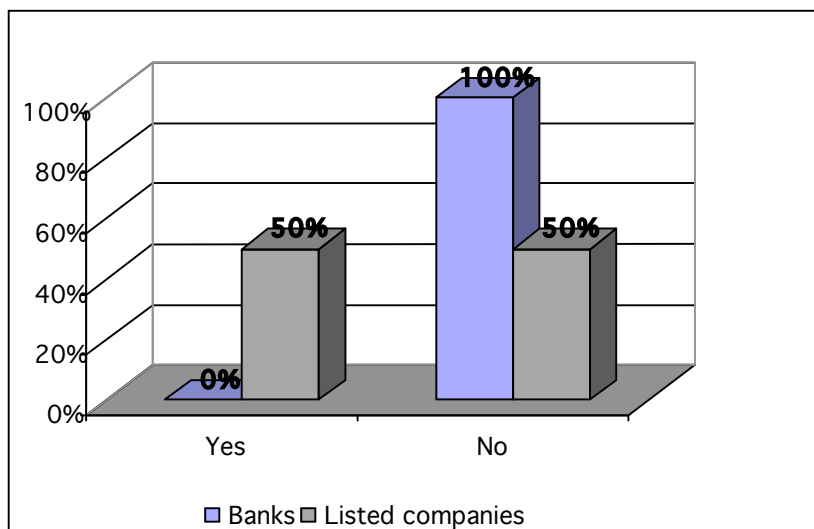
i. Establishing a family constitution

The family constitution is commonly defined as a statement on the family’s core values, vision, and mission of the business. The constitution also defines the roles, compositions, and authorities of key governance bodies of the company and family, including family members, shareholders, managers, and directors. In addition, the family constitution defines the relationships among the governance bodies and how family members can meaningfully participate in the governance of their business.

In summary, the establishment of a family constitution provides FOEs with a tool to differentiate the family interests from those of the company and regulate the policies that will guide the relationship between the family and the company.

Figure D-9 clearly illustrates that while 50% of listed companies had adopted a family constitution, not a single bank had done so. This is likely explained by the fact that banks operate under a strict regulatory environment, which often contain ownership restrictions and fit and proper tests that family members are subject to, and hence many banks may not feel that they would benefit from such a family constitution, although they might well do so.

Figure D-9: Presence of family constitutions



ii. Implementing succession planning

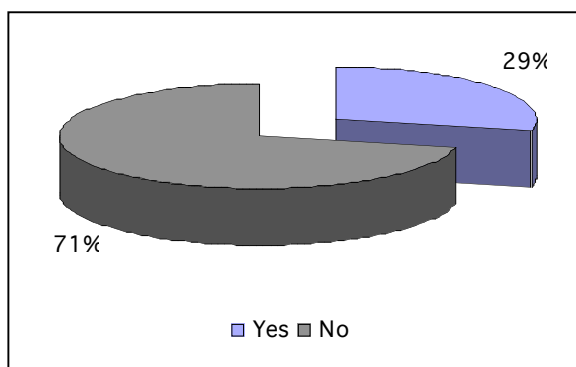
Succession planning is defined as the process of continuously searching for future leaders and the systematic development of their professional, managerial, and leadership qualities. Succession planning is neither limited to the board chairman and CEO, nor does it suffice to simply appoint a deputy. Best practice calls for the process of succession planning to begin many years before the actual transition, in order to identify and develop the successor.

A planned succession process allows for the gradual transfer of responsibility from one business leader to the next and increases the likelihood of a successful transition, i.e., one that is hardly noticed. Eventually the transition from one business leader to the next must end on an agreed-upon date at which time the incumbent transfers authority.

The ideal method of choosing a successor is through the consensus of the existing business leader, the directors, the management team, and the family. It works best when the incumbent business leader sees it as his or her responsibility and follows through on the necessary actions in a timely manner.

Unfortunately, family succession plans are not widespread in the region, and results from Figure D-10 show that only 29% of respondents have prepared a succession plan.

Figure D-10: Presence of succession plans



Did you know that the following five steps are considered best practice in properly managing the succession planning process in family businesses: (i) prepare the incumbent business leaders to eventually relinquish control and develop next career moves or retirement plans; (ii) prepare the business to function without the incumbent business leaders; (iii) develop the successor for future roles in the business, including the business leader’s role; (iv) prepare the family, e.g., by having the family agree on a family mission statement, the values stated in which will influence the succession planning process; and (v) prepare the owners of the business for a transfer of ownership from one generation to the next?

iii. Developing a family member employment policy

Family members often play an important role in FOEs that should not be minimized or underestimated, supporting the mission and values in which the company was founded—indeed, what many consider to be an essential part of the success and future growth of FOEs. At the same time, family members can often lead to a company’s downfall. How? Many FOEs that do not establish a clear employment policy for family members end-up with more employees from the family than the company needs. In some instances these family members are ill-equipped for

the jobs that they are given within the business. Even worse, some FOEs find themselves acquiring businesses that have no relationship with their original business or keeping some unprofitable business lines just to ensure that everybody in the family receives or remains employed within the company. Before a FOE enters into the sibling partnership stage, good practice calls for families to formalize their family members' employment policies.

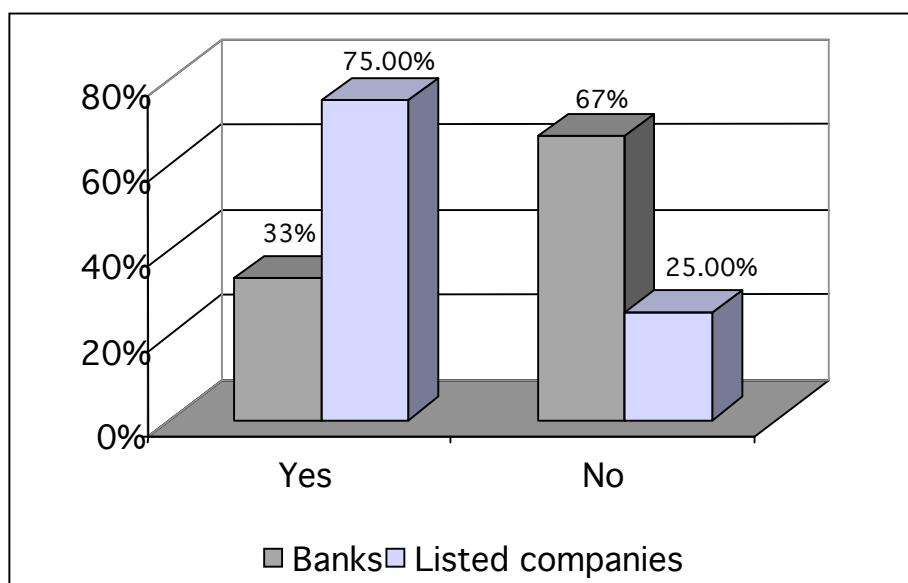
Did you know that a family member employment policy should be regularly reviewed and updated, and contain the following seven elements: (i) entry into the business (age, qualifications, skills, and requirement for prior experience outside of the business); (ii) permission of part-time work; (iii) remuneration; (iv) training and personal development; (v) employment of spouses; (vi) termination; and (vii) retirement? This would require setting-up clear rules about the terms and conditions of family employment within the firm.

Once developed and agreed upon by the family, the written employment policy should be made available to all family members. This will help set the right expectations about family employment among all family members from the very beginning.

Finally, the appointment of external managers and directors allows the FOE to receive impartial and objective opinions provided purely on business grounds.

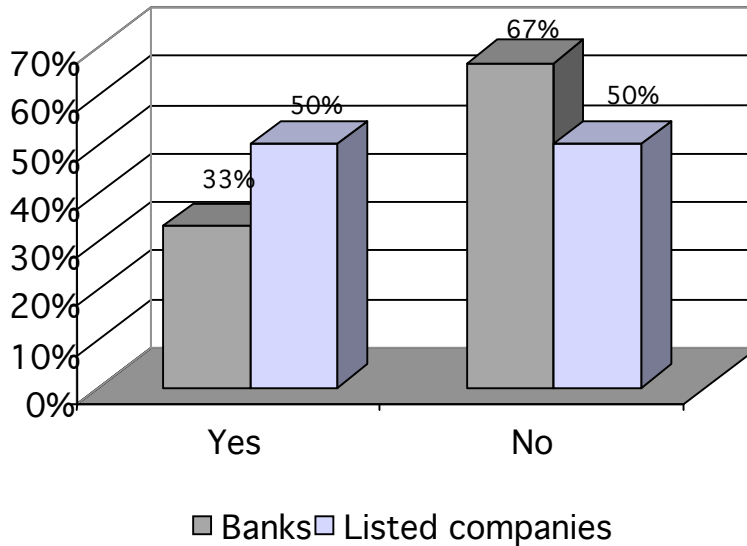
Figure D-11 shows that family membership at the board-level is prevalent in listed companies, with 75% of respondents citing that their boards are composed of a majority of family members. Banks on the other hand show a substantially higher degree of non-family membership, with only 33% of boards being composed of a majority of family members. A reason is likely to be the strict fit and proper requirements imposed on family-owned banks by the regulator. Indeed, all family-owned banks (FOBs) responding to the survey cited that family board members were required to comply with eligible qualifications for being a board member, while this percentage falls to 50% for listed companies.

Figure D-11: Family members serving on boards of family-owned banks and enterprises



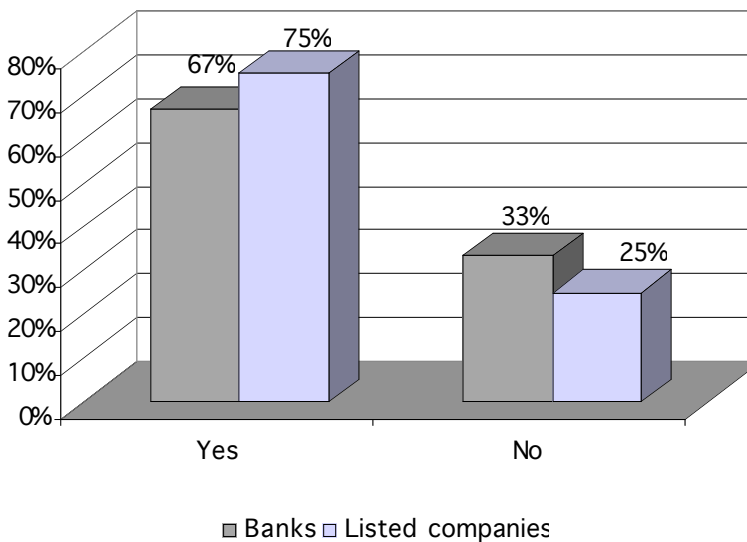
At the same time, the position of CEO is held by a non-family member among 67% of FOBs, while this percentage falls to 50% for FOEs, as shown in Figure D-12.

Figure D-12: Is the position of CEO held by a family member?



Results of the survey show that most of the family-owned banks and family-owned listed companies surveyed (67% and 75%, respectively) have family employment policies or professional requirements for family members applying for a position within the company, as observed in the following Figure D-13.

Figure D-13: Presence of family employment policies or requirements



However, as stated above, it appears that few companies have formally captured such requirements in a family employment policy.

Did you know that the performance of family-owned UK firms tends to suffer when they are managed by the eldest son of the founder? A study of inherited family firms and management practices in the UK shows that while family ownership seems to improve a company's management practices, family management of family-owned firms often leads to performance woes.³²

The two problems with family management are that:

- Selecting a CEO from the small group of potential family members severely restricts the available pool of managerial ability
- Assuring family members of managerial positions later in life can lead to the "Carnegie effect", in which family members work less hard at school and early in their careers with the knowledge of a guaranteed family job.

Even worse, choosing a CEO by "primogeniture" (selecting the eldest son to lead) tends to lead to extremely bad performance. The lack of a selection pool and the Carnegie effect become much more severe in situations of primogeniture, since the CEO position is determined from birth.

iv. Establishing a family council

The family council is a working governing body that is elected by the family assembly among its members to deliberate on family (business) issues. The council is usually established once the family reaches a critical size, i.e., more than 30 family members. In this situation, it becomes very difficult for the family assembly to have meaningful discussions and make prompt and qualified decisions. The family council is established at this point as a representative governance body for the family assembly in coordinating the interests of the family members in their business.

Did you know that the duties of a typical family council would include: (i) being the primary link between the family, the board, and senior management; (ii) suggesting and discussing names of candidates for board membership; (iii) drafting and revising family position papers on its vision, mission, and values; (iii) drafting and revising family policies such as family employment, compensation, and family shareholding policies; and (iv) dealing with other important matters to the family.³³

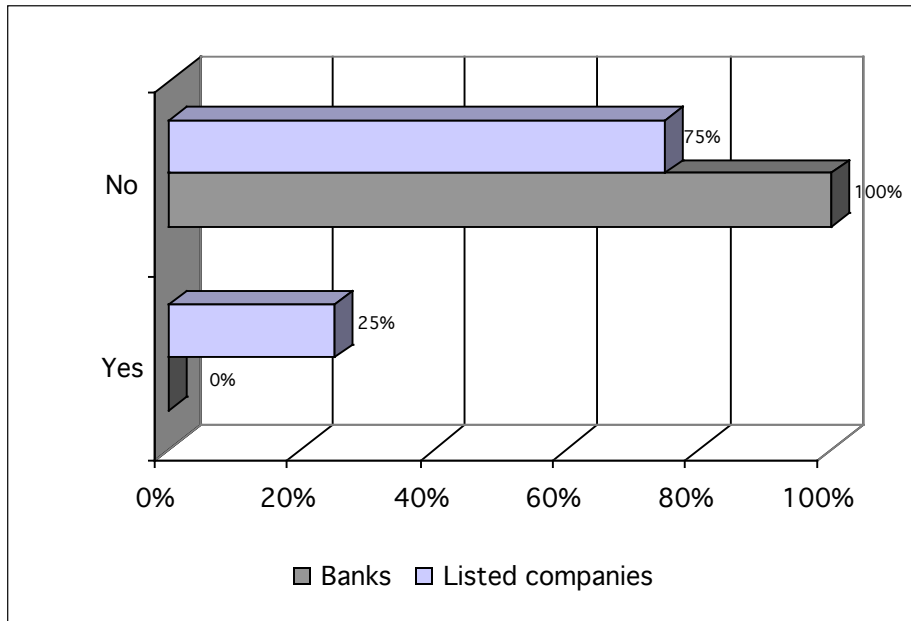
Just as any well-functioning committee, the family council should have a manageable size, i.e., from approximately five to ten members. One good practice is to set limited terms for the council's membership so as to allow more family members to be part of the council and create a feeling of fairness and equal opportunities within the family. Depending on the complexity of issues facing the family, the council would meet from two to six times per year.

³² From "Inherited Family Firms and Management Practices: The Case for Modernising the UK's Inheritance Tax." Centre for Economic Performance, London School of Economics.

³³ Ivan Lansberg, *Succeeding Generations: Realizing the Dream of Families in Business* (Harvard Business School Press, 1999); Fred Neubauer and Alden G.Lank, *The Family Business: it's Governance for Sustainability* (Routledge New York, 1998).

As seen in Figure D-14 below the survey shows that this body is not commonly established in the region, neither for banks nor for listed companies.

Figure D-14: Presence of family councils



III. Corporate governance issues related to state-owned enterprises

Best practice calls on governments to:³⁴

1. Ensure a level-playing field for state-owned enterprises competing with the private sector by: (i) clearly separating the state's ownership role from its regulatory role; and (ii) allowing more flexibility in capital structures while making sure that state-owned enterprises face competitive access to finance.
2. Become more informed and active shareholders by: (i) simplifying the chain of accountability through centralizing or more effectively coordinating shareholding responsibilities within the state administration; (ii) reducing political interference in day-to-day management; and (iii) introducing a transparent nomination process for boards, based on competence and skills.
3. Empower boards by: (i) clarifying their mandates and respecting their independence; (ii) separating the role of chairman and CEO and providing boards with the power to appoint CEOs; and (iii) systematically monitoring the board's performance.
4. Improve transparency by: (i) strengthening internal controls; (ii) carrying-out independent, external audits based on international standards; (iii) disclosing any financial assistance from the state; and (iv) producing aggregate performance reports.

Indeed, corporate governance helps governments evaluate and improve the way SOEs perform, and manage their responsibilities as company owners more effectively. This holds particularly true

³⁴ The OECD Guidelines on Corporate Governance for State Owned Enterprises, April 2005. See www.oecd.org.

given the fact that most SOEs traditionally operate in strategic sectors, such as electricity, telecommunications, infrastructure, and utilities.

Several specific governance challenges affect SOEs, including conflicts in reconciling competing social and profit-seeking objectives, poor board practices and opaque nominating procedures for directors and senior managers, lax control processes and procedures, poor transparency and disclosure, and competing ‘ownership’ interests between government agencies.

i. Exercising property and ownership rights

The main corporate governance challenge regarding SOEs is the exercise of property rights and the performance of the ownership function, considering the potentially diffuse identity of the major shareholder (the State). The control over the company can be seen from a dual perspective: on the one hand, who has the property rights; on the other, who exercises the political rights. In different countries SOEs are not owned by the State itself but by a different entity, such as a municipality, or a special holding, such as a central national unit that puts together all the participations of the state and acts as the owner.

Figure D-15 below shows that a significant majority of the sample surveyed (67%) is owned by the state itself. Only one fifth of the respondents (19%) are owned by a central national unit acting as an ownership entity. Best practice is increasingly, although not unequivocally, calling for centralized national units to act as an owner and, at a minimum, coordinate corporate governance improvements in SOEs.

Figure D-15: Ownership of state-owned enterprises

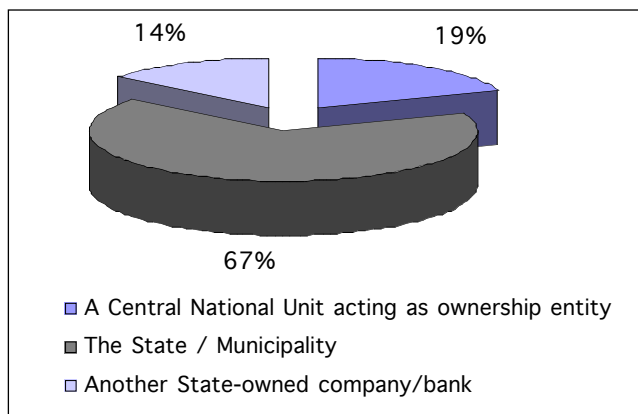
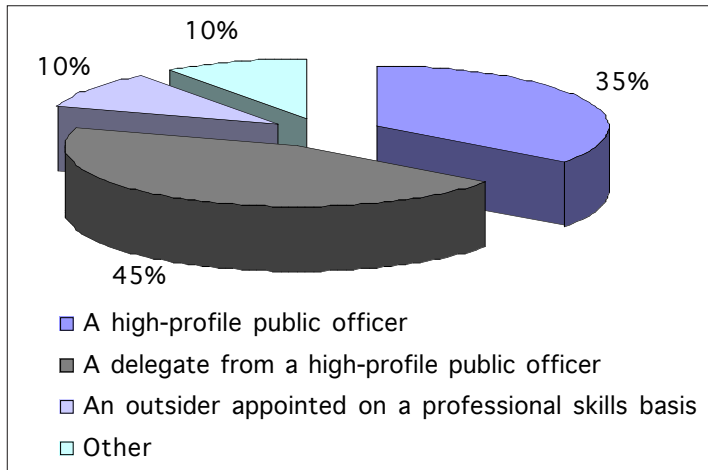


Figure D-16 reveals that the exercise of political rights is usually a competence of a high-profile public officer or delegate (80% of responses in aggregate terms), regardless of the shareholder’s identity. (Of note is that an overwhelming majority of state-owned banks (SOBs), over 90% of respondents, declared that property rights are exercised by a high-profile public officer or a delegate, while this percentage falls to 62% of respondents for SOEs that are partially listed on an exchange.)

Figure D-16: Exercise of political rights

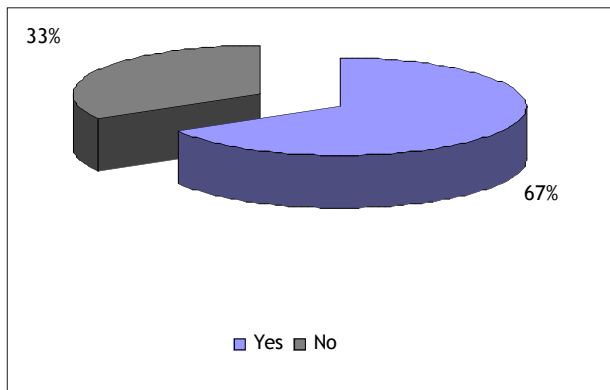


In exercising its ownership, the state should act as an informed and active owner, establishing clear and consistent ownership policies, ensuring that the affairs of its SOEs are carried out in a transparent and accountable manner, with the necessary degree of professionalism.

Any obligations and responsibilities that a SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations, and publicly disclosed, with related costs being covered in a transparent manner.

Figure D-17 illustrates that there is an effective separation between public policy and the business objectives of SOE, with 67% of SOEs citing an existing difference between social and profit-seeking objectives.

Figure D-17: Difference in social and profit-seeking objectives



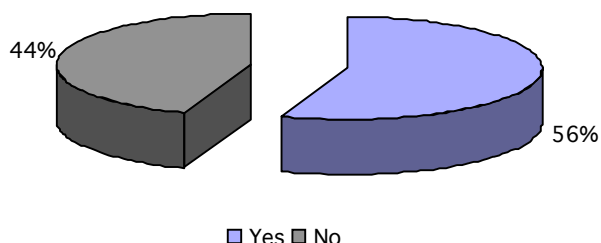
Most SOEs report to the controlling agency on an ad-hoc basis, upon request (45%), and not on a pre-determined and periodic basis, for example, annually (25%).

ii. Demonstrating commitment to good corporate governance

The OECD Guidelines on Corporate Governance for SOEs (OECD SOE Guidelines) represent the first international benchmark to assist governments in improving the corporate governance of SOEs, and how they perform their ownership function. The Guidelines provide the framework applicable to SOEs and synthesize the core elements of a good corporate governance regime for SOEs.

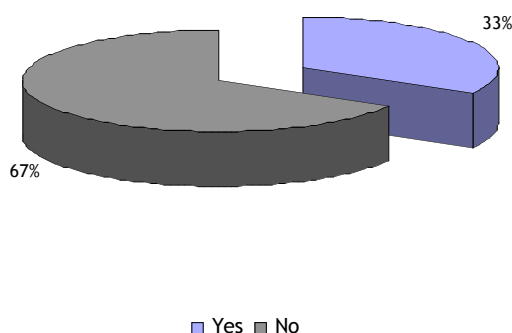
It appears from Figure D-18 that the OECD SOE Guidelines are not as well known as the OECD Principles or BSBC Guidelines, as just over half of the respondents (56%) declared to be familiar with their content and scope. And so awareness raising on the importance of corporate governance for SOEs should be pursued by the relevant public and private sector stakeholders.

Figure D-18: Are key officers and directors familiar with the OECD Guidelines?



Importantly, only 33.3% of government ownership entities have a policy or requirement for their SOEs or SOBs to adopt good corporate governance practices, demonstrating that corporate governance does not appear to be of primary concern for most governments (see Figure D-19).

Figure D-19: Public policies requiring SOEs or SOBs to adopt good corporate governance



iii. Implementing good board practices

a. The composition of the board

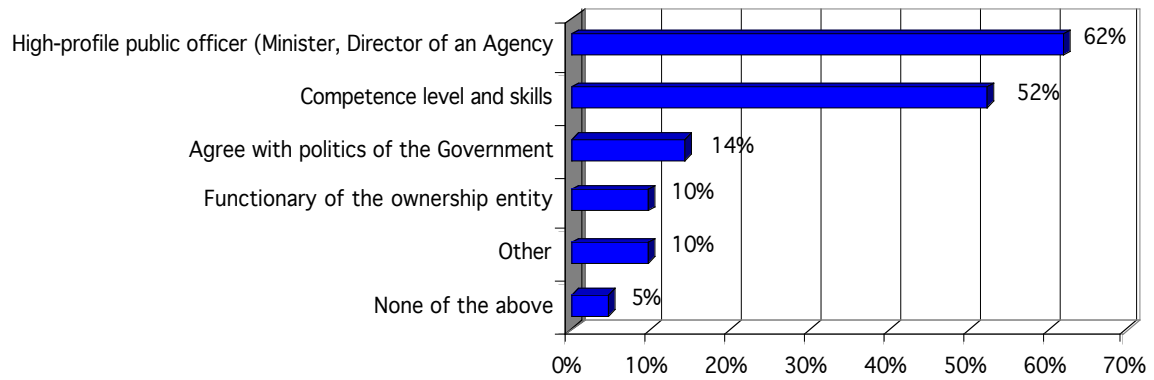
The boards of SOEs should have the necessary authority, composition, and competency, and structure to strategically guide and monitor management. In doing so, it is of great importance to have appropriate nomination procedures to ensure that only those directors are nominated to the board that demonstrate the highest integrity, competency, and accountability.

The procedure for appointing board members in SOEs has traditionally been opaque. However, the nomination and election of directors is one of the major challenges to finding a balance between the state’s responsibilities for actively exercising its ownership functions while at the same time refraining from imposing undue political interference in the management of the company.³⁵

³⁵ OECD Guidelines on corporate governance - Foreword

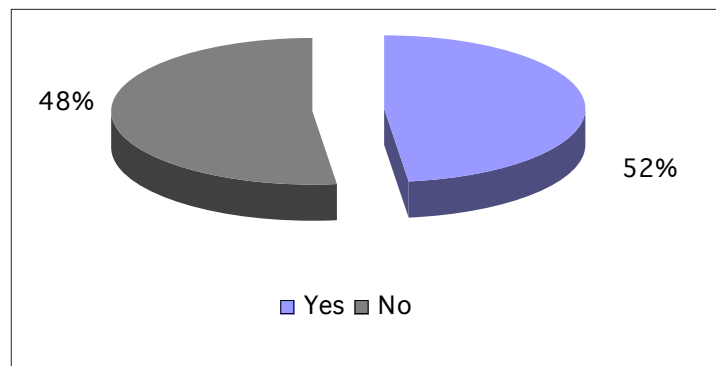
Figure D 20 shows that being a high-profile public officer (62%) remains the primary criteria for nominating a director to the board of a SOE, contrary to good practice. Competency and skills are a secondary requirement, fortunately considered as an important criterion by 52% of SOEs.

Figure D-20: Nomination criteria for board membership



Finally, results show that just over half of those surveyed (52%) state that directors are remunerated for their board services (see Figure D-21).

Figure D-21: Remuneration of directors



Section E. Annexes

I. Annex 1: survey methodology

i. Survey population

The survey population consisted of 1,044 banks³⁶ and listed companies from 1111 MENA countries, divided into three separated groups: non-listed banks (57 cases); listed banks (65 cases); and listed companies (922 cases). As shown in Table E-1, banks and listed companies are distributed among countries as follows:

	Non-listed banks	Listed banks	Listed companies	TOTAL
Bahrain	1	6	41	48
Egypt	21	17	125	163
Jordan	13	2	204	219
Kuwait	1	6	164	171
Lebanon	0	0	9	9
Morocco ³⁷	5	0	52	57
Oman	1	5	139	145
Saudi Arabia	2	9	71	82
Tunisia	5	9	35	49
UAE	5	7	57	69
WB & Gaza	3	4	25	32
TOTAL	57	65	922	1044

To design a representative sample, a measure of the size of the banks and listed companies being part of the population was considered. Specifically, and as shown in Table E-2, banks have been grouped into four categories in terms of their assets: (i) small banks with less than \$1,000 million in assets; (ii) medium-sized banks, with between \$1,000 and \$4,000 million in assets; (iii) large banks with more than \$4,000 million in assets; and (iv) banks for which information on assets was non available (n/a).

³⁶ Lebanese banks were not included in the survey, as IFC had previously conducted a survey of banks in Lebanon, which can be viewed under www.ifc.org/mena/corporategovernance.

³⁷ There is no available information on the fact of being listed or not for five Moroccan banks. Those banks have not been included in the population

Listed companies in turn were grouped along sales into the following four categories: (i) less than \$10 million; (ii) between \$10 and \$50 million; (iii) more than \$50 million; and (iv) information on sales non available (n/a).³⁸

	Small			Medium			Large			n/a			TOTAL		
Banks	< \$1,000			1,000 - 4,000			> 4,000								
Listed COs	< 10			10 – 50			> 50								
	Non-listed banks	Listed banks	Listed companies	Non-listed banks	Listed banks	Listed companies	Non-listed banks	Listed banks	Listed companies	Non-listed banks	Listed banks	Listed companies	Non-listed banks	Listed banks	Listed companies
Bahrain	1	1	3	0	3	17	0	1	17	0	1	4	1	6	41
Egypt	8	5	39	5	6	37	5	1	47	3	5	2	21	17	125
Jordan	6	1	105	4	0	47	2	0	14	1	1	38	13	2	204
Kuwait	0	0	15	1	1	51	0	5	97	0	0	1	1	6	164
Lebanon	0	0	0	0	0	1	0	0	2	0	0	6	0	0	9
Morocco	0	0	6	0	0	14	0	0	23	5	0	9	5	0	52
Oman	0	1	52	0	3	38	0	1	20	1	0	29	1	5	139
Saudi Arabia	0	0	24	0	1	22	0	8	22	2	0	3	2	9	71
Tunisia	3	1	8	0	8	16	0	0	11	2	0	0	5	9	35
UAE	0	1	1	2	1	1	3	5	8	0	0	47	5	7	57
WB & Gaza	0	3	4	0	0	3	0	0	1	3	1	17	3	4	25
TOTAL	18	13	257	12	23	247	10	21	262	17	8	156	57	65	922

³⁸ Sector of activity has not been a principal criterion in order to design the sample, as it was arranged. However, when selecting the companies being part of the sample, we have tried to select companies from all the sectors of activity, in order to best represent the different sectors of the economy of each country.

³⁹ Amounts are in millions of US dollars in sales.

ii. Theoretical background: random sampling

Consider the following symbols:

- $h = 1, \dots, H$ groups into which the surveyed population was divided (3 classes defined by the type of company, $H=3$),
- N_h number of units in group h (= number of companies in group h)
- $N = N_1 + \dots + N_H$ number of units from the total population
- n_h no of units in the sample for group h
- $n = n_1 + \dots + n_H$ total number of units in the global sample
- p_h ratio of units in group h that meet a certain requirement "A"

The following formulas were used in order to estimate proportions

- The ratio of units in group h that meet requirement „A“ is calculated as follows:

$$\hat{p}_h = \frac{a_h}{n_h}$$

- Where a_h is the number of meeting requirement „A“, in the h group, and this number may be interpreted as a sum for all the units in group h of the values of a binary value Y , which indicates the fact that requirement „A“ has been met:

$$a_h = \sum_{j=1}^{n_h} Y_{h,j}$$

Formulas used in order to calculate the precision of the estimates made are as follows.

- Estimate p_h falls subject to sample error, due to the fact that only one sample of the population group h is being studied, not the entire group. The maximum sample error, with a confidence level of $1-c$, is given through the following formula

$$SAMPLE \ ERROR \leq Z_{c/2} \sqrt{\frac{N_h - n_h}{N_h - 1} \frac{0.5 \times 0.5}{n_h}}$$

- Where $Z_{c/2}$ denotes the percentile $c/2$ of the distribution of a standard normal random variable ($Z_{c/2}=1.96$ if a confidence level of 95% is considered). Sample error is strictly lower than this upper bound when p_h is different from 0.5.

iii. Sample design

Each of the three groups is treated independently of the others. Hence, three samples were selected, each one being representative of one of the three groups considered:

- Listed banks: $h=1$
- Listed banks $h=2$
- Listed companies: $h=3$

For each of these groups, size was determined in such a way that sample error (i.e. the difference between the ratios in the sample and the entire population for the units meeting requirement “A”) will be lower than 5%, with a confidence level of 95%. Results for the whole population will then be estimated by using the corresponding weights for companies in each sub sample. Such sizes are:

- No listed banks: $n1 = 50$
- Listed banks: $n2 = 56$
- Listed companies: $n3 = 272$

Since the population sizes are small, samples are relatively large: they are almost exhaustive for both groups of banks and 29.4% of the listed companies need to be interviewed to fulfill the requirements on sample error.

Each sample was proportionally distributed among all countries (ten countries for banks⁴⁰ and 11 countries for listed companies) and among groups of total assets or gross sales respectively, obtaining the following samples design (see Table E-3).^{41,42}

⁴⁰ As referred to in Footnote 1.

⁴¹ Please note that the distribution of listed companies among countries is not exactly proportional, as the sample for the countries with the smallest number of listed companies (Lebanon +3, Tunisia +1 and WB & Gaza +3) have been slightly over sampled to reduce sample error. These deviations will be compensated by establishing the appropriate weight in the procedure of sample calibration.

⁴² Please note the considerations regarding the sector of activity are already referred to in Footnote 3.

Table E-3: Distribution of respondents⁴³

	Small			Medium			Large			n/a			TOTAL		
Banks	< \$1,000			1,000 - 4,000			> 4,000								
Listed COs	< 10			10 - 50			> 50								
	Non-listed banks	Listed banks	Listed companies	Non-listed banks	Listed banks	Listed companies	Non-listed banks	Listed banks	Listed companies	Non-listed banks	Listed banks	Listed companies	Non-listed banks	Listed banks	Listed companies
Bahrain	1	1	1	0	3	5	0	1	5	0	1	1	1	6	12
Egypt	7	4	11	5	5	11	4	1	14	2	4	0	18	14	36
Jordan	5	1	29	4	0	13	2	0	4	0	1	10	11	2	56
Kuwait	0	0	4	1	1	16	0	4	28	0	0	0	1	5	48
Lebanon	0	0	1	0	0	0	0	0	1	0	0	4	0	0	6
Morocco	0	0	2	0	0	4	0	0	6	4	0	3	4	0	15
Oman	0	1	14	0	2	11	0	1	6	1	0	9	1	4	40
Saudi Arabia	0	0	7	0	1	7	0	7	7	2	0	0	2	8	21
Tunisia	3	1	3	0	7	5	0	0	3	1	0	0	4	8	11
UAE	0	1	1	2	1	1	3	4	2	0	0	13	5	6	17
WB & Gaza	0	3	2	0	0	1	0	0	1	3	0	6	3	3	10
TOTAL	16	12	75	12	20	74	9	18	77	13	6	46	50	56	272

⁴³ Amounts are in millions of US dollars.

With this design, the sample error with a confidence level of 95% for each type of entity in each country is depicted in Table E-4.

Table E-4: Sample Error for each type of entity			
	Non listed banks	Listed banks	Listed companies
Bahrain	0.0%	0.0%	24.1%
Egypt	8.9%	11.3%	13.9%
Jordan	12.1%	0.0%	11.5%
Kuwait	0.0%	19.6%	11.2%
Lebanon	--	--	24.5%
Morocco	24.5	0.0%	21.5%
Oman	0.0%	24.5%	13.2%
Saudi Arabia	0.0%	12.2%	18.9%
Tunisia	24.5%	12.2%	24.8%
UAE	0.0%	16.3%	20.1%
WB & Gaza	0.0%	32.7%	24.5%
TOTAL	5%	5%	5%

Banks and listed companies were selected on a random basis for each group as defined by country, type of company and size of bank/company.

iv. Sample calibration

Once the field work was completed, potential deviations from the designed sample were analyzed and corrected by considering the appropriate weight for each company or bank being part of the sample.

II. Annex 2: Corporate governance scoring methodology (indicators)

The corporate governance indicators for the MENA region as shown in Section C.I.ii were determined as follows:

Thirty two (32) questions were taken from the survey's key sections (Table E-5), each of which the survey authors thought to best represent adherence to key corporate governance practices.

Table E-5: List of corporate governance indicators

<i>Section</i>	<i>Number of indicators</i>
<p>I. Demonstrating commitment to corporate governance</p> <p>1. Banks and listed companies (hereinafter companies) that have a corporate governance code.</p> <p>2. Companies that provide training for the board in corporate governance issues.</p> <p>3. Companies whose boards are responsible for developing corporate governance practices.</p> <p>4. Companies that are able to properly define corporate governance.</p> <p>5. Companies that have cited implementing corporate governance practices as a very important priority.</p> <p>6. Companies that have a formalized code of ethics.</p>	6
<p>II. Implementing good board practices</p> <p>7. Companies that have at least two (2) independent board members.</p> <p>8. Companies where board members receive materials at least one week before the board meeting.</p> <p>9. Companies that conduct an annual board performance evaluation.</p> <p>10. Companies whose boards meet at least six (6) times a year.</p> <p>11. Companies that have formalized qualification requirements for being nominated to the board.</p> <p>12. Companies in which shareholders have a “say on pay”.</p> <p>13. Companies in which there is at least one female board member.</p> <p>14. Companies that have a succession plan in place.</p> <p>15. Companies that separate the position of chairman and CEO.</p>	9
<p>III. Building a robust control environment and processes</p> <p>16. Companies where the internal audit function reports to the board or the board’s audit committee.</p> <p>17. Companies that have an audit committee composed of a majority of independent directors.</p> <p>18. Companies that have defined a policy of external audit-partner rotation.</p> <p>19. Companies in which the external audit firm does not provide additional services different than audit.</p> <p>20. Companies whose audit committee develops procedures and policies for internal control and risk management.</p> <p>21. Companies that have an internal control function/internal controller.</p>	6
<p>IV. Strengthening transparency and disclosure</p> <p>22. Companies that prepare their financial reports according to IFRS.</p> <p>23. Companies that disclose financial information on their website.</p> <p>24. Companies that disclose non-financial information on their websites.</p> <p>25. Companies that disclose related party transactions to shareholders, for example, via their annual report.</p> <p>26. Companies that disclose their corporate governance policies and practices in their annual report.</p>	5
<p>V. Protecting shareholders rights</p> <p>27. Companies that have a voting policy allowing for cumulative voting.</p> <p>28. Companies where shareholders are notified more than 20 days in advance of the shareholders meeting.</p> <p>29. Companies where shareholders receive supporting documents prior to the shareholders meeting.</p> <p>30. Companies where their board members and management disclose and abstain from voting on issues where there is a conflict of interest.</p> <p>31. Companies where tag along rights are in force to protect minority shareholders.</p> <p>32. Companies that disclose the dividend policy on their website.</p>	6
TOTAL	32

- The scores of the thirty two (32) indicators were then used to construct a measure of good corporate governance (all items were given equal weights).
- The survey’s authors identified the banks and listed companies that satisfied each of the criteria using the survey responses.
- Finally, companies were grouped into five different levels of compliance, depending on the number of indicators they met, ranging from underdeveloped to best practice, as shown in Table E-6 below:

Table E-6: Indicators by banks and listed companies	
<i>Ranges</i>	<i>Level of practice</i>
0-7	<i>Underdeveloped practice</i>
8-15	<i>Emerging practice</i>
16-23	<i>Improved practice</i>
24-31	<i>Good practice</i>
32	<i>Best practice</i>
TOTAL	

The country comparison was conducted by averaging the number of indicators met by all listed companies and banks located in a particular country.

