CORPORATE GOVERNANCE IN SAUDI ARABIA-CONTEXTUAL ANALYSIS OF THE CURRENT SCENARIO

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ABSTRACT: *The corporate governance concept has an inordinate significance due to the financial failures and economic crises which several nations have witnessed in the last few decades. The effective application of corporate governance rules rest on the existence of infrastructure regulations. However, there are many countries who are still in infancy to implement corporate governance rules successfully and Saudi Arabia is one of them. Saudi Arabia commitment to corporate governance and observance to international principles and codes is widely appreciated, agreed that the Saudi Arabia, in many aspects, stands as the linkage among the West and the East [1]. However, there is still a room for a lot of improvement. In light of this, the paper will review the emergence of corporate governance framework and its current state in the Saudi Arabian context. Moreover, it also highlights some of the areas where the status quo of corporate governance still prevails. The Paper depends on theoretical library researches and the literature review in this field. It will help the head starters and the policymakers to get a quick review of current corporate governance status in the country.*

Keywords: Corporate Governance, shareholders, Corporate Governance in Saudi Arabia, Company Law, Report on the Observance of Standards and Codes

1. INTRODUCTION

The word Corporate Governance has come from the Greek word "kyberman" meaning to direct, guide. The term Corporate Governance has grown in prominence only in last two decades [2] Corporate Governance can be defined as a method by which the relations between ownership and the managerial systems are organized into the firms. The system of Corporate Governance is not a standard part of the International Business; however, the corporations today are striving to make the best out of it [3]. After the massive failure of biggest corporations around the world like WorldCom 2002, Adlephia 2002, Enron 2001 and Commerce Bank 1991, Corporate Governance received ample consideration. Over the recent years, the matter of Corporate Governance has gained popularity in both parts of the Atlantic Aguilera and [4]. It has become the issue of confab almost ubiquitously including boardrooms, classrooms and the mass media [5]. The main purpose of the consideration towards corporate governance was mainly led by the sequence of corporate catastrophes. These disasters affected both the internal and external stakeholders including the corporate environments.

The whole world was negatively impacted due to the failure in complying with corporate governance rules, for example, Asia, Russia, United States and Australia. Due to the poor Corporate Governance, countries, markets, and organizations had severe crises and failed to survive [6]. The investors did not have a long-term view assuming the profits to rise in the financial markets of the region. Europe and United States have also played their part in the problematic decisions of management which caused a massive loss including Enron Corp. and many other institutes like, United States' long-term credit management and Europe's Morgan Grenfell Chambers, (2002). Australia has also been averse because of the latest collapses of One Tel Ltd, Atele Communications Company, and HIH Insurance Company Ltd. Corporate Governance's importance became more evident after these cases [7]. With the financial crises, it became quite clear that without control, accountability in corporate boards and shareholder rights, even the strong economies can fall rapidly [8]. This fall is mainly caused by the loss of confidence of the investors in the economy. It was in the year 1998 that the "Organization for Economic Cooperation and Development"OECD came up with the "Principles of Corporate Governance", and gave the codes of Corporate Governance that are followed by the business [9].

2.0 EMERGENCE OF CORPORATE GOVERNANCE IN SAUDI ARABIA

Like many other nations who adopted the codes of corporate governance very late, the emergence of corporate governance started in 2006. After the times of King Abdul Aziz in the year, 1930s Saudi Arabia started emerging as one of the most significant parts of the world's business environment. The main business of the companies working in the Kingdom of Saudi Arabia is oil production, extraction, and distribution. Saudi Arabia is one of the most vital and strong members of G20 countries. The economy of Saudi Arabia is one of the richest and healthiest economies among the Gulf countries [10]. The economy of the country has started to incline towards the industrialization and there is an increased level of privatization. It was in the 1970s that the company law in the country was formulated. The law restricted the investments from the foreigners in

KSA [11].Kingdom of Saudi Arabia case is different from the rest of the world with reference to the improvement of Corporate Governance codes. In the Gulf region, Saudi Arabia was the second nation after Oman to incorporate corporate governance codes. After 2006 Saudi Corporate Governance Regulations (known as SCGRs) were regulated. In the same year, tadawul (stock market) crashed [12]. Principles that are followed in the business world of Saudi Arabia, for the purpose of Corporate Governance are mainly guided by the organizations like International Corporate Governance Network (ICGN) and the Organization for Economic Cooperation and Development (OECD. The Corporate Governance Model followed in the Kingdom of Saudi Arabia is more focused on the shareholder model/Anglo Saxon model.

The model of the Anglo-American model in Corporate Governance is similar to the model followed in Saudi Arabia. The only gap between the two is the model followed by the Saudi organizations is not only focused on the wealth of the shareholders and the strategies of the wealth maximization [13]. The Saudi model of corporate governance is one-tier and bear a resemblance to the Anglo-American model, however, there is also one key factor that influences the CG of KSA that is Islamic principles and code of conduct.

3.0 CRITICAL REVIEW OF CURRENT STATUS OF CORPORATE GOVERNANCE

The models followed by the organizations in Saudi Arabia are more Shariah complied and follow the Islamic principles and the Sunnah models. In other words, it can be said that the model of Corporate Governance in the Saudi organizations is focused on the maximization of the wealth of the investors but in ways that are Shariah complied [14]. The first of the Corporate Governance codes in the country was published in the year 2006; they were again reviewed in the year 2009. The idea of the Corporate Governance in Saudi Arabia is still in quite a weak state, it is mainly due to the lack of information available on the concept. However, [15] stated that the Codes of Corporate Governance that are valid for the organizations working in the western world may not be appropriate for the organizations doing businesses in Saudi Arabia. Even if the codes are applied, there will be a number of amendments and customizations required for the implementation of the codes. In light of this, the following provisions are compared to review some weaknesses of the Saudi Corporate Governance regulations. The main aim of SCGRs (Saudi Corporate Governance Regulations) is to give general regulations for publicly listed firms and their stockholders. This was aimed to expand the protection level for all stockholders, specifically for the minority.In 2009 it was required by the listed companies to establish audit committees with a minimum of three outside directors CMA). The audit committee is accountable for, amongst other items, instituting vigorous internal controls, dealing with external auditors, and creating suitable accounting rules.The Saudi Corporate Governance Regulation incorporates five major zones, the introduction to corporate governance, the privileges of stockholders, disclosure and transparency, the board of directors and the closing provisions [16]. Most of the SCGR (Saudi Corporate Governance Regulation) are only suggestions excluding few that are compulsory for the listed companies to adhere with. Since most of the Saudi Corporate Governance Regulations are optional and there is no penalty if the listed companies are not complying with it therefore many firms get the room to evade these provisions. Saudi Arabia has taken major steps for improving the corporate governance codes as stated by the World Bank report published in 2009. The ROSC Report on the Observance of Standards and Codes established that the country has widely implemented rules for shareholder rights protection (ROSC, 2009). However, the report highlighted a few limitations pertaining to shareholder rights in the corporate governance codes. For instance, there are many hindrances for the shareholders with less number of stocks, to attend the annual general meetings. Shareholders cannot vote electronically however they can appoint any shareholder to vote on their behalf. Corporations may distribute diverse classes of stocks and are needed to reveal explanations of groups permitted disproportionate control. However, the agreement between the stockholders that is a result of this disproportionate control are not disclosed. The system of voting in the country is not compatible with corporate governance and economic health, which provides to the expansion and movement of capital markets [17].The system of voting permits the major stockholder or allied stockholders to practice their votes to strengthen the control of other stockholders by nominating themselves. Majority or large stockholders can take benefit of such corporations as many individual stockholders do not attend the annual meetings [18]. Additionally, the large portion of ownership can represent the board which at times owns only 10 per cent of the stocks.The practical consequence of this system of voting is that not all stockholders have identical privileges, responsibilities and rights. This questionable is an indication of control by the individual at the expense of the institution. Another weakness of the Saudi Corporate Governance Regulations is that it fails to provide corporate governance definition. Saudi Corporate Governance Regulations also don't employ state of the art technology for the purpose of general meetings of the board which in turn deprives many stockholders of voting on general meetings decisions online. Certainly, this gap had a negative impact on many stockholders as most of them who own a small fraction of stocks are unable to bear the transportation, boarding and lodging cost to come and vote in general meetings [16]. One of the advantages of Saudi Corporate Governance Regulations is that it really deals well with the problems of disclosure and transparency, however, most importantly they overlook the sanctions for violating disclosure and transparency rules and regulations. Additionally, the Saudi Corporate Governance Regulations are bind with Saudi corporate law 1965. Saudi Corporate Governance Regulations still quotes articles from SCL 1965 which caused some issues since the Corporate law of 1965 is very old[16].Some of the scholars argue that the Saudi Corporate Governance Regulations should only be used for guidance and not as a compulsion, Indeed most of SCGR guidelines are only to direct but it doesn't matter if few of them are made compulsory when required [16].Though SCGR has adopted many rules from SCL 1965 still there are many contradictions between the rules and articles. For instance, Article 88 of corporate law 1965 demands publications 25 days before the general meeting of board scheduled date, whereas the SCGR required 5 days less that are only 20 days. Another example is the appointment of chairman and Managing director. In corporate law 1965, one board member can occupy both the positions whereas in SCGR position of chairman and CEO cannot be with one person. The irony is that the script has used the word 'prohibited' though the context is for guidance only. Either way, such conflicts are not in the welfares of the corporation and its stockholders, and for any weakness the law or guidelines, there must be clear and precise legal requirements to inhibit misperception in their application [19].The fiduciary duties for the board of directors are still an underdeveloped legal concept in the country, and corporate governance regulation compliance on the board main duties is still in embryonic stage as is the effectual enforcement of punishments for violating these fiduciary duties (CML).The stockholders have the privileges to file lawsuits of liability against directors via redress procedure explained in the corporate law. However, there is no law concerning precisely to minority stockholders. Till now, no litigations involving director's obligations have been filed in Saudi Arabia. The corporate law needs disclosure of compensation procedures and thresholds, however, there is no certain regulation on associating the remuneration of the board and senior management with the long-term interest of the corporation and stockholder [20].The board nomination procedures also lack provision in the corporate law for disclosure principles. The World Bank stated that not all the corporations are incorporating the functions of internal audit. The country cross board memberships are also equally low as cited by the World Bank [21].

4.0 CONCLUSION AND RECOMMENDATION

Economists have noted that the current SCGRs are (theoretically) being applied in joint stock companies but many are trying to avoid their implementation. This state will expose the door to exploitation on the part of those corporations. The capable authorities must attempt to impose the implementation of the laws. According to a report on the observance of standards and codes of corporate governance in Saudi Arabia, 2009, (ROCG) the Corporate Governance awareness needs more attention. Many stockholders are unaware with the term Corporate Governance; there is an overall weakness in disseminating the notion of Corporate Governance, and the purposes of the CMA(capital market authority) in terms of educating stockholders. Similarly, there is a necessity to propagate the significance of corporate governance in all the establishments and to start off with public and private universities in the country should espouse teaching corporate governance literature. More and more scholars should focus on expanding the literature in the region. In a nutshell, this would add to refine the legal and commercial environs in the region. Another vital step would be to secure shareholder, though the CMA's 2004 Regulations incorporate rules to inhibit market , however, protection of minority stockholders is not ensured. Stockholders with minority might be frightened of taking the initiatives as they are unaware of the risks. Thus, the CMA, as financial market regulator should call minority stockholders to make unions safeguarded by a CMA special unit formed specifically for this purpose. This unit must have the expert jurists who are aware with the financial markets and thus they can notify stockholders of their privileges and guide them through any legal accusations [22]

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