CORPORATE GOVERNANCE DISCLOSURE PRACTICES AND PROTECTION OF SHAREHOLDERS IN SAUDI ARABIA

A Thesis Submitted for the Degree of Doctor of Philosophy in Law

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Declaration

I declare that, except where acknowledged, this work effort is my own, completed with the direction and advice of my supervisor.

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Abbreviations

CGR	Corporate Governance Regulations
CL	Company Law
CMA	Capital Market Authority
CML	Capital Market Law
CSR	Corporate social responsibility
CRSD	Committee for the Resolution of Securities Disputes
EGM	Extraordinary general shareholder meeting
EU	European Union
FSA	Financial Services Authority
GCC	Gulf Cooperation Council
GSM	General shareholder meeting
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
LR	Listing Rules
LSE	London Stock Exchange
OECD	Organisation for Economic Co-operation and Development
ROSC	Report on the Observance of Standards and Codes
SAMA	Saudi Arabia Monetary Agency
UK	United Kingdom
US	United States of America

Journal Abbreviations

ABR	Accounting and Business Research
AER	American Economic Review
AJPA	Australian Journal of Public Administration
ALQ	Arab Law Quarterly
BBLJ	Berkeley Business Law Journal
CG	Corporate Governance
CGA	Corporate Governance Advisor
CL	Company Lawyer
FRBNY EPR	Economic Policy Review – Federal Reserve Bank of New York
FRL	Finance Research Letters
GCGF	Global Corporate Governance Forum
GLR	Georgia Law Review
HLR	Hofstra Law Review
IBLJ	International Business Law Journal
ICCLJ	International & Comparative Corporate Law Journal
ICCLR	International Company and Commercial Law Review
ICT	Industrial and Commercial Training
IFLR	International Financial Law Review
IJHSS	International Journal of Humanities and Social Sciences
IJMBS	International Journal of Management & Business Studies
IJSR	International Journal of Science and Research
JAE	Journal of Accounting Economics
JAR	Journal of Accounting Research
JBE	Journal of Business Ethics
JBL	Journal of Business Law
JC	Journal of Communications
JCL	Journal of Corporation Law
JED&C	Journal of Economic Dynamics and Control
JEP	Journal of Economic Perspectives
JF	Journal of Finance

JFE	Journal of Financial Economics
JFQA	Journal of Financial and Quantitative Analysis
JFRC	Journal of Financial Regulation and Compliance
JPA	Journal of Public Affairs
JPE	Journal of Political Economy
KKUJ	King Khalid University Journal
MAJ	Managerial Auditing Journal
MEED	Middle East Economic Digest
MF	Management Review
OJLS	Oxford Journal of Legal Studies
PA	Public Administration
RAEE	Research in Accounting in Emerging Economies
RIBF	Research in International Business and Finance
SMJ	Strategic Management Journal

Abstract

Corporate governance in general has become the new crucible in which corporations are tested and declared worthy of the trust of international investors. In an age when countries compete in a global economy, compliance with corporate governance standards has become crucial to the survival of businesses. Especially in the Middle East, which is culturally and politically distant from the rest of the world, compliance with the internationally accepted principles of corporate governance has become a challenge.

This thesis aims to examine how a specific aspect of corporate governance—disclosure and transparency—is viewed and applied in the Saudi Arabian context. The results of this study are important primarily for Saudi Arabian businesses positioned to play a significant role in the global economy. The Saudi economy is one that has a number of industries such as the oil industry, which forms the largest contributor of the GDP of the nation; about 67%. Other companies in the country include those, which deal in consumer goods, the financial sector, the media, retail, telecommunications, technology, travel and leisure and telecommunications. The largest conglomerates are those that deal in the oil and gas industry. These companies could benefit greatly from the financial strength provided by international investments, the technical and strategic advantages offered by partnerships and joint ventures with foreign companies and the market leadership obtained by gaining the trust and confidence of consumers in the global market. Achieving these benefits becomes feasible only if Saudi firms can comply with the minimum disclosure and transparency requirements.

The thesis employs critical and comparative analyses. It explores the academic literature on corporate disclosure and discusses the theories and principles espoused in the context of the Saudi Arabian legal and regulatory framework. Also discussed is the vital role of the Islamic principles in Sharia law, which forms the basis of the Saudi legal system. This study proposes corporate disclosure practices as the basis for comprehensive reform of Saudi Arabia's Capital Market Authority. The idea of corporations is alien to the Islamic law, but the idea of disclosure and transparency is a fundamental of the Islamic corporate governance. The disclosures that the organizations make have a target of attaining transparency and the promotion of market discipline concerning the same institutions. There is also the conceptualization of the fact that the

effectiveness of the corporate organizations relies on how they complement the international standards. The study offers recommendations for increasing transparency, disclosure and the associated principles in the Saudi Arabian stock market and better protecting minority shareholders. These recommendations follow the United Kingdom's corporate governance approach but reflect the interests, culture, treaties, Sharia principles and legislative reforms of the Kingdom of Saudi Arabia. The thesis concludes by presenting the Saudi perspective on disclosure and transparency and its prospects for future development.

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Chapter One

Introduction

1.1 Preamble

At the outset, it will be useful to clarify the meaning of disclosure and transparency. Disclosure can be defined as a state in which corporations make themselves open to the public through actions with regard to their operations, such as releasing information about their administration, financial status and other aspects of governance and management. This openness helps members of the public to understand the corporation's situation, thus shaping their attitude towards it and making corporate governance easier. Transparency entails the exercise of virtues such as accountability and goodwill by corporate managers and multinational corporations in the performance of their duties and responsibilities. These two concepts, disclosure and transparency, are extremely important; they enable companies to secure honest leaders who possess credibility and dignity and permit no ambiguity that could lead to various misunderstandings and problems in the future. Therefore, research on these concepts is of great importance.

The objective of this thesis is to explore disclosure and transparency within the context of corporate governance in Saudi Arabia. A general overview of fundamental concepts and theoretical models of corporate governance are discussed first. This is followed by the history of the development of corporate governance in the United Kingdom (UK) and Organisation for Economic Co-operation and Development (OECD) frameworks. Next, the state of corporate governance and the level of disclosure and transparency in the Saudi context, including the legal system and accountability framework, are analysed. This study also examines how corporate governance is understood by various authors, present practices and frameworks of corporate governance and their impacts on different aspects of corporate governance in Saudi Arabia.

1.2 General Background

Corporate governance has existed since antiquity, when tribal communes supervised the activities of tribal members to ensure that they conformed to tribal norms. In the agricultural communities that followed, family councils performed family-centric monitoring for the same reasons as the tribes.[1] The Roman Empire appointed municipal bodies to manage public affairs and compel administrators to be transparent in order to serve the public good. Elsewhere, nomadic tribes in the Arabian region held councils to enforce fair play and equitable dealings with one another. Later, when the great religions of Christianity and Islam arose, the religious hierarchies performed the function of oversight of community members.[2] On the other hand, corporate governance refers to the set of rules, processes and practices that direct and control a company. Such activities may essentially entail the balancing of the interests of the stakeholders of the company such as the shareholders, the management, suppliers, customers and others. Corporate governance gives a framework that helps in the attainment of the objectives of a company through its encompassing of all spheres of management. Capital and securities markets are those concerned with financial investments that relate both indirectly and indirectly with capital. Therefore the laws that govern such processes are what this work will refer to as securities and capital market regulations.

During the Renaissance and the era of discovery, traders and explorers from Europe travelled the seas to set up the first centres of global trading, and the earliest corporations were formed to conduct trade along these routes. Global traders reported their activities to their monarchs, similar to the modern concept of corporate governance in which corporate auditors report to government regulators or oversight agencies. Among the 16th century naval voyagers, the best, most active traders came from England, which became the most powerful trading nation in the world. To ensure the accountability, efficiency, effectiveness and optimal performance of trading

[1] Lai Oso and Bello Semiu, 'The Concept and Practice of Corporate Governance in Nigeria: The Need for Public Relations and Effective Corporate Communication' (2012) 3(1) JC 4.
[2] AP Kurkure, 'Elements of Excellence in Corporate Governance Systems and Structures: Lessons Learned' (UICC World Cancer Congress, Washington DC, 2006).

companies to the satisfaction of shareholders, the Bank of England formulated rules and a regulatory framework with which trading companies were required to comply.[3]

The early beginnings of corporate governance are evident in the development of regulations and compliance procedures. These became institutionalised and adopted as common practices in industry. Many rules survived to form the basis for modern corporate governance, which was formalised in the 1970s and which continues to be the subject of serious debate worldwide.

Reforms aimed at developing a world model for corporate governance that address cross-border investments in a global economy are expected to emerge as foreign shareholders are concerned with the exercise and enforcement of their rights in their overseas investments. To meet such concerns, corporate directors' duties and powers might be expanded significantly in order to ensure they maintain their legal accountability and their duty of loyalty to shareholders and the company.[4]

Modern discussions on corporate governance tend to reference three official documents released since 1990: the 1992 UK Cadbury Report, the 1998 and 2004 OECD Principles of Corporate Governance and the 2002 United States (US) Sarbanes-Oxley Act. In addition, numerous models of corporate governance exist around the world. Such debates provide the background against, which Saudi Arabia's business entities could learn the approaches of corporate governance even while the country does not have a similar approach to corporations as the west. The arguments provide some of the best practices that provide the similarities between the two economies especially with regard to the rules of disclosure and transparency. Such rules also provide the framework against which the rest of the countries across the world perceive investment in Saudi Arabia.

The differences in these models depend on the extent to which they have adopted capitalism. For example, the Anglo-American model emphasises the shareholder's interests, and the Japanese model shares these principle. Corporations are created according to and governed by the rules and regulations of a specific jurisdiction. When exploring the issue of corporate governance, it is prudent to evaluate the legal environment, specifically the applicable codes and guidelines. Key

[3] Oso and Semiu (n 1) 4–5.
[4] Oso and Semiu (n 1) 5.

parties in corporate governance include government agencies, corporate management and stock exchanges. All corporate governance settings need mechanisms and controls that lessen the occurrence of inefficiencies which can arise within a corporation. Various researchers have developed theories to explain the concept of corporate governance.

1.3 Research Significance

Modern business affairs have forged linkages between multinational corporations and domestic enterprises in an increasingly globalised economy. For business transactions to flow freely, trust must be fostered among all partners and parties. This is the principal reason why companies, especially publicly listed firms, should abide by the universal tenets of good corporate disclosure even—and especially—across borders. Foreign direct investments are facilitated by an investment climate perceived as low risk, which can exist only with transparency and full disclosure of company information. A level playing field created by an appropriately regulated financial system is crucial for competition to spur a robust business milieu.

The study of corporate governance, particularly transparency and disclosure, as applied in the business field is vital to understanding the free market regime under which international business systems thrive. This thesis sheds light on the issues of disclosure and transparency as they pertain to the Kingdom of Saudi Arabia. As the seat of Islam and the Middle Eastern country with the largest land mass and population, the Kingdom can play a pivotal role in the region's emerging economies. An understanding of the status of corporate disclosure and transparency and how it can be improved will be crucial to these countries' and the region's economic success.

1.4 Research Problem

The primary research question addressed by this thesis is: What are the roles of disclosure and transparency in enhancing corporate governance and its principles in Saudi Arabia? The research will also explain the conceptualization of the Islamic law with regard to corporations. Such an element of the work means that there is a review of the provisions that the Sharia law has on corporations after a consideration that the Islamic law is contractual. To achieve the objectives mentioned in the preceding section, this thesis also seeks to answer the following research questions:

(1) What is corporate governance as conceived in the West and as understood under Sharia principles?

(2) How is corporate governance, particularly disclosure and transparency, observed and practised in Saudi Arabia?

(3) How have the Saudi legal framework and practices developed regarding international standards for corporate governance, particularly disclosure and transparency?

1.5 Research Methodology

This thesis employs critical and comparative analyses. The critical analysis reviews the available literature, laws and regulation in order to construct a comprehensive overview of the Saudi legal framework for corporate governance and to gain insights into possible reform measures. The review also includes legal opinions and decisions by the Capital Market Authority (CMA) Board and the Committee for the Resolution of Securities Disputes (CRSD) in cases dealing with themes of corporate disclosure and transparency.

This thesis presents a case study of Saudi Arabia's corporate governance regime and its level of implementation. Special attention is given to the corporate governance framework established by the Capital Market Law[5] (CML) and its implementing regulations. Although data were drawn

[5] The Capital Market Law, pursuant to Royal Decree No M/30, dated 31 July 2003 (CML).

mostly from secondary sources (written documents), primary information was obtained from visits to the CMA and the Saudi Arabia Monetary Agency (SAMA). During personal meetings, officials and personnel at these agencies provided numerous details. They clarified uncertainties in the secondary data and created a clear picture of how these bodies function and fulfil their responsibilities while developing good corporate governance practices.

In addition, this thesis performs a comparative analysis of Saudi corporate disclosure regulations and their counterparts in UK statutes and OECD corporate governance principles, particularly with reference to the development of a suitable framework for corporate governance. Comparative analysis frames emergent legal controversies by how they are resolved in comparable legal jurisdictions, thereby extending the scope of laws and increasing the resilience of the resulting legal model.[6]

1.6 Research Aims

The general aims and objectives of this thesis are to:

(1) Examine the concept and rationale of corporate governance;

(2) Conduct a comprehensive assessment of corporate governance in Saudi Arabia;

(3) Describe in-depth the status of disclosure and transparency in Saudi Arabia and the degree to which it complies with international standards;

(4) Compare the corporate governance mechanisms and practices in the UK and Saudi Arabia; and

(5) Describe the role of Sharia in Saudi corporate governance.

[6] Jonathan Hill, 'Comparative Law, Law Reform and Legal Theory' (1989) 9 Oxford Journal of Legal Studies 102.

1.7 Research Scope and Limitations

This thesis thoroughly investigates the issue of corporate governance in Saudi Arabia, focusing on disclosure and transparency and considering issues that directly or indirectly affect the state of corporate governance in the Kingdom. The study also assesses international standards of corporate governance to determine Saudi Arabia's level of compliance with them. It examines the state of and laws regarding corporate governance in other nations, namely the UK, in an attempt to draw comparisons with Saudi Arabia. Regarding the social factors that influence corporate disclosure, the study considers Sharia law and its influence on the business environment. Disclosure and transparency are discussed with special reference to Saudi Arabia.

1.8 Thesis Structure

After the first chapter presents an overview and the general background of this research and its significance, methodology, aims, main questions, scope and limitations, the second chapter discusses the fundamental concepts of corporate governance and its importance, beneficiaries and models. The chapter also elucidates on theories concerning the development of corporate governance, including shareholder, agency, stakeholder and corporate social responsibility (CSR) theory. The philosophies of different jurisdictions, such as the UK, US, Germany and the OECD, are also considered. In addition, the roles of disclosure and transparency in the stock market are addressed.

The third chapter narrows the focus from the general area of corporate governance to the more specific issues of corporate disclosure and transparency. Definitions of disclosure and transparency are discussed, followed by the role, importance, advantages and principles of disclosure, including what types of information should be disclosed and to whom. This chapter also briefly considers important points regarding disclosure in financial and international scandals. In addition, this chapter considers various forms of disclosure applied to corporate governance as well as the legal and civil remedies for non-disclosure.

The fourth chapter begins by describing the background of Saudi Arabia, its basic law and legal framework. This chapter outlines the institutional infrastructure of the corporate governance

framework in Saudi Arabia. The government agencies and institutions charged with the oversight and regulation of corporate activities in order to ensure compliance with corporate governance principles are identified and described. Included in this are the CMA; its subordinate unit, the General Department of Corporate Governance; the CRSD, which includes the Securities Disputes Committee and the Securities Conflict Appeal Committee; the SSE or Tadawul; the Ministry of Commerce and Industry; and the accounting and auditing professions regulated by the Saudi Organization for Certified Public Accountants (SOCPA) The current practices of and improvements to the Saudi corporate governance framework are analysed and evaluated, including corporate governance regulations and the Company Law (CL).[7]

The fifth chapter describes and examines minority shareholders and their protections under the CL. The Saudi Corporate Governance Regulations (CGR)[8] and the role and rights of shareholders and stakeholders under it are discussed. Finally, this chapter turns to the accountability framework, including the influence of Sharia law in the Saudi business environment and the Islamic perspective on accountability. In addition, a description is given of the role of the board of directors in Saudi corporate governance and the principal fiduciary duties of corporations' board of directors are explained: the duty of care, the duty of loyalty and the duty to act within the board's powers. The roles and responsibilities that are created by these board members' powers are also described. The determination of board members' compensation, a sensitive topic in corporate governance in the aftermath of the 2008 global financial crisis, is highlighted. The Saudi ownership structure is also considered.

Chapter Six deals with issues involving corporate transparency in the Saudi capital market. Topics discussed in this chapter include the Saudi approach to disclosure and transparency, disclosure provisions in the CML and regulations of market abuses, such as price manipulation, irregular trading and 'name and shame'. The regulatory response to the market crash of February 2006 is described, followed by the degree and manner of Saudi Arabia's compliance with the OECD Principles of Corporate Governance. This compliance includes investor protection, disclosure and enforcement. Shortcomings in the legal framework, such as the lack of separate regulation, scarcity of competent staff in capital markets and factors in the cultural environment,

[7] Company Law, Royal Decree No M/6, dated 22 July 1965 (CL).
[8] Corporate Governance Regulations in the Kingdom of Saudi Arabia, issued by the Board of Capital Market Authority pursuant to Resolution 1/212/2006, dated 12 November 2006 (CGR).

are identified. This chapter also suggests reforms and conditions necessary for the effective implementation of the principles of corporate governance, particularly disclosure and transparency. Disclosure and transparency provisions are highlighted in detail, along with the important role of disclosure performed by the board annual report.

Chapter Seven summarises the main points of the thesis and presents conclusions and recommendations.

1.9 Chapter Summary

This first chapter defined the research problem and its context: determining the role of disclosure and transparency in enhancing corporate governance in Saudi Arabia. Corporate governance is seen as a requisite for participation and leadership in international trade and investments, and disclosure and transparency emerge as the miracle cure for corporate governance. The most important concern of multinationals and international businesses and investors is the eradication, or at least the reduction, of risk and exposure to loss. The assurances offered by comprehensive information that are provided through transparency and disclosures are necessary for risk reduction.

This case study utilises critical and comparative analysis, focusing on Saudi Arabia's attempt to enhance corporate governance as viewed against international standards and practices. This chapter also highlighted the general background, significance, methodology, aims, questions, scope and limitations of the research.

The chapter concluded with a concise description of the thesis structure in order to show how it arrived at the logical conclusions that address the research problem and questions. The next chapter discusses the research proper, including the definitions of corporate governance, transparency and disclosure; international standards, models and theories; and the principal concepts upon which this thesis is based.

The chapter also provides a prelude to what will take place in the following chapters. It traces the development of corporate governance through the years and the seven chapters, and in tandem

with the growth of the legal structure in Saudi Arabia. More importantly, the chapter considers the procedures and methodologies that will be involved in working on the paper.

Chapter Two

Corporate Governance: Definition, International Standards, Models and Theories

2.1 Overview

The second chapter deals with the theoretical foundations of corporate governance and the accumulated body of knowledge on the subject. Establishing the theories on corporate governance is important to anchor the discussion of Saudi Arabian corporate governance within the literature and to explain where the Saudi framework is consistent with or differs from the contemporary models and the reasons why it converges or diverges.

2.2 Fundamentals of Corporate Governance

2.2.1 Definition and Fundamental Concepts of Corporate Governance

The concept of corporate governance can be interpreted both narrowly and broadly, depending on whether it is viewed from the perspective of the shareholder or the stakeholder. In its narrow definition, corporate governance deals with the relationships between the corporation's managers, board of directors and shareholders. This definition views proper corporate governance as the accountability of management to the board of directors and of the board to the shareholders, and as the management of the corporation's affairs being consistent with the interests of the shareholders as they are the owners of the company.

The broad definition encompasses the corporation's relationship not only to shareholders but also to all stakeholders and society in general. This definition also includes the combination of numerous laws, regulations, rules of the stock exchange, codes of conduct and private sector practices that enable the firm to attract capital, perform according to its charter, generate profit and accomplish its obligations both under the law and in the expectations of society in general. Table 1 presents specific definitions of corporate governance.

Table 1. Definitions of Corporate Governance[9]

DEFINITION	ORIGIN / PERSPECTIVE
Corporate governance describes ways of ensuring that corporate actions, assets and agents are directed at achieving the corporate objectives established by the corporation's shareholders	Sternberg (1998) gives a definition very much in favour of a shareholder perspective.
The approach of corporate governance that social, moral and political questions are proper concerns of corporate governance is fundamentally misconceived. Expanding corporate governance to encompass society as a whole benefits neither corporations nor society. Because management is ill-equipped to deal with questions of general public interest.	Lipton and Lorsch (1992) clearly speak for the shareholder perspective as management is not "well-equipped" enough to deal with multiple constituencies.
Corporate governance is the process of control and administration of the company's capital and human resources in the interest of the owners of a company.	Hess (1996) about the general position within the US. The shareholder is the focus of the company.
Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment	Shleifer and Vishny (1997). This definition is broader than a pure shareholder perspective, as other creditors in addition to the shareholders are mentioned.
Corporate governance is the whole system of rights, processes and controls established internally and externally over the management of a business entity with the objective of protecting the interests of all stakeholders.	Centre of European Policy Studies (CEPS, 1995); The objective of protecting the interest of all stakeholders is clearly a sign of a Continental European definition.
Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.	The Cadbury Report (1992), para 2.5 gives a quite neutral definition of corporate governance, highlighting the importance of shareholders and boards of directors.
Corporate governance defines a set of relationships between a company's management, its board, its shareholders and other stakeholders	The OECD Principles of Corporate Governance (2004) are trying to give a very broad definition as it should serve as a basis for all OECD countries.

The definitions in Table 1 include a fair representation of both the shareholder (narrow definition) and the stakeholder (broad definition) views. The definitions of Sternberg, Lipton and Lorsch and Hess all lean towards the narrow viewpoint, which is the traditional perspective and consequently has more proponents.[10] However, the Centre of European Policy Studies definition

[9] Udo C Braendle, Alexander N Kostyuk and Rodolfo Apreda (eds), *Corporate Governance* (Virtus Interpress 2007).
[10] ibid 7.

reflects the Continental European preference for the broad view of corporate governance.[11] Other definitions adopt a neutral position between shareholders and stakeholders (the Cadbury Report, 1992)[12] or transcend the narrow definition without entirely adopting the broad view (Shleifer and Vishny).[13]

There are many more definitions not included here, and this highlights the wide range of meanings attributed to corporate governance which sometimes results in ambiguity in corporate stakeholders' expectations. Further development of this theme, therefore, is necessary. However, for the purposes of this thesis the broad definition is adopted with particular focus on legislative measures which affect particular actors (e.g. management, shareholders, board of directors) in the corporate governance framework.

2.2.2 Concept of Corporate Governance

Corporate governance is a process that targets the allocation of resources in a way that helps to maximize the stakeholders' value. The stakeholders in this case could refer to the investors, the customers, suppliers, the employees as well as the environment that determines the nature of corporations. Corporate governance targets to hold the mentioned parties responsible through an evaluation of the decisions they make concerning inclusivity, transparency, responsibility and equity. Therefore, corporate governance refers to the existence of a set of processes, policies, customs and laws that influence the direction of a company and the nature of its operations. The process could also incorporate the existing relationships among the stakeholders mentioned and the functions for which there is governance of the companies.

Corporate governance has nebulous beginnings, vaguely conceived of as a means with which to control, direct and make corporations accountable by focusing on the fulfilment of the social obligations of corporation leaders in the matters of wealth creation and sustainability.[14] The concept of corporate governance has become more explicit and clear: it requires businesses to be

[11] Centre of European Policy Studies, *The objective of protecting the interest of all stakeholders is a clear sign of a Continental European definition'* (1995).
[12] Adrian Cadbury, *Report of the Committee on Financial Aspects of Corporate Governance* (Gee 1992) 19.
[13] A Shleifer and W Vishny, 'A Survey of Corporate Governance' (1997) 52(2) Journal of Finance 737.
[14] I Wilson, 'Regulatory and Institutional Challenges of Corporate Governance in Nigeria Post Banking Consolidation' (2006) 12(2) Nigerian Economic Summit Group Economic Indicators 1–10.

socially responsible, morally upright, transparent and accountable for their activities. It is no longer confined to the relationship of managers and shareholders but positions the corporation as a quasi-public institution answerable to its stakeholders and society in general. Corporate governance represents a paradigm shift in the philosophy of business management and has changed the environment in which businesses thrive.[15]

While the regulatory framework of corporate governance varies among nations, a number of basic principles are common to all corporate governance models worldwide:

(1) The fundamental *rights and equitable treatment of shareholders* are protected and guaranteed, including their full participation in the affairs of the corporation through general meetings.[16]

(2) Corporations have the obligation to recognise the *interests of stakeholders* in the formulation of policies and the conduct of operations.

(3) It is the *role and responsibility of the board of directors* to oversee the proper management of the corporation. Therefore, board members must have the competence, skills and understanding necessary to make decisions as members of the corporation's highest decision-making body, along with the wherewithal to challenge management in the proper execution of their duties.[17]

(4) Central to the practice of good governance is the maintenance of *integrity* and observance of *ethical behaviour* at all levels of the corporation, including ethical and responsible decision-making, the proper management of risk and compliance with the law in order to avoid lawsuits. Most corporations adopt a code of conduct that specifies favoured and discouraged or forbidden behaviours.[18]

(5) *Disclosure and transparency* are requirements in the performance of management and the board's dealings with the company's stakeholders because the management and board are held to a high degree of accountability by the stakeholders, government and society in

[15] Oso and Semiu (n 1) 3.
[16] Oso and Semiu (n 1) 5.
[17] ibid.
[18] ibid.

general. It is the duty of organisations to publish the identities, roles and responsibilities of the board and executives, to regularly report their performance and executive compensation and to submit to an independent verification of the corporation's financial reporting. In other words, the firm must fully disclose all material information concerning the organisation.[19]

In addition, the principle of consistent policies that enables participants along the value chain to have accurate expectations and be stronger as a whole is also common. Companies should realise that they influence the mobilisation of resources, not only their own but also those of others along the value chain, and inconsistencies in their policies creates less stability for its suppliers, contractors, customers and investors.[20]

2.2.3 Importance of Corporate Governance

The growing prominence of corporate governance, especially in the past 20 years, indicates the importance of corporate governance in the modern business environment. There are five specific reasons for this growing importance.[21]

(1) Wave of Global Privatisation

The privatisation of productive undertakings is an international trend in business, especially in former communist countries whose economies are undergoing a transition to free market regimes. In Europe, it is necessary to adopt a free market economy with private enterprises participating actively in order to accede to the European Union (EU). The wave of privatisation, which originated in the UK, accounts for approximately 90% of privatisation proceeds in the EU

[19] ibid 5-6.
[20] Dr Yılmaz Argüden is the Chairman of ARGE Consulting, an Istanbul based strategy boutique and the Chairman of Rothschild, Turkiye. This article is based on a corporate governance model developed by Dr Argüden, Pınar Ilgaz, and Burak Ersahin from ARGE Consulting. Dr Argüden is a member of the Global Corporate Governance Forum Private Sector Advisory Group. Dr Yilmaz Argüden, 'Corporate Governance Model: Building Responsible Boards and Sustainable Businesses' (Private Sector Opinion, issue 17, 2010) 3.
[21] Marco Becht, Patrick Bolton and Ailsa Röell, 'Corporate Governance and Control' (European Corporate Governance Institute Finance Working Paper No. 02/2002, October 2002) <http://ssrn.com/abstract_id=343461> accessed 10 May 2012.

since 1991; while Australia, France, Italy, Japan and Spain account for 60% of all privatisation internationally since 1995.[22]

Former state-owned corporations tend to perform a crucial function in the economy and society. Once privatised, their new ownership and control become critical issues because of the effect on how the companies are run and its impact on the economy and society. In Europe, great care was taken to ensure that control was transferred to large shareholders in order to ensure the continuing interest of a dominant, competent entity and encourage consolidation. In contrast, the UK constructed a form of 'shareholder democracy'[23] and conducted most sales by public offerings instead of private placements. The composition of and interests represented by the owners of a vital enterprise have a strong influence on the quality of corporate governance after privatisation, and the public interest and welfare rides upon this governance.[24]

(2) Pension Fund Reform and Growth of Private Savings

It is common in most developed countries, particularly the US, for sizeable resources to be set aside in anticipation of retirement by senior citizens. This practice has built pension funds and similar investment entities that have grown into massive, powerful institutions. This has contributed to the need for good corporate governance. In 2007, shortly before the subprime mortgage crisis, US institutional investors alone accounted for 60% of total equity investment in the OECD; combined with UK institutional investors, the percentage rises to 76%. Of this figure, 40% consisted of pension funds in the UK and US.[25] The managers of these funds have a duty of accountability to their individual investors, especially in light of the public welfare interest resting in the funds and the need for substantial appreciation to finance investors' retirement.[26] The safety of such investments necessitates assurances of good corporate governance.

(3) Wave of Mergers and Takeovers

During the 1980s in the US and from the 1990s to the present in Europe, large corporations have merged with or acquired other companies across industries. Takeovers frequently have been

[22] Becht, Bolton and Röell (n 21) 4, 122.
[23] ibid 4, 122.
[24] Becht, Bolton and Röell (n 21) 4, 122.
[25] Braendle, Kostyuk and Apreda (n 9); ibid 5, 126.
[26] Becht, Bolton and Röell (n 21) 4, 122.

hostile, meaning that the acquisition of the target company was transacted without the agreement of the management (not necessarily the shareholders).[27] Takeovers of large companies tend to concentrate power and control in a relatively small group of shareholders. Moreover, when the companies are in the same industry, they tend to create large corporations that operate as monopolies and discourage healthy competition. Cross-border transactions, such as the US$200 billion takeover bid of Mannesmann by Vodafone in 2000, also partially shift regulatory control to another political jurisdiction. They have serious implications for corporate governance because of the relations between the new shareholders and management. The EU, therefore, has made regulation of takeovers part of its political agenda.[28]

(4) Deregulation and Integration of Capital Markets

The integration and linkage of world capital markets and the widening of cross-border transfers of equity capital has increased interest in corporate governance among global investors unfamiliar with the accounting report systems and legal systems in other countries where they might invest. The establishment of common frameworks for corporate governance is expected as companies continue to source capital from overseas investors.[29]

[27] ibid 6, 122.
[28] Braendle, Kostyuk and Apreda (n 9); ibid 6, 126.
[29] Becht, Bolton and Röell (n 21) 7, 122.

(5) Economic Crises

Frequently, economic crises highlight weak corporate governance practices in many countries. In many cases, it is widespread corruption, deceit, failure to comply with the law and similar acts of poor corporate governance that trigger and spread economic crises. The proper workings of the free market economy depend heavily on the free flow of information and full disclosure of the affairs of corporations so that investors, suppliers and customer can make decisions which maximise their interest. Poor corporate governance prevents the economy from growing. Therefore, more consistent observance of good corporate governance will result in a stronger economy and fewer severe economic crises. The case of Saudi Arabia presents an economy that deals with the corporate governance regulations that have their foundations in religion. For this case, there are a number of complications that the system holds especially in its comparison to the West and main guiding principle is that of disclosure.

2.2.4 Beneficiaries of Corporate Governance

Corporate governance produces a number of benefits.[30]

- Good corporate governance increases shareholder value, leading to an appreciation of the share price.
- Eight out of 10 institutional investors will pay a premium price for a well-governed company.
- Company executives rank financial returns lower than transparency and honest practices. However, US companies with good corporate governance practices outperformed those considered to have below average corporate performance by 18.9% over a two-year period.
- Good corporate governance practices can prevent corporate failure caused by: (1) poor strategic decisions; (2) over-expansion and ill-judged acquisitions; (3) greed, hubris and

[30] Oso and Semiu (n 1) 3.

the desire for power; (4) failure of internal control at all levels from the top down; and (5) ineffectual and ineffective boards.[31]

Having identified the benefits, the beneficiaries become evident. Good corporate governance apparently works to the greatest advantage of corporate shareholders because all aspects of corporate governance first and foremost seek to protect the shareholders whose rights are guaranteed by law. As owners of firms, shareholders have the ultimate responsibility to ensure that the businesses they own earn profits and conduct their affairs legally. Therefore, they are entitled to be informed of the firms' actions and empowered to exercise control over them.

Institutional investors—those who buy shares not for the purpose of running the firms as owners but for capital appreciation and dividend income purposes—benefit from the firm's reputation for good corporate governance. Companies reputed for their integrity and compliance with the law and norms can develop brand loyalty and customer patronage, driving sales and bottom lines that justify dividend pay-outs and price appreciation. Consequently, stock prices rise, thus giving investors an added incentive to purchase their shares.

Employees, suppliers and contractors also benefit from good corporate governance. These stakeholders have direct dealings with the corporation, and the assurance that the firm abides by the principles of good corporate governance increases their confidence in the firm and their commitment to engage with it. This improves its stability and growth.

Finally, good corporate governance benefits the government, community and society because the practices of transparency and disclosure create a bond of trust between the company and its external public. This allows the state to collect more taxes, supports public acceptance of the company and reliance on its sense of corporate responsibility and facilitates collaboration to address any environmental damage to the community. The ultimate result is that the company prospers.

[31] Stewart Hamilton and Alicia Micklethwait, 2006, cited in WB Dabiri, 'Corporate Governance and Accountability' (April 2012) Adnews Monthly 28.

2.2.5 Corporate Disclosure and Transparency

Disclosure and transparency in the stock market play crucial roles in corporate governance, allowing organisations to publish data on key management practices, such as financial and non-financial statements, CSR activities and audit reports. These policies make shareholders aware of events affecting investment. This constitutes an important aspect of shareholder theory, that the directors of the company should manage it on behalf of the shareholders. This is not a true agency relationship and so creates a fundamental problem in corporate governance regarding costs.

Shareholders need to know about their capital in the company which is managed by corporate directors and make sure that the directors are leading the company for the benefit of the shareholders' interests. Procedures and strategies for the organisation in order to reduce costs to shareholders that result from the failure of management in the performance of its duties are also necessary. Consequently, disclosure has become highly important in corporate governance. Interested parties should be aware of the company's activities in order to determine whether the business is serving their interests. Disclosure can also reveal faults within the company and conflicts of interests between management and shareholders. In addition, disclosed information can affect the value of the company, the buying and selling of shares and the appointment and exemption of directors.

The insider and outsider models explain the ownership structures of companies. In the models of concentrated ownership, shareholders control the management of the company whereas, in the dispersed ownership model, there is no controlling shareholder. The latter model prevails in large companies on the UK stock market. Small businesses in the UK and large ones in many other countries, including Saudi Arabia, usually follow the concentrated ownership type. These two mentioned approaches to disclosure differ. Protecting shareholders against abuse of management is the main concern of the dispersed model while the concentrated ownership model is concerned with protecting minority shareholders against controlling shareholders and management.

The outsider model is also referred to as the Anglo-American model or the UK-US model, and it provides a more feasible option for shareholders to liquidate their shares as opposed to being

actively involved in decision making.[32] On the other hand, the insider model, which is also referred to as the stakeholder model, is synonymous with the German corporate governance style. Unlike the shareholder model, this model enables the parties involved to be active in the decision-making process.[33]

Based on this discussion, it is worth noting that the company directors have to deliver benefits for various interested groups, including consumers, suppliers and employees. Consequently, in corporate governance, disclosure is extremely influential and allows all parties to find out what is going on in the company and whether the company operations serve their interests.

2.2.6 Corporate Governance Models

A number of models highlight different aspects of corporate governance. The most popular models distinguish between the stakeholder and shareholder perspectives, as explained earlier concerning the outsider or shareholders model and the insider or stakeholders model. The two models are described in Table 2.

[32] Jia Xinting, 'An overview of corporate governance models' (Centre for International Corporate Governance Research 2003) <http://www.business.otago.ac.nz/mgmt/ANZAM2004/CD/Papers/ABSTRACT309%20 REVISED%2015-10-2004.htm> accessed 18 November 2014.
[33] ibid.

Table 2. Shareholder and Stakeholder Models

Shareholder Model	Stakeholder Model
• Market regulations and legislation are the main channels for imposing control. • The owners of the corporation have only a temporary (i.e. speculative) interest in it, not an interest in running it for the long term. • There is distance (i.e. no close relationship) between the shareholders and the management. • There exists an active market for corporate control, in the form of takeovers, specifically hostile acquisitions. • Shareholder rights are accorded higher importance than those of other groups in the organisation	• Corporate control is dictated by stakeholders, not market regulations or laws. • The firm's owners have an enduring interest in seeing the company prosper and grow. • Stakeholders often occupy positions on the board of directors and senior management. • The management and the shareholders have a close, stable relationship. • Conditions for an aggressive market for corporate control are not present; that is, there is little chance of hostile takeovers. • Employees are accorded formal rights to have a say in important managerial decision.[34]

The stakeholder model emphasises external control in response to a hostile corporate environment. The presence of an active market for corporate control is created in part by the temporary nature of the relationship of the firm's owners with the organisation itself. In such cases, shareholders are interested in protecting their rights only to the extent that it serves their speculative interest in the firm. In contrast, the insider model prevails when the owners of the firm have a long-term interest in it and meet attempts at hostile takeovers with strategic defences (e.g. poison pill, golden parachutes, supermajority, crown jewels defence).[35]

[34] Adapted from Roustem Davletguildeev, 'The Role of Employees as Stakeholders in Corporate Governance' (Trade Unions Advisory Committee to the OECD Third Eurasian Roundtable on Corporate Governance, Bishkek, 29–30 October 2003) <www.oecd.org/corporate/.../corporategovernanceprinciples/19802369.ppt> accessed 11 August 2012.
[35] E Gadajolvie and D Shapiro, 'Evidence from five countries' (1998) 19 SMJ 533.

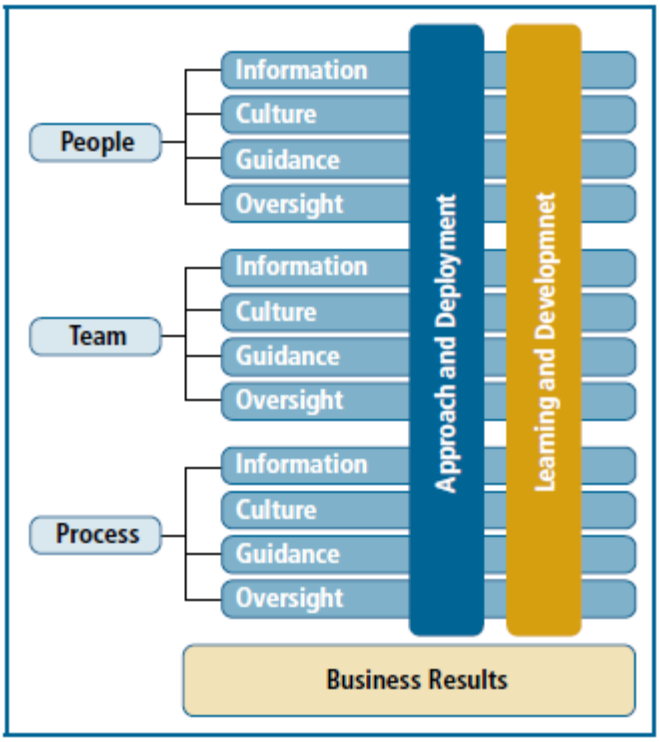
Specialised 'crafted' corporate governance models are specifically designed by experts who wish to add greater detail to aid practitioners. One such model, shown in Figure 1,[36] seeks to address both structural and behavioural issues and link these aspects of corporate governance to a wide number of performance results. It also implements continuous improvements processes, like the tenets of total quality management, as a process undertaken by organisations.

This model links the right people, the right team and the right process in order to provide the motivating force behind the corporate governance effort. These elements help disseminate timely and updated information, defined cultural values and principles and guidance based on the information consistent with the corporate mission and principles. These elements also assist in defining the processes, principles and rules for oversight.[37]

Two integrating actions are involved: first, the immediate approach and deployment of corporate governance measures; and second, the long-term learning and development that take place during the course of the current deployment. Ultimately, the model's effectiveness is seen in the business results from the firm's operations relevant to the corporate governance measures and practices adopted.

[36] Y Arguden, 'Corporate Governance model: Building Responsible Businesses' (2010) 17 Corporate Governance Forum 10.
[37] ibid 11.

Figure 1. Self assessment guide[38]



[38] Arguden (n 36) 10.

2.3 Theories Associated with the Development of Corporate Governance

A number of theories of corporate management schemes in contemporary academic literature, including agency, and shareholder and stakeholder theories, have influenced the development of corporate governance. These began as Western theories but were gradually adopted by corporate theorists worldwide. The following analysis will be based on the comparison of shareholder theory and agency theory. It is noteworthy that the shareholder and agency theories have always had differing implications for corporate governance, and this has meant that these theories are perceived to be opposed to the role of corporate governance. For instance, shareholder theory focuses on improving the welfare of the shareholders of a given company while agency theory involves enhancing the financial growth of the company.[39] In this case, it can be established that the agency and stakeholder theories have different perspectives of corporate governance. Nevertheless, the analysis in this paper will be largely based on the shareholder theory because it focuses on the welfare of the individuals that foster corporate governance.

2.3.1 Shareholder Theory

Interest in shareholder theory saw a sudden rise in the 20th century. This theory differentiates between corporate ownership and management and asserts that the management acts as an agent of the shareholders of the corporation (or the owners of the business, whatever their legal form). Friedman first expressed this theory in 1970 when he claimed that business has only one social responsibility: to increase the firm's profits by engaging in open, free competition without engaging in fraud or deception.[40]

Theoretically, the agent should always act in the interest of the owners, and as the proxy for the owners, the management cannot decide or act in any other party's interest. When management

[39] Solomon Jill, *Corporate Governance and accountability* (John Wiley & Sons 2007) 26.
[40] Norman E Bowie, 'Corporate Social Responsibility in Business' (2012) <www.leadership.umn.edu/documents/Bowie5-30.pdf> accessed 27 July 2011.

decides or acts in the interest of parties other than the owners and these external interests conflict with those of the owners then management has violated its lawful power.[41]

Ultimately, under shareholder theory, the shareholders' rights are protected; indeed, most corporate governance frameworks do so. For example, the OECD principles declare that not only should shareholders' exercise of their rights be protected and facilitated, but all shareholders—minority and majority alike—should have equal access to the remedies afforded in law when unfairly disadvantaged in their shareholdings.[42]

2.3.2 Agency Theory

Agency theory, on the other hand, holds that corporate shareholders are many and that their opinions and desires are divergent so management is better positioned to steer the company and provide the returns sought by the shareholders. Generally, managers are acknowledged to be more competent and skilled at running the business and, therefore, are entrusted with the power to decide the company's direction, formulate its strategies and generate revenues and profits.[43] However, it is also understood that management will tend to make decisions on the basis of its own interests, which could conflict with shareholders' interests.[44] The implication of agency theory for corporate governance is the necessity to delegate broad powers to management but, at the same time, compel the principal agents—the board of directors and the top executives—to be transparent, honest and accountable to the shareholders for their decisions and the exercise of their authority.

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[41] S Letza, X Sun and J Kirkbride, 'Shareholding Versus Stake-holding: A Critical Review of Corporate Governance' (2004) 2(3) CG 242.
[42] OECD, 'Policy Brief on the OECD Principles of Corporate Governance' (August 2004) <http://www.oecd.org/daf/ca/corporategovernanceprinciples/33647763.pdf> accessed 15 June 2011.
[43] JH Davis, L Donaldson and FD Schoorman, 'Toward a Stewardship Theory' (1997) Management Review 20.
[44] A Peter and L Handschin, *Conflict of Interest in Global Public and Corporate Governance* (Cambridge University Press 2012) 149.

2.3.3 Stakeholder Theory and Corporate Social Responsibility

Of the three primary theories, stakeholder theory is the most expansive as it takes into account the interests of the greatest number of people. Stakeholder theory is grounded in organisational strategy. Its central idea is that organisational success depends on the successful management of relationships with key groups: direct stakeholders who have contractual relationships with the firm and indirect stakeholders who, despite having no firm legal relationship with the organisation, nevertheless are affected by its actions and decisions and, therefore, have a stake in the results of operations.[45]

Some authorities believe that a firm is accountable to its direct stakeholders for corporate governance accountability (i.e. employees, suppliers, contractors, customers) while its accountability to its indirect stakeholders falls under the more general concept of CSR. Some scholars, however, do not make this distinction and hold that corporate governance and CSR apply to both direct and indirect stakeholders.[46]

2.4 Development of Corporate Governance

The background provided earlier describes the early history of corporate governance, which has evolved dramatically over the centuries. Modern corporate governance concepts are embodied in the different approaches adopted by states and global regulatory organisations. The most prominent models are discussed by jurisdiction in this section.

2.4.1 UK-US Corporate Governance

The general view of corporate governance in Anglo-American countries, primarily the UK and US, is considered to be liberal. It gives priority to the shareholders' benefits and, consequently, the influence of banks and financial institutions in corporate governance is very limited. This

[45] Robert A Phillips, *Stakeholder Theory: Impact and Prospects* (Edward Edgar Publishing 2011).
[46] Albert Lester, *Project Management, Planning and Control* (5th edn, Butterworth-Heinemann 2007).

model arose in these countries after a long period of rising demand for capital in companies. This model best meets this need and has become common throughout the world.[47]

Over time, financial crises in firms in different parts of the world were caused by their inability to repay banks. In response, financial institutions asked for significant measures to reform loan mechanisms and modify corporate governance in companies in order to avoid repeating such crises. Under the new system of corporate governance, existing companies found it necessary to comply with the new regulations as they provided the fundamental source of funds.[48]

Due to the increase in capital requirements, firms created new sources of capital to fund their activities, including selling shares. Consequently, corporate governance had to take into consideration new parties—namely, shareholders—and their rights and interests. A mechanism to manage companies was needed so shareholders elected a certain number of themselves to form a board of directors to direct the company in serving shareholders' interests.[49]

As stated, the primary goal of Anglo-American corporate governance is to protect shareholders' rights and interests in companies, and this has made it the dominant and preferred model in most countries.[50] This philosophy of maximising profits and protecting shareholders' interests reflects that of Friedman, who holds that businesses owe social responsibility only to their owners and have no duty other than to increase profits.[51]

2.4.2 German Corporate Governance

The German concept of corporate governance follows the more magnanimous approach of Freeman, who contends that organisations, like individuals, have a moral relationship with the people and organisations affected by their conduct. Two principles support this theory: first, deontological ethical reasoning stresses that no moral individual should harm the rights of others

[47] Nehaa, 'The Anglo-American model of Corporate Governance—Basic Overview' (5 September 2009) <http://implicity.wordpress.com/2009/09/15/the-anglo-american-model-of-corporate-governance-basic-overview/> accessed 13 July 2014.
[48] ibid.
[49] ibid.
[50] ibid.
[51] Tom Kirchmaier, Geoffrey Owen and Jeremy Grant, C*orporate Governance in the US and Europe* (Palgrave 2004) 112, 120.

or unjustly prevent them from enjoying these rights; second, on the basis of teleological ethical reasoning, the organisation is responsible for the effects and repercussions of its actions.[52] In this case, the corporate governance structure of Germany is aimed at shielding the involvement of shareholders in a corporation from the involvement of directors of a corporation and other executives. However, the greater emphasis of Germany's corporate governance is based on the requirement to protect the stake of the creditors of a company from those of the AG and its shareholders. The protection of the shareholders' stake against the directors and other members of a company's executive is achieved through the Stock Corporation Act, the principle statute governing German corporations, and the statutory accounting principles.[53] As a result, this approach towards corporate governance in Germany differs greatly from Anglo-American corporate governance methods.[54] One of the major reasons for the differences between the Anglo-American corporate governance model and the German corporate governance model is that the German model mainly focuses on protecting the rights of shareholders who operate within the company. Therefore, the German governance model protects the rights of stakeholders of a company due to the fact that it focuses on the insiders of a given corporation.[55]

2.4.3 OECD Principles of Corporate Governance

Issued in 1999 and amended in 2003, the aim of the OECD Principles of Corporate Governance is to provide specific guidance for improving the legal, institutional and regulatory framework underpinning corporate governance, specifically for publicly listed companies trading on stock exchanges. The Financial Stability Forum endorsed the principles as one of the 12 key standards essential for financial stability. The OECD Principles address six main areas of corporate governance frameworks:[56]

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[52] Jonathan Charkham, *Keeping Better Company: Corporate Governance Ten Years On* (Oxford University 2005) 28, 38.
[53] Stephan Hutter, Mark Devlin and Johannes Burkard, 'Corporate Governance in Germany' (October 2002) IFLR 1.
[54] ibid.
[55] ibid.
[56] OECD (n 42) 17-24.

I. Ensure the basis for an effective corporate governance framework by promoting transparent, efficient markets consistent with the rule of law and clearly dividing responsibilities among the supervisory, regulatory and enforcement authorities;

II. Protect and facilitate shareholders' exercise of rights and key ownership functions;

III. Ensure the equitable treatment of shareholders, including minority and foreign shareholders, and allow all shareholders the opportunity to obtain redress for violations of their rights;

IV. Recognise the legal and contractual rights of stakeholders in corporate governance and encourage active collaboration between corporations and stakeholders in creating wealth, jobs and sustainability in financially viable enterprises;

V. Ensure timely and accurate disclosure on all matters of importance about the corporation, including its financial situation, performance, ownership and governance;

VI. Ensure the strategic guidance of the company, effective monitoring of management by the board and the accountability of the board to the firm and its shareholders.

In these principles, the OECD clearly seeks to incorporate the best aspects of both the stakeholder and the shareholder models of corporate governance. Principles II and III enshrine support and equitable treatment of shareholder and their rights, while Principle IV emphasises the financial health of the firm and the commitment to honour the legal rights of stakeholders and economic benefits from corporations' partnership with stakeholders. The OECD Principles adopt a balanced approach to the stakeholder-shareholder divide and hold that the firm must first be financially robust before it may be held responsible for fulfilling its social obligations.

2.5 Summary

This chapter is grounded in actual situations and practices. The following fact-based analyses are also grounded in the practices and principles of corporate governance explained in this chapter. The definitions, concepts and their significance explained here aim to prepare the ground for a discussion of the Saudi situation. The scope, implications, beneficiaries and models of corporate

governance are introduced, along with the various theories that influenced the development of schools of thought on corporate governance (shareholder, stakeholder and agency theory). Finally, a brief account of the development of corporate governance in major jurisdictions (the UK-US, Germany and OECD) is presented to provide the basis for comparison and contrast with Saudi Arabia.

In this chapter, the definition, theories and models of corporate governance have been gradually introduced and discussed. In addition to these three, international standards that are of varying importance are also briefly discussed with a view to establishing and deriving proper meanings from them. Definitions generally in the social sciences and law have somewhat different semantic interpretations, and the one at hand is not different. Agency, shareholder and stakeholder theories have been discussed as part of the recent theories developed in corporate governance literature sweeping through the academic world. In essence, these are Western derived theories but they have found relevance in different parts of the globe. However, it is obvious that both theories reflect the performance of a company differently, and so they embody dissimilar perspectives. Nonetheless, the chapter is more focused on the shareholder theory rather than the agency theory.

Chapter Three

An Overview of Corporate Disclosure and Transparency

3.1 Overview

Out of all corporate governance principles, the twin concepts of disclosure and transparency have been most praised and most broadly accepted worldwide. These cornerstone principles have become the benchmark against which corporate governance systems in all advanced economies have been measured.[57] In this chapter, the concepts of disclosure and transparency are discussed, along with their purpose and significance in practice. An understanding of the requisites and elements of the practice of disclosure leads to a discussion of its benefits and advantages, as well as the consequences of the absence of transparency in financial scandals.

3.2 Definition of Disclosure and Transparency

Transparency, defined in its legal sense, is the lack of any hidden agenda in releasing information. It is a requisite for free, open exchange between parties.[58] Disclosure and transparency inform market anticipations, supporting the stability of the market in uncertain times and increasing the efficiency of declared strategies.[59]

In corporate governance, free, open exchange takes place primarily between corporate leaders, including management and the board of directors, and investors and shareholders who are most in need of information to guide their decisions about their capital invested in the corporation.

The authoritative *Black's Law Dictionary* defines transparency as the 'degree of disclosure minimum for all verified agreements, practices and dealings', that is, any and all transactions, agreements and dealings, to be valid and binding.[60] When transparency is lacking and the minimum level of disclosure is not met, the party not in possession of complete information

[57] Tarek Abdel Aal, *Corporate Governance: Concepts, Principles*, Experiences (University House 2005) 40.
[58] The Law Dictionary, 'What is Transparency?' (2013) <http://thelawdictionary.org/transparency/> accessed 23 February 2012.
[59] International Monetary Fund, 'Report of the Working Group on Transparency and Accountability' (IMF 1998) 7.
[60] IMF (n 59).

makes decisions without the full facts, and any consent that the party gives in agreements or negotiations is impaired. The concepts of transparency and disclosure thus are intertwined; disclosure is the action or the tool by which transparency, a condition or status, is achieved.

In order to establish the context of disclosure in corporate governance it is necessary to analyse the various forms of disclosure predominantly applied on corporate governance. In most cases, rules with regard to disclosure rely on the period within which the disclosure covers. For instance, the rules of disclosure may vary on the following conditions:

(i) **Disclosure in advance of a listing of shares**: The essence of disclosure before listing of shares to the public relies on the ability to demonstrate the validity of shares. In this case, companies are allowed to disclose information through a prospectus which outlines all the details concerning the government's resources and liquidity position. This is in order to ensure that individuals willing to purchase shares have adequate details on the security that comes with the shares.[61]

(ii) **Disclosure in the annual report:** The aim of disclosure on an annual basis is based on the requirement of corporations to provide details on the basic business activities of a company in addition to the financial position of a corporation.[62] In this case, disclosure in an annual report aims at establishing the performance of a company in a financial year.

(iii) **Disclosure to the market as events occur**: Based on the fact that corporations are given a mandate by law to operate, it is essential for the corporations to disclose any information in the event the corporations desire to make changes. This is in order to ensure that any activities conducted by corporations based on the market changes should be recognised by law in order to facilitate regulation by government authorities.[63]

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[61] Inc, 'Sec Disclosure Laws and Regulations' <http://www.inc.com/encyclopedia/sec-disclosure-laws-and-regulations.html> accessed 11 November 2014.
[62] Sarkar Deepa, 'Securities Exchange Act of 1934' (Legal Information Institute) <http://www.law.cornell.edu/wex/securities_exchange_act_of_1934> accessed 18 November 2014.
[63] Liebman, H, Sonnie M and Bojilova E, 'Public Disclosure for Private Companies: U.S. vs. Europe' <http://www.jonesday.com/public_disclosure_requirements/> accessed 18 November 2014.

(iv) **Disclosure to the board meeting:** Disclosure of information to the board in a meeting is critical to the performance of the corporation based on the agency and stakeholders' theory.[64] In this case, with regard to agency theory, non-disclosure of information by managers to the board puts the rest of the shareholders and potential investors at a disadvantage of a company's operations. In addition, the stakeholders theory also establishes that lack of disclosure of information to the stakeholders of a company puts the company at risk based on the fact that the stakeholders involved cannot effectively run the company.[65] As a result, disclosure of information to the board is essential since it enables the board to analyse the loopholes in the company's policies. This would enable the board of the company to implement effective policies of a respective company.

3.3 Consequence of non-disclosure

Disclosure is meant to enhance a corporation's accountability and performance. As a result, there are no definite legal implications due to non-disclosure. Moreover, the rules of disclosure are flexible, and this subsequently leads to a lack of definite rules that provide remedies for non-disclosure.[66] However, in extreme cases there may be a requirement for intervention since non-disclosure may be exploited to facilitate fraud within corporations. Therefore, the legal and civil remedies for non-disclosure may depend on the statutory policies with regard to non-disclosure during the specific period of non-disclosure as witnessed in the following situations:

(i) **Criminal proceedings or regulatory proceedings to impose penalties:** Criminal proceedings may be imposed on the entire company or individuals involved in the event that shareholders exercise their right to facilitate other resolution options. However, based on the fact that frequent criminal proceedings hinder the management process, it is essential for a company to avoid reliance on criminal proceedings.[67]

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[64] Solomon (n 39) 144.
[65] ibid.
[66] Liebman, Sonnie and Bojilova (n 63).
[67] Law Commission, *Shareholder Remedies* (Law Com CP No 142, 1985).

(ii) **Civil proceedings by minority shareholders for a civil remedy:** Under the civil procedure requirements, minority shareholders have the right to impose a derivative action in court in the event that a minority shareholder seeks a civil remedy for a wrong committed by the majority shareholder. The derivative action requires the minority shareholders to prove to the court that civil wrong has been perpetrated by a majority shareholder.[68]

(iii) **Civil proceedings in connection with a particular purchase of shares arising from non-disclosure in connection with the purchase:** The civil proceedings with regard to such cases would be based on a breach of fiduciary duty. Civil proceedings in this case accord a shareholder the right to proceed with civil proceedings provided the shareholder shows that the non-disclosure was perpetrated by an individual who consented to a purchase of shares.[69]

3.4 The Role of Disclosure

Disclosure is a soft law considered crucial to adequately inform shareholders and other stakeholders of the conduct of the company's top management and the board of directors. The principal role of disclosure and transparency is significant because they allow shareholders and regulators to monitor the actions of corporate leaders.[70] In addition, disclosure and the institutions designed to facilitate reliable disclosure to investors and shareholders[71] give them a reliable basis on which to assess the risks they assume if they maintain their investments in the company. The nature of soft law permits the required coordination as well as cooperation in a real of rapidly developing as well as the politically contentious environments. Is such environments experts ensure that there is no pressing legal strengths unless through the constitutional reviews that ensue a balance between the involved parties. There are clear limits for the scope of the laws, or even flaws in the use of the legal structure in some cases, but there is

[68] Law Commission (n 67).
[69] ibid.
[70] Robert Monks, 'Redesigning Corporate Governance Structures and Systems for the Twenty-First Century' (2001) 9(3) CG 142.
[71] Paul M Healy and Krishna G Palepu, 'Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature' (2001) 31 JAE 405.

a need in the current global world to allow institutions to control their trade.Without such mechanisms, management might intentionally hide the true condition of the company—that is, not fully disclose corporate health—so that shareholders will not sell the stock in a panic and depress its price or react similarly. Doing so might protect for a short while board members and executives who quietly decide to take an advantageous position in the market before the price becomes volatile in reaction to whatever bad news is released. Such actions are deceptive, utterly unfair to shareholders and contrary to the principles of corporate governance if disclosure is any degree less than it should be.

3.5 Importance of Disclosure

3.5.1 Concrete Advantages for the Market

Transparency in a firm's disclosure methods creates many advantages in the open market. The perfect market conditions for securities and the perfectly competitive market for goods and services both depend on the free flow of information through which people can form well-considered decisions. A company that practices full disclosure provides shareholders the means by which to more effectively exercise their rights of ownership. Annual reports and general meetings, which are elements of transparency and disclosure, enable shareholders to assess the continued viability and profitability of the business. Thus, current shareholders and potential investors can weigh the potential risks and likely returns in their investment decisions.[72]

Another benefit of full disclosure is the trust it engenders among players in the market. This allows the market price of the firm's shares to approximate their true value. Stock market action is not devoid of a healthy level of speculation because a stock price rises and falls in the short term based on the most recent rumours about the company. While rumours persist, speculation continues, and the longer speculation-driven market action occurs, the greater market players' fear that the volatility might be manipulated or staged. With full disclosure, whatever rumours that might be circulating will eventually be resolved and the uncertainty settled, thus maintaining

[72] Michael Simkovic, 'The Effect of Mandatory Disclosure on Open Market Stock Repurchases' (2009) 6(1) BBLJ 96.

the integrity of the market and eliminating unscrupulous traders. Disclosure dispels uncertainty, which reduces both market participants' fears and the risks they face in the stock market.[73]

3.5.2 Concrete Advantages for the Company

Disclosure and transparency are also beneficial to the company. In this context, disclosure takes the form of accurate, timely reports to managers and employees. Managers, in particular, need information to support decision-making especially during contingencies which require quick, correct and decisive action. An empowered managerial structure enables the firm to build leadership traits down the chain of command, developing a pool of future upper-level managers and increasing the productivity, growth and profitability of operations.[74]

Disclosure to employees is important in matters relevant to the conduct of their jobs and personal circumstances. Employee engagement is a vital, useful tool in employee retention and job satisfaction and can be secured only in an atmosphere of trust and open communication between firm and employee.[75] It is important that a firm not only improves communication with its workforce but also that it is perceived as doing so in good faith, with concern for employees' welfare.

While the internal effects of disclosure work to create greater trust, the same is true regarding the effects of disclosure on communities and how residents regard the company. There are many reasons why a firm prefers to be regarded favourably by its neighbours and those further away. Most immediate is the opportunity to promote the company's brand and engender loyalty, which increases sales. Good community sentiments towards the company can also alleviate the effects of possible negative publicity about the firm. In addition, resources in the community, such as water and power sources, sustain the firm and, if limited, might create friction with residents. Therefore, it is important for the firm to generate a sense of trust and acceptance in its locality

[73] Frank Westerhoff, 'Speculative Markets and the Effectiveness of Price Limits' (2003) JED&C 28(3) 493.
[74] Clyde Wilcox, 'Transparency and Disclosure in Political Finance: Lessons from the United States' Democracy Forum for East Asia Conference on Political Finance, June 2001).
[75] Centre for Protection of National Infrastructure, 'Managing the Disclosure of Employee-Related Information' (2012) <http://www.cpni.gov.uk/documents/publications/2012/2012018-disclosure_employers> accessed 12 September 2012.

(or those of its branches and networks) by adopting a policy of disclosure and open communication with community leaders and the public at large.[76]

3.6 Advantages and Principles of Disclosure

The principles of disclosure and transparency have long been embraced in the democratic West and have been spread worldwide through the workings of multinationals and the global economy. However, these principles do not easily translate into Arabian culture and society, particularly in Saudi Arabia where notions of democracy are not harmonised. The alternative of adopting the Western model *in toto* is ill-advised because of natural resistance to the intrusive imposition of foreign norms and customs.

A useful approach is to examine the crucial issues and unintended consequences of the evolving international standards and to explore areas of compatibility between the foreign and indigenous standards. Such issues include the determination of the parties to whom disclosure should be made, what information should be disclosed and the manner of disclosure. In its most basic form, disclosure consists of the publication of periodic financial reports for the benefit of the public, shareholders, creditors, potential investors and government regulators. This is mandated by Saudi Arabia's laws (the CL and CGR). There is a need however for a clear distinction between corporate transparency and political transparency. As such, corporate transparency defines the rules that the govern principles of disclosure of information concerning commercial activity. On the other hand, political transparency refers to the existence of a system that holds responsible and accountable all the political leaders of a nation. However, there is a considerable relationship between the two aspects of transparency because the corporations operate in the political environments.

Similarly, although not mandated by law, there is the publication of reports on company sustainability and CSR compliance for the firm's various stakeholders, including employees, suppliers, contractors, environmental regulators, the community and society. Through these reports, the board and executive management have a regular channel through which to explain to

[76] Steven Waldman, *Information Needs of Communities: The Changing Media Landscape in a Broadband Age* (Diane Publishing 2011).

their various publics the rationale behind their decisions and their expectations and reservations concerning the foreseeable future, in addition to facts about company operations.

Some information naturally is of a sensitive or even uncertain nature and may properly not be disclosed depending on the company's discretion.[77] On the other hand, some related party transactions, although not pertinent to the firm's internal operations, must be disclosed to dispel doubts about the firm's agenda.[78] Non-financial disclosure, unlike financial disclosure, is not legally required but is subject to executive discretion. Corporate leaders then must prudently decide what information can be made public without unnecessarily agitating a sensitive stock market (the case of publicly traded companies) or misleadingly sensationalising minor developments.

3.7 Information that should be Disclosed According to Company Strategy

The degree to which a company is transparent is determined by the depth of information about itself it is willing to disclose, within the commonly accepted limits of prudence.[79] In many cases, the markets for goods and services and for capital funding provide more opportunities for companies that engage in greater disclosure and are perceived as more transparent because of the higher level of trust based on the available information about them. Strategically, the most vital information a company can provide is included in reports by executives and the board to the shareholders and externally audited financial statements and mandatory reports to state regulators, such as Form 10-K to the US Securities and Exchange Commission or the audit reports and forms.[80]

Some industries or businesses, especially those which need high levels of innovation, require a high level of confidentiality. The amount of capital investment in cutting-edge research and development requires a measure of secrecy to protect pipeline projects from industrial espionage.

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[77] S Claessens, S Djankov, H Fan and P Lang, 'Disentangling the Incentive and Entrenchment Effects of Large Shareholders' (2002) JF 57(6) 2741.
[78] U Bauman and E Nier, 'Market Discipline and Financial Stability' (Bank of England Financial Stability Review, 2003) 134.
[79] Archon Fung, Mary Graham and David Weil, *Full Disclosure: The Perils and Promise of Transparency* (Cambridge University Press 2007).
[80] For instance, Form AA06 is required for companies, and Form LL AA06 for limited liability partnerships.

Intellectual properties, such as technical designs or pharmaceutical formulae, cannot be divulged due to the risk of piracy by unscrupulous competitors. To overcome public anxiety or suspicion about the propriety or safety of these products without full disclosure of the products' details, the firm has to rely on its reputation for integrity and trustworthiness or on the favourable assessment or endorsement from government regulatory agencies and respected experts.

3.8 To Whom Information should be Disclosed

Stakeholders are important to a company as they own part of it. Hence, they should be in charge of deciding who should receive vital information about company operations. Information about the company's financial status should be made available to the lenders.[81]

These measures ensure that the company can confirm the net worth of the security used to secure a loan. Specific information about the company should be available to outside investors to assure them that certain shareholders do not receive preferential treatment.[82] The availability and accessibility of information to shareholders increases their confidence in the firm's ability to conduct its operations with their best interests at heart. The public needs access to some company information in order to become familiar with their service providers. It is hard for a company to claim a large market share if it operates in anonymity.[83] A level of disclosure and transparency is needed when dealing with the public. It is important to note that these groups have access to different types of information.[84]

3.9 Financial Scandals and Disclosure

In more severe cases, a lack of compliance with or deficiency in meeting disclosure requirements leads to the filing of criminal charges. It should be noted that transparency is not a hard and fast

[81] J Fairbanks, KB Plowman and BL Rawlins, 'Transparency in Government Communication' (2007) 7(1) JPA 22.
[82] E Al-Moataz and K Husainey, 'Determinants of Corporate Governance Disclosure in Saudi Companies' (2010) <http://ainshamsaccounting.com/Download/9185.pdf> accessed 9 May 2012.
[83] M Jensen, 'Agency Costs of Free Cash Flow, Corporate Finance and Takeovers' (1998) 76(2) AER 323.
[84] K Hussainey and A al-Nodel, 'Corporate Governance Online Reporting by Saudi Listed Companies' (2008) 8 RAEE 39.

requirement under the law, and the absence of it does not of itself constitute an infraction of the law deserving punishment. A lack of transparency is ambiguous, and the degree to which a firm lacks transparency is undefinable. However, regulations stipulate that all businesses must disclose some information, particularly pertaining to the submission of specific reports and filings at a certain time and in a specified form. The mandate is more severe and strict for companies listed and traded in the open exchanges because of the increased public interest and implications for public policy.

The criminal nature of the act of non-filing, whether advertent or inadvertent, does not proceed from the mere failure to submit the required documents or errors in the contents thereof but from the imputed intention to mislead, misrepresent, conceal, defraud, evade or otherwise elude efforts to provide shareholders and other stakeholders with information vital to making crucial decisions.

The required transparency of the capital market operations is fair. Information regarding listed companies is usually available, while the Tadawul website classifies listed companies according to industry and provides monthly, quarterly and annual financial information. However, a number of factors decrease the transparency and efficacy of the SSE: 1) insufficient publicly available non-financial information, particularly with respect to beneficial ownership; 2) the lack of foreign competition due to the ban on foreign companies in the Tadawul; and 3) inappropriate behaviour and abuse of position by brokers and industry insiders. These considerations have prompted increased awareness that the creation of a dependable and more transparent capital market requires the introduction of corporate governance disclosure conditions. This need is all the more crucial as the number of listed companies is constantly increasing. For instance, from 2004 to 2007, the number of listed companies rose from 73 to 111.[85]

[85] World Bank (WB), 'Corporate Governance Country Assessment: Kingdom of Saudi Arabia' (February 2009) <http://www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf> accessed 10 October 2012.

3.10 International Standards

From the foregoing account of the *Al Gosaibi vs Al Sanea* case, even when the scandal had been revealed and the case was under litigation, the very procedure to resolve the controversy itself was mired in a lack of transparency. The protagonists needed to resort to cross-border jurisdictions in order to obtain a fair hearing of a case affecting more than 100 global banks. This case highlights the urgency of harmonising national and international standards of transparency and disclosure if a state wishes to remain a significant player in international business and finance.[86] As such, the relevance of the case to the Saudi Arabian context is the impact that it creates on the needfulness of transparency in the country. Far as much from the political jurisdiction of the US, the case still gives a basis for the evaluation of the levels of transparency required. The OECD Principles of Corporate Governance provide the best model for national laws to adopt. As discussed in Chapter 2, the OECD recommends addressing six key issues in a country's corporate governance structure:

- The establishment of a legal framework for corporate governance;
- The assurance of shareholders' rights and key ownership functions;
- Equitable treatment of all shareholders, whether majority or minority;
- Recognition of stakeholders' wider role in corporate governance;
- Disclosure and transparency;
- Determination of the various responsibilities of the board.[87]

Of these areas, the international community lays the strongest emphasis on disclosure and transparency, particularly regarding the actions and decisions of firms' boards and executives. As in the cases of *DP World* and *Al Gosaibi vs Al Sanea*, large businesses with transnational

[86] Reuters, 'Saudi Billionaire Battle between Al Gosaibi and Al Sanea Tossed out of New York Court' (2012) <http://www.thenational.ae/business/banking/saudi-billionaire-battle-between-al-gosaibi-and-al-sane> accessed 9 April 2014. *Mashreqbank PSC v Ahmed Hamad Al Gosaibi and Brothers Co*, and *Ahmed Hamad Al Gosaibi and Brothers Co v Maan Abdul Waheed Al Sanea et al* New York State Supreme Court, Appellate Division, First Department, Nos 6917 and 6918.

[87] OECD, 'OECD Principles of Corporate Governance' (2004) <http://www.oecd.org/dataoecd/32/18/31557724.pdf> accessed 9 May 2012.

operations often have an impact upon states and business institutions entangled in crises and scandals, which adversely affect the lives and circumstances of many individuals. Such effects cross borders and spread contagion during financial and economic crises, drawing further attention to the need for countries to adopt the OECD governance framework.

3.11 Summary

This chapter has defined the dual concepts of disclosure and transparency and has explained how they have set an international benchmark of corporate governance. Their importance, advantages and the principles by which they operate are analysed from a theoretical perspective. Scandals and disclosures in real-world global and regional events are examined in order to understand how a lack of transparency and disclosure can undermine corporate governance efforts. Insights obtained from this study of global disclosure and transparency are applied in the next section to the realities in the Saudi capital market.

In this chapter, the practices related to these concepts in Saudi Arabia are also described. Examples are given which suggest the extent of the application of these concepts by listed companies and the importance of disclosure and transparency in offering accurate information and creating a good investment environment. In addition, disclosure and transparency requirements are investigated and a range of these requirements which listed companies have broken and the fines imposed by the CMA Board are discussed, following the defamation approach for punishing violators.[88]

Disclosure and transparency are both beneficial to the company. In this context, disclosure takes the form of accurate, timely reports to managers and employees. Managers, in particular, need information to support decision-making, especially during contingencies which require quick, correct and decisive action. An empowered managerial structure enables the firm to build leadership traits down the chain of command, developing a pool of future upper-level managers and increasing the productivity, growth and profitability of operations.[89]

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[88] *Al-Riyadh Newspaper* (26 February 2010) Issue 15222.
[89] Wilcox (n 74).

Disclosure to employees is important in matters relevant to the conduct of their jobs and personal circumstances. Employee engagement is a vital, useful tool in employee retention and job satisfaction and can be secured only in an atmosphere of trust and open communication between firm and employee.[90] It is important that a firm not only improve communication with its workforce but also that it be perceived as doing so in good faith, with concern for employee welfare.

The next chapter examines the current practices and development of the Saudi corporate governance framework. A review of Saudi Arabia's history as a state and developing economy leads to a focused discussion of the Saudi CGR, CL and CML. As the vital element in corporate governance, this chapter provides a compelling discussion on disclosure and introduces current issues on disclosure.

[90] Centre for Protection of National Infrastructure (n 75).

Chapter Four

Current Practices and Improvement of Saudi Corporate Governance Framework

4.1 Overview

The preceding chapter described the notions of disclosure and transparency and their purpose and importance in practice. An understanding of the requirements and elements of the practice of disclosure leads to a discussion of its benefits and advantages, as well as the consequences of a lack of transparency during financial scandals. The Saudi approach to disclosure and transparency is also examined based on the evidence given in board annual reports. This chapter highlights the way the Saudi legal system evaluates corporate governance and its legal basis.

4.2 Background information about Saudi Arabia

In 1932, King Abdul Aziz Ibn Abdul Rahman Al-Faisal Al-Saud succeeded in consolidating the kingdoms of Nejd and Hejaz to create the independent Islamic monarchy of the Kingdom of Saudi Arabia following three decades of sporadic fighting.[91] Since early August 2005, Saudi Arabia's head of state has been Custodian of the Two Holy Mosques His Majesty King Abdullah Ibn Abdul Aziz Al-Saud. King Abdullah serves as president of the Council of Ministers through which the Kingdom of Saudi Arabia is administered.[92] He is supported by numerous ministers, including the first deputy premier (His Royal Highness Crown Prince Sultan Ibn Abdul Aziz Al-Saud) and second deputy premier (His Royal Highness Crown Prince Nayef Ibn Abdul Aziz Al-Saud).

The Basic Law of the Kingdom of Saudi Arabia confirms the country's position as an Islamic monarchy.[93] The Basic Law outlines a precise structure for the country's government. The Consultative Council, established in 1993, is charged with providing the Council of Ministers

[91] The Kingdom of Saudi Arabia was established by the enactment of Royal Decree No 2716, dated 18 September 1932.
[92] The Council of Ministers was established pursuant to Royal Order No A/13, dated 20 August 1993.
[93] The Basic Law was promulgated under Royal Order No A/90, dated 1 March 1992.

with advice regarding Saudi Arabia's policies and reviews and commentary on contracts, international accords, special rights, laws and bylaws. The Consultative Council also gives feedback on the various government ministries' yearly reports. Saudi Arabia is made up of thirteen provinces, which are further divided into governorates, districts and, finally, centres. Each province has its own provincial governor, selected by King Abdullah, and a vice governor. Provincial councils are made up of these two individuals and a minimum of ten other members. To become a member of a provincial council, an individual must first be nominated by the provincial governor, then approved by the Minister of the Interior and appointed by the King. Provincial councils submit requests for funds from the annual budget, suggest improvements and initiatives for their area and have the power to determine the particular developmental requirements of their area.[94]

The majority of Saudi citizens are Muslim, and Saudi Arabia is an Islamic nation and part of the Muslim world. Miles and Goulding claim that the Muslim world is often written off as being behind the times, rife with corrupt leaders, terrorist activity and low literacy. The appeal of Muslim markets would be minimal if all of these claims were borne out in reality.[95] However, Miles and Goulding note that there is increasing interest among the global academic community in researching the commercial and company law of Islamic nations, which now conduct significant amounts of trade with the Western world. It is estimated that Islamic nations conduct 87% of their trade with non-Islamic countries, meaning that only 13% of trade is carried out between Islamic nations themselves.[96] Foreign traders and investors cannot ignore the importance of the Muslim world, especially as the international market continues to diversify.

Saudi Arabia is notable among developing Islamic nations because it enjoys good political stability, offers its private business sector liquidity and financial incentives and has a solid infrastructure, inexpensive labour and energy and low taxes. In addition, Saudi Arabia's considerable gas and petrol reserves[97] make it a creditworthy and active global market.[98] Oil takes a leading role in any discussion of Saudi Arabia. The country has slightly less than 245

[94] Latham and Watkins LLP, 'Doing Business in Saudi Arabia Report' (2010) 2 <www.lw.com> accessed 15 September 2011.
[95] L Miles and S Goulding, 'Corporate Governance in Western (Anglo-American) and Islamic Communities: Prospects for Convergence?' (2010) 2 JBL 137.
[96] ibid 138.
[97] Saudi Arabia is estimated to be the world's largest exporter and third-largest producer of oil.
[98] J Bancal, 'Legal, Tax and Fiscal Engineering for Industrial Co-operation in Saudi Arabia' (1993) 6 IBLJ 687.

billion barrels of oil in its reserves, thought to account for more than 66% of the oil in the Middle East and 25% of the world's oil supply. Saudi Arabia also has as much as 1 trillion recoverable barrels of oil in its territory and thus faces no competition in oil-related industries.[99] All elements of Saudi Arabian life reflect the country's oil-rich status, and this wealth forms the foundation of the liquidity in Saudi Arabia, providing high levels of confidence in investments in the Saudi Arabian market.[100]

El Sheikh has observed that, as investors are primarily interested in making a profit, the high liquidity enjoyed in Saudi Arabia is a strong selling point.[101] Saudi Arabia's economic resources have also enabled it to create an infrastructure that meets high global standards. Investors pay very little or even no tax, and do not have to make any substantial contribution to infrastructure, such as roads, telecommunication towers or energy stations.

Considering the substantial benefits of investing in the Saudi Arabian business market, it would be reasonable to think that domestic and international investment in the country faces no real barriers. Sadly, this is not true. A key barrier to investment is the Saudi Arabian commercial and company legal system, especially its treatment of minority shareholders in private firms. The CL was implemented before commercial activity in the region began to grow. Its provisions appear to take their inspiration from civil law. Saudi Arabian company and commercial law hinder both domestic and international investment. An American or British lawyer would find it nearly impossible to provide appropriate guidance to clients operating in this jurisdiction without the support of a local legal expert.[102] Investors and businesspeople have become acutely aware of the importance of legal systems and the need for clear provisions. Consequently, the Saudi legal system alone might reduce investment.[103] This section describes Saudi Arabian company law and how the legal system treats both foreign and local minority shareholders.

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[99] International Energy Agency, 'By Country, Saudi Arabia, 2008' <http://iea.org!country/n_country.asp?COUNTRY CODE=SA&Submit=Submit#bottom> accessed 16 February 2011.
[100] F Almajid, 'A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective' (PhD thesis, University of Manchester 2008) 47.
[101] F El Sheikh, *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia* (Cambridge University Press 2003) 24. Saudi Arabia does levy varying amounts of tax on foreign companies, but they may seek exemptions under certain conditions.
[102] ibid 76.
[103] Miles and Goulding (n 95) 137.

4.2.1 Basic Law of Governance

Dispersed written rules were codified as Saudi statutory law in 1992 under King Fahd Al Saud's (1921–2005) ratification of the reform of the constitutional law. The King explicitly laid out four substantial sets of laws: the Basic Law of Governance, the Regional Law, the Council of Ministers Law and, lastly, the Consultative Council Law.[104]

The Basic Law of Governance is the most vital set of laws, and contains nine chapters with 83 legal articles. The first part of the Basic Law of Governance establishes the country's framework, religion, language and capital city.[105] The second part sets the succession of the Saudi throne from the parents and sons of the country's founder.[106] The third part declares the fundamentals of Saudi civilisation,[107] emphasising the importance of education in making each Saudi citizen a positive member of society.[108]

The Basic Law of Governance addresses economic affairs and stipulates that the government owns all natural resources.[109] It identifies the country's overall financial statements[110] and controlling governmental organisations (whether financial or administrative).[111] Specifically, the Basic Law of Governance advises that the government should treat and counsel all citizens equally and fairly.[112] Furthermore, it tasks the government with protecting human rights, civil rights and autonomy so no citizens or residents may be detained without any legal actions.[113]

It is claimed that Saudi Arabia has no statutory law because its legal system is based on the *Quran* and the *Sunna*. This claim is reinforced by Article 1 of the Basic Law of Governance which states that: 'The religion in Saudi Arabia is Islam and the constitution is the Book of God and the *Sunna* (traditions) of His Messenger'.[114] Although the Basic Law of Governance is called

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[104] Basic Law of Governance, Royal Order, No. A/90, dated 1 March 1992; Consultative Council Law, Royal Order, No A/91, dated March 1992; Regional Law, Royal Order, No A/92, dated 1 March 1992; Council of Ministers Law, Royal Order, No A/13, dated 20 August 1993.
[105] Basic Law of Governance (n 93) Articles 1, 2, 3 and 4.
[106] ibid Article 5.
[107] ibid Articles 9 and 10.
[108] ibid Article 13.
[109] ibid Article 14.
[110] ibid Article 13.
[111] ibid Article 79.
[112] ibid Article 8.
[113] ibid Articles 26 and 36.
[114] ibid Article 1.

the country's constitution, the term 'constitutional' has a different meaning in Saudi practice than in common law. From the Saudi perspective, the term indicates the fundamentals of Saudi society. Others believe that the Basic Law of Governance established constitutional law. Therefore, the Basic Law of Governance can be understood as preserving the core values of the constitution, thus acting as a true constitutional law.[115] Consequently, there are conflicts between the Basic Law of Governance as constitutional law and the principal foundations of Sharia law.

4.2.2 The Saudi Legal Framework

As mentioned earlier, Sharia law is the fundamental source of law in Saudi Arabia and consists of basic principles taken from a number of texts, most notably the *Quran*, scholarly work on the Sharia and a collection of the sayings of the Prophet Mohammed known as the *Sunna*. Law in the Kingdom of Saudi Arabia is also established by legislation enacted through Royal Decrees, Royal Orders, Ministerial Circulars, Ministerial Resolutions and the Council of Ministers Resolutions. However, any enacted legislation is subject to Sharia law and must be firmly in line with the principles of Sharia.

Various different adjudicatory organisations and courts of law form Saudi Arabia's judicial system, including a number of specialised committees, the Board of Grievances and Sharia courts. Typically, the Sharia courts preside over civil claims, excluding those claims falling under the jurisdiction of another of the country's adjudicatory organisations. Sharia courts see cases concerning a range of property issues as well as family law. Most criminal prosecutions take place in a Sharia court. The country's specialised committees were created by different government agencies and ministries and have very specific jurisdictions specified in their constitutive rules. Three key specialised committees are the Committee for the Settlement of Labour Disputes, the Negotiable Instruments Offices and the Committee for the Settlement of Banking Disputes. Certain specialised committees act independently of both the Board of Grievances and Sharia courts.[116]

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[115] Abd Rahman Al-Shlahoub, *Constitutional Order in KSA between the Law and Comparative Law* (Arabic edn, 1999) 91.
[116] Latham & Watkins LLP (n 94) 2.

A new Law of Judiciary enacted by King Abdullah in 2007 undertook significant reform of the Kingdom's judiciary system.[117] The law reorganised Saudi Arabia's judiciary bodies and dispute resolution bodies, including the creation of specialised courts, such as labour, commercial and criminal courts. The Board of Grievances now acts as an administrative court. Enacted in 2007, the Law of Judiciary is being introduced in stages and has not been fully implemented.

Whilst the principle of legal precedent that lies at the heart of the UK common law system provides a level of predictability and impartiality, the ambiguous nature of legal precedents in Islamic courts create uncertainty. In Saudi Arabia, there is no concept of a judicial precedent, which means that the decisions of a court or a judicial committee have no binding authority in other cases.[118] In general, the Kingdom lacks a system of court reporting so it is not always possible to conclude how a Saudi court or judicial committee will view a particular case.The systems of governance in the Kingdom of Saudi Arabia. Basically, the nation's legal framework is one that finds its relevance in the teachings of Islam, one of justice, equity and fairness. The corporate governance processes of the country also have the same inclinations. Considerably, the law does not permit the exploitation of people by means of business. Such a case is contrary to the external world, especially the West in which, there is a competitive atmosphere for all business people. As much as the laws of such nations do not allow people to exploit others, there are considerable levels of exploitation considering that the law is not a fundamental teaching.

The non-precedent nature of Saudi/Islamic law creates further potential for scepticism by Western organisations and cultures, which may feel unsure of the validity of the legal system, particularly in foreign disputes. Therefore, foreign judgments should abide by Sharia codes and public rules.[119]

[117] Law of Judiciary, Royal Decree No M/78, dated 1 October 2007.
[118] Saudi Arbitration Regulations, Royal Decree No M/46, dated 24 April 1983; Implementing Rules, Council of Ministers Resolution, No 7/2021/M, dated 28 May 1985.
[119] New York Convention, Royal Decree No M/11, dated 29 December 1993.

4.3 Institutional Corporate Governance Framework

This section first focuses on government and government-regulated institutions established to enforce compliance and see that the actions of corporations are in line with the corporate governance law.

4.3.1 The Capital Market Authority

The CMA was created in 2003 pursuant to the CML.[120] It enjoys legal, administrative and financial independence, reporting directly to the King in his capacity as President of the Council of Ministries. The CMA exercises executive and legislative powers in passing and adopting regulations supporting the validity and reliability of the market's valuation mechanism. Due to its regulatory functions, the CMA is prohibited from engaging in commercial activities of any kind, to have any interest in any profit-making endeavour, to lend or borrow any funds or to acquire, own or issue any financial instruments.[121] The CMA is endowed with the authority to create rules, enforce regulations and exercise mandatory power to properly discharge its duties. It may subpoena witnesses, collect evidence and compel parties to produce any books, papers, records or other documents deemed material and relevant to its investigations.[122]

The limitations on engaging in commercial activities extend to each employee, agent and member of the board of the CMA,[123] including their relatives. Article 8 of the CML states that:

> Any person who becomes an employee or a member of the Board of the Capital Market Authority should, immediately upon accepting its functions, disclose to the Capital Market Authority, in the manner set forth in the regulations of the Capital Market Authority, the securities he owns or has at his disposal or the disposal of one of his relatives, and thereafter declare any change thereon, within three days of becoming aware of such change.[124]

[120] CML (n 5) Article 4.
[121] CML (n 5) Article 4(b).
[122] ibid Article 5(c).
[123] The CMA Board was established under Article 7 of CML. Its composition, duties and responsibilities and qualification of its members are specified in Article 7 (a)–(d) of CML.
[124] CML (n 5) Article 8.

Furthermore, Article 9 of the same law affirms that:

> The members of the Board and the employees of the Capital Market Authority shall not engage in any other profession or job, including occupying a position or a post in any company, in the government, or within any public or private institutions. Furthermore, they shall not provide advice to companies and private institutions.[125]

While the individuals mentioned in the Article may hold or acquire securities and therefore have interests in commercial gains, there is a strict requirement for full disclosure of these holdings and interests, including those of their relatives, and of any changes made to these holdings and interests within three days. Full disclosure is also mandated for the agents of the CMA in matters related to the work entrusted to them by regulations.[126]

The CMA is a semi-governmental body governed by a board whose members are appointed. Five permanent members, who must possess high qualifications, serve for a term of five years, which may be renewed only once. After appointment, members nominate the chairman and deputy chairman and receive salaries predetermined by Royal Order.[127] The CMA develops the implementing rules and regulations for the laws passed by the legislature or by Royal Decree in consultation with experts in the government agencies and the private sector. Regulations passed by the CMA include the following:[128]

- Anti-Money Laundering and Counter-Terrorist Financing Rules;
- Authorised Persons Regulations;
- Corporate Governance Regulations;
- Glossary of Defined Terms used in the Regulations and Rules of the Capital Market Authority;
- Investment Fund Regulations;
- Listing Rules;
- Market Conduct Regulations;
- Merger and Acquisition Regulations;

[125] ibid Article 9.
[126] ibid Article 8.
[127] ibid Article 7(A) and (B).
[128] Bushra Gouda and Ali Gouda, 'The Saudi Securities Law: Regulation of the Tadawul, Stock Market, Issuers, and Securities Professionals Under the Saudi CML 2003 of 2003' (2012) XVIII Annual Survey of International and Comp Law 115 <http://digitalcommons.law.ggu.edu/cgi/viewcontent.cgi?article=1160&context=annlsurvey> accessed 18 September 2012.

- Real Estate Investment Funds Regulations;
- Securities Business Regulations.[129]

The principal objectives of the CMA are to:

- Develop the Saudi market;
- Regulate the issuance of and trading in securities;
- Achieve transparency and fairness in securities transactions;
- Monitor the disclosure of information connected to securities and listed companies;
- Adjust the actions of the stock exchange and listed companies.[130]

To achieve these objectives, the CMA performs the following functions:

- Lays down policies, work plans and regulations necessary to achieve the agency's objectives;
- Formulates the implementing rules and regulations necessary to effect regulations;
- Grants the flotation of securities;
- Adjourns stock exchange actions for designated periods of time;
- Bans for cause any security traded on the stock exchange;
- Develops vital principles for external auditors who review the reports of the stock exchange, brokerage companies, investment funds and listed companies.[131]

It is evident that the CMA's principal role is to enact and implement regulatory measures to ensure that the SSE is properly governed and operating. The CMA Board initiates activities that until recently were performed by the Ministry of Commerce and Industry. The specific function of overseeing corporate governance provisions is delegated to the General Department of Corporate Governance.

[129] CML (n 5) Article 66.
[130] ibid Article 5(A).
[131] CML (n 5) Article 6.

4.3.2 The General Department of Corporate Governance

The CMA is organised so as to be able to perform its functions under the CML. It created the General Department of Corporate Governance which is charged with the improvement and implementation of the corporate governance system through the following duties:[132]

(1) Developing communication with specialised institutions, both local and international, which are involved in the corporate governance of publicly traded companies;

(2) Encouraging perceptions of transparency, disclosure, liability and equality;

(3) Increasing investors' knowledge of listed companies through the appropriate CGR provisions;

(4) Promoting and overseeing implementation of corporations' self-regulation of their corporate governance policies;

(5) Training representatives of listed companies in the proper implementation of corporate governance practices.[133]

The Corporate Governance Department has direct responsibility for monitoring and regulating companies' compliance with the CGR. The department also has the power to bring legal actions against corporations which violate the CGR through the CRSD. In the course of its oversight functions, the department analyses listed corporations' articles of associations, online and print announcements, pronouncements through the stock exchange, and annual board financial reports. The department passes its decisions about violations onto the CMA Board, which reviews the decision, the recommended penalties and the legal basis for them.[134]

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[132] CMA Board Annual Report (2011) 25.

[133] Recently, in many Saudi districts, the General Department of Corporate Governance has held workshops about preparing the report to the board of directors and completing forms related to the rules of corporate governance. See *Al-Riyadh Newspaper* (9 January 2012) Issue 15904.

[134] CML (n 5) Article 7(d), empowering the CMA to delegate its functions through published Resolutions.

4.4 Committee for the Resolution of Securities Disputes

Judicial authority in Saudi Arabia is conferred on three institutions: the Sharia courts, Board of Grievances and quasi-judicial committees under bodies which discharge executive and legislative functions. The quasi-judicial committees are not firmly structured because of their limited jurisdiction and oversight by governmental and semi-governmental bodies. Unlike impartial judicial bodies which take no sides, dispute committees are charged with protecting investors and market equity and resolving disputes involving the CML and its implementing regulations.[135]

4.4.1 Securities Disputes Committee

Two committees that perform vital roles in the implementation of corporate governance in Saudi Arabia are the CRSD and the Securities Conflict Appeal Committee. The CRSD is a quasi-judicial committee composed of several legal advisors with expertise in Islamic financial and legal transactions, capital market laws and the interpretation of financial contracts. The legal advisors are appointed by the CMA Board for terms of three years with the opportunity for reappointment after the first term. It is necessary that the advisors and their relations to the fourth degree have no direct commercial interest with the parties involved in grievances being heard.[136] This qualification is intended as an assurance that the legal advisors' decisions are not biased.

The CRSD has jurisdiction to hear a broad range of disputes, including:[137]

(1) Public cases or actions brought against parties who refuse to comply with provisions of the CML and its implementing regulations;

(2) Private cases or actions brought by investors against groups in authority;

(3) Grievance cases or claims by parties against complex regulations and proceedings implemented by the CMA Board or the stock exchange;

[135] ibid Article (A) and (B).
[136] CML (n 5) Article 25(A).
[137] ibid Article 25(D).

(4) Temporary cases presented to the CRSD to obtain a ruling on transitory matters.

Despite the CRSD's broad scope of authority, it may hear cases only with the permission of the CMA, which has 90 days to consider the issue.[138] Claimants may not proceed directly to the CRSD within this period. This would be seen as an intervention by the CMA in the CRSD's authority which extends beyond listed companies and exceeds that of the CMA.

4.4.2 Securities Conflict Appeal Committee

The Securities Conflict Appeal Committee comprises three members nominated by the Council of Ministers' Royal Decree. They serve for a term of three years subject to renewal. In most cases, the appointed members are representatives from the Ministries of Finance and Commerce and Industry and from the Bureau of Experts under the Council of Ministers.[139] Decisions by the CRSD can be appealed to this Committee within thirty days of the decision. The Appeals Committee may decide to accept or refuse an appeal, and its decision is final and binding.[140]

4.5 The Saudi Stock Exchange

The SSE was established in 1984 in response to the launch of other stock exchanges in neighbouring countries, particularly Kuwait and Jordan. In addition, the public exhibited growing awareness and interest in stocks and stock trading, and Saudi corporations planned to switch from national to public ownership. The SSE was created under the supervision of the Ministry of Commerce and Industry and SAMA[141] and initially had 70 listed companies. By 1996, with a capitalisation of $45.9 billion and a market price-to-earnings ratio of 13.1 times, the SSE ranked as the thirteenth largest developed market in the world and the dominant stock market among Arab Gulf countries.[142]

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[138] ibid Article 25(E).
[139] CML (n 5) Article 25(G).
[140] Resolution of Securities Disputes Proceedings Regulations 2011, Article 39.
[141] Asam Al Ghamdi, *Commercial Law: Business, Dealer, Commercial Companies* (Arabic edn, Shaqri Library 2007) 38.
[142] International Finance Corporation, *Emerging Stock Markets Fact Book* 328 (World Bank 1995).

In 2003, the new SSE was reformed under the CML for the purpose of trading in securities.[143] The SSE is governed by a board of governors representing a number of governmental agencies, including the Ministry of Finance, Ministry of Commerce and Industry and SAMA. Other members include representatives from four licensed brokerage companies and two listed corporations.[144] Over time, the number of listed companies has more than doubled from the original 70 to 150.

Among the SSE's most important responsibilities in relation to the corporate governance framework is the oversight and enforcement of the requirement for corporations to hold annual GSMs and to ascertain that shareholders are accorded their rights through these meetings as guaranteed by law. The SSE also discharges obligations to:[145]

(1) Guarantee the equity of listing requirements;

(2) Ensure that transactions are impartial and fair;

(3) Ensure that firms meet transparency requirements;

(4) Certify technical mechanisms and information for securities listed on the stock exchange;

(5) Resolve disputes between board and shareholders and approve regulations.

The SSE represents a form of self-regulation because of the broad participation by representatives of brokerage companies and listed companies. Regulation is not only a one-way, top-down approach but follows a more responsive and more effective approach. The self-regulation mechanism give the SSE a sense of practice for corporate governance in the principles of sharia law. The mechanism is one that ensures that the Saudi stock exchange has differentiated aspects that protect it from the manipulation of the westernized concepts.

The International Company Listing For SSE

- Banks & Financial Services (12)
- Petrochemical Industries (14)

[143] CML (n 5) Article 20(A).
[144] ibid Article 21.
[145] ibid Article 20(C).

- Cement (14)
- Retail (14)
- Energy & Utilities (2)
- Agriculture & Food Industries (16)
- Telecommunication & Information Technology (4)
- Insurance (35)
- Multi-Investment (7)
- Industrial Investment (14)
- Building & Construction (17)
- Real Estate Development (8)
- Transport (4)
- Media and Publishing (3)
- Hotel & Tourism (4)
- Not Listed (106)

4.6 The Ministry of Commerce and Industry

The major government agency which oversees regulatory measures and corporate governance is the Ministry of Commerce and Industry. It is charged with certifying that the listing of companies is performed with full compliance with the CL, good corporate governance principles and respect for shareholders' rights.[146] A vital department under the Ministry of Commerce and Industry is the Department of General Companies. It is responsible for assessing and modifying the articles of association of newly-established corporations.[147]

[146] CL (n 7) Article 49.
[147] ibid Article 83.

4.7 The Accounting and Auditing Professions and the Saudi Organization for Certified Public Accountants

Standing vanguard over the entire corporate governance framework is the auditing profession, which acts with professional detachment and strict standards. Audits assess the financial condition and conduct of the company, particularly managerial actions. Auditors are subject to a wide range of liabilities in the conduct of their functions, which ensures the competent and impartial assessment of firms' governance. Recent events in the international collapse, however, have cast a negative light on this profession. Its members have been perceived as remiss in the discharge of their functions and a causal factor in the global financial crisis.[148] The Saudi accounting and auditing profession is believed to have issued unprofessional and misrepresenting assessments, which were a principal cause of the Saudi stock market collapse in 2006.

The first accounting and auditing firm in Saudi Arabia was established by the Ministry of Finance in 1957. The Ministry issued permits to seven duly licensed accounting and auditing companies, one Saudi and the rest foreign.[149] There was no earlier licensed Saudi accounting or auditing firms because of the lack of suitably educated and trained accountants and auditors.[150] The CL specifies the qualifications for certification in accounting and auditing firms, including nationality, residence, professional standing, members' certificates and experience. The CL has become a significant driver of the continued professionalisation of the accounting and auditing field.

The CL orders corporations to submit their financial reports to a chartered public accounting and auditing company. The chartered company is also empowered to access the company's records, demand information about its operations, assets and liabilities, and perform the necessary due-diligence asset inspection to determine the accuracy of valuations.[151] However, the accounting profession is still hampered by the lack of an appropriate set of accounting standards applied

[148] Istemi Demirag and Jill Solomon, 'Guest Editorial: Developments in International Corporate Governance and the Impact of Recent Events' (2003) 11(1) Corporate Governance: An International Review 1.
[149] Awad Al Rahele, 'Audit Committees as One of the Pillars of Corporate Governance' (2008) 22 Journal of King Abd al-Aziz University of Economics and Management 179.
[150] Hussam Al Angari, *Auditing in the Kingdom of Saudi Arabia* (Arabic edn, Sarawat Library 2004) 10.
[151] CL (n 7) Article 130.

uniformly to companies with comparable operations. The CL also lacks the body of appropriate legislation to properly regulate the accounting and auditing profession.[152]

For these reasons, the SOCPA was founded in 1992 with the task of overseeing the accounting and auditing profession and promoting its development and the formulation of accounting standards and principles. SOCPA's stated functions are to:[153]

- Review, develop and approve accounting standards;
- Review, develop and approve auditing standards;
- Establish the necessary rules for fellowship certificate examination (CPA exam), including for the professional, practical and scientific aspects of the auditing profession;
- Organise continuous education programmes;
- Establish an appropriate quality review programme to ensure that certified public accountants implement professional standards and comply with relevant provisions and by-laws;
- Conduct special research and studies in accounting, auditing and related subjects;
- Publish periodicals, books and bulletins on accountancy- and audit-related subjects;
- Participate in local and international committees and symposiums relating to the profession of accounting and auditing.

To help professionalise accounting and auditing as instruments of corporate governance, the SOCPA has issued recommendations to the boards of directors of various listed Saudi corporations about the inadequacy of transparency in their audit committee functions and the lack of satisfactory control rules. It is largely due to the perseverance of the SOCPA that these corporations have committees discharging the board's nomination, remuneration, risk and audit oversight functions. The first of these specialised committees were established only two years ago.[154]

[152] S Mohammad Al-Amari, 'The Development of Accounting Standards and Practices in the Kingdom of Saudi Arabia' (PhD thesis, University of Glasgow 1999) 71.
[153] Saudi Certified Public Accountants (2007) 10.
[154] SOCPA (n 153) 10.

4.7.1 Accountability from an Islamic Perspective

The concept of accountability is one of the most important aspects of Islam because of its link to belief in the Day of Judgment. This belief is one of the six articles of faith for Muslims, for whom, not the present life, but life after death is not the ultimate goal. The Quran calls the Day of Judgment by many names, including the Day of Accountability, the Day of Resurrection, the Hour and the Last Day, when all will be called to give an accounting of our decisions, including those made in business and work. For Muslims, therefore, accountability is not only an ethical concept but more a moral and spiritual one, for which all good Muslims are eternally answerable to God.[155] As all people will be questioned about their actions, Sharia law stipulates that all deeds be free of cheating and stealing. This belief supports the concept of disclosure and transparency in corporate governance as all the company proceedings and operations will be shown honestly to the public. Therefore, a conclusion drawn out of the thought is that accountability in the Islamic corporate world is a religious obligation guided by the sharia principles. Corporate institutions have the obligation of keeping their business transactions accountable to the governing authorities and the stakeholders. Such are principles that govern disclosure in the Islamic context. Zakat and sharia direct that all business people in the Islamic world have the transparency and accountability required of them by the community because they are directives of Allah. Furthermore, the corporate leaders such as the managers and the directors and other concerned parties should be responsible for their actions.

[155] Reem, 'The Importance of Accountability' (*Inside Islam*, 2012) <http://insideislam.wisc.edu/2012/03/the-importance-of-accountability/> accessed 27 August 2013.

4.8 Saudi Corporate Governance Regulations (2006)

The CMA first introduced the CGR as a set of voluntary, not mandatory, guidelines, unlike other regulatory functions (e.g. market conduct and merger and acquisition regulations) which were compulsory from the start. The CMA declared that the role of the CGR was to provide standards for the administration of listed corporations and encourage compliance. At its discretion, the CMA may enforce the CGR articles provided that the CMA Board determines the measure is appropriate for the Saudi market.[156]

Shareholders and other stakeholders play a vital role in corporate governance by providing a counterbalance to the board and management who tend to act in their own interests which might conflict with stakeholders. The interests of the stakeholders are the motivation for the practice of good corporate governance. Stakeholders (employees, shareholders, community, society) are most affected by corporation actions decided by the board and management but are the least directly involved in the making of these decisions.

The World Bank (WB) ranked Saudi Arabia 17th out of 183 countries evaluated for the protection of investors, particularly minority shareholders.[157] This indicates that Saudi law is well within the norms of most countries. The rights accorded shareholders are specified in Article 3 of the CGR:[158]

(1) The right to a share of the profits of the firm through dividends;

(2) The right to a proportionate share of the corporation's assets when liquidated;

(3) The right to dispose of their shares in the firm according to their preference;

(4) The right to attend the general shareholders' meetings, to contribute to the discussion, to ask management to explain their decisions and to vote on applicable resolutions;

(5) The right to oversee the activities of the board of directors;

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[156] CML (n 5) Articles 20(a) and 21.
[157] See U.S.-Saudi Arabian Business Council, 'Saudi Arabia ranks 12th most business friendly Economy in the World <http://www.us-sabc.org/custom/news/details.cfm?id=1156#.VBKdZG9O5dg> accessed 24 September 2013.
[158] CGR (n 8) Article 3.

(6) The right to file responsibility claims in a liability action against board members;

(7) The right to request and access information without prejudice to the corporation's benefits and in a way that does not reverse the CML and the implementing regulations; and

(8) The right to appoint and remove members of the board of directors.

Regarding the rights of shareholders in Saudi Arabia, the 2009 WB Report on the Observance of Standards and Codes (ROSC) states that Saudi Arabia has either fully or broadly implemented all the sub-principles within Principle IIA on shareholder rights protection. Regarding shareholders' rights to participation and information about fundamental corporate changes, the ROSC finds that Saudi Arabia has 'broadly implemented' all the sub-principles within Principle IIB. The exception is Sub-principle IIB 3 on extraordinary transactions. It has not been implemented, indicating major shortcomings in this area. According to the assessment, the available legal provisions 'appear too broad to capture the essence of the principle'.[159]

The Returns of Spontaneous Circulation in the ROSC highlight a number of shortcomings regarding this principle. Several obstacles impede some entitled shareholders, mostly those holding less than a specific number of shares, from attending general shareholder meetings (GSMs). There are no requirements for companies to disclose their remuneration policies. Shareholders may not vote by post or electronically although they may, in writing, delegate another shareholder to vote on their behalf. While companies may issue different classes of shares and are required to disclose descriptions of groups granted disproportionate control, the disproportionate control resulting from shareholder agreements are not disclosed.[160]

In Saudi Arabia, the CMA's Mergers and Acquisitions Regulation[161] regulates corporate takeovers, with the Competition Law containing certain restrictions against mergers. In addition, companies must treat all shareholders equally during a takeover. The assessment observes that, unless stated by internal company policy, there appears to be no obligations for institutional investors to vote or consider voting.[162] Therefore, the Saudi corporate governance laws that relate to shareholders are less well established and arguably do not demand the same level of confidence as their counterparts in non-Islamic-based law systems.

[159] WB (n 85) 18-20.
[160] ibid 19-22.
[161] Mergers and Acquisitions Regulation, CMA Board's Resolution No 1-50-2007, dated 3 October 2007.
[162] WB (n 85) 23.

Principle IIIA on minority protection states that all holders of the same class of shares should be treated equally. For these sub-principles, Saudi Arabia received ratings ranging from fully and broadly implemented to partially implemented in the 2009 WB ROSC. The assessment also found Principle IIIB on the prohibition of insider trading and abusive self-dealing to be partially implemented and Principle IIIC on the disclosure of material interests of board members and key executives to be broadly implemented. This evaluation details several ex-ante and ex-post protection measures available to minority shareholders. Under certain circumstances, however, these shareholders do not have the means to require the company to purchase their shares.[163]

In addition, voting by proxy is still limited in Saudi Arabia although the evaluation does note that the Ministry of Commerce and Industry[164] is considering the option of issuing rules on making use of phone and internet for contribution purposes. The CML and Market Conduct Regulations define and prohibit insider trading and manipulative practices.

Al-Fawaz claims that the voting system in Saudi Arabia is not compatible with corporate governance and economic health, which contribute to the development and the flow of capital markets.[165] The voting system allows for the largest shareholder or allied shareholders to use their votes to tighten the control of other shareholders by nominating themselves. Majority or large shareholders can take advantage of such companies as many individual shareholders (small shareholders or speculators) do not attend GSMs, and these require a quorum only of those in attendance. It follows that a large part of the ownership is representative of the board of directors which sometimes possesses up to 10% of company stock. The practical result of this voting system is that not all shareholders have equal rights, duties and interests. This arguably is a manifestation of individual control at the expense of the institution.

[163] ibid. See also Lena Al-Zahrawi, 'The Impact of Corporate Governance on the Evaluation of the Performance of Investment Funds Applied to the Case of the Saudi Financial Market' (PhD thesis, Syria Higher Institute of Business Administration 2009) 54, 60.
[164] Establishing the Ministry of Commerce and Industry, Royal Order No 5703/5/22/10, dated 17 March 1954.
[165] F Al-Fawaz, 'Loss of Minority Rights: Between Major Shareholders and Corporate Governance' (*Al-Eqtisadi* Newspaper, 2007).

Al-Fawaz argues that the solution is to expedite the issuance of new corporate law even though national economic interests might make it advisable to delay reform of the voting system (one vote per share).[166] The law requires that company boards describe all interests and rights of their members, key executives and immediate family who have shares in the company or its subsidiaries. Violations of such rules by board members or managers are subject to fines. In Saudi Arabian corporate governance, stakeholders are also of great importance, as reflected in the laws which protect them. Companies have proposed system guarantees of minority rights through reform of this flaw in voting so it is advisable to expedite the approval of this reform.[167] Companies have proposed system guarantees of minority rights through reform of this flaw in voting so it is advisable to expedite the approval of this reform.[168]

Further to that, legislation displays a lack of enthusiasm for corporate governance. Advocates hope to apply the CMA's obligations in full and give the SAMA another role in the governance of the banking sector. Several parties have resisted these regulations in an attempt to maintain a comfortable, profitable monopoly. Amid talk of economic and financial reforms, and price increases in the Kingdom, perhaps the first step to resolve these conflicts is to break this monopoly and force entrepreneurs to innovate, take risks and not exploit the system to maximise their narrow interests at the expense of those of the nation, citizens, transparency and radical economic reforms. The government, too, should be cautious as it has influential shares in some joint stock companies (JSCs). Developing mechanisms for electronic voting is also recommended.

However, investors have no cause to engage in insider trading. In addition, the law requires that company boards describe all interests and rights of their members, key executives and immediate family who have shares in the company or its subsidiaries. Violations of such rules by board members or managers are subject to fines.[169] In Saudi Arabian corporate governance, stakeholders are also of great importance, as reflected in the laws which protect them.

The case of Saudi Integrated Telecom Company (SITC) shows that official departments are willing to interfere to resolve an issue. This is not the first incident which has affected the rights

[166] Al-Fawaz (n 165).
[167] ibid.
[168] ibid.
[169] ibid.

of minority shareholders. Multiple companies had done so earlier but what happened to the SITC had not happened to any other company. The company offered public subscriptions without paying the full share of the founders and used bank guarantees instead of bank certificates of deposit from the shares owned by shareholders. Many parties contributed to the accumulation of the problems. First, the bank abrogated its responsibility in pledging to cover the Initial Public Offering (IPO), an action known to run contrary to statutory procedures for IPOs. As the source of collateral, the bank should bear responsibility for the silence about the preliminary prospectus which shows the use of financial guarantees as certificates of deposit for shares possessed by the company's principal owners. For its silence, the newsletter also shares responsibility for the consequences.

This process also involved two institutions reputed to be cautious and conservative: the SAMA and Ministry of Commerce, which did not prevent explicit violations. The CMA also has some responsibility to bear for tolerating offering the company shares without applying the LR which the prospectus refers to. In addition, the silence of the Telecommunications Authority and the monetisation of non-adherence to the safeguards to stop trading shares raise questions about this body's role in misleading shareholders and other official bodies during the establishment of the company without supportive market conditions.

The CMA suspended the shares of SITC on the SSE on 4 January 2012. Order 05/09/1433 AH adjusted the company's status. The CMA stated that it would consider further action if the company had not repositioned itself six months after the date of this decision.

This issue was clear cut. The company founders had not abided by corporate law or listing rules and procedures and, intentionally or unintentionally, exposed shareholders to high-risk practices. Thirty-five per cent of the company's shares were owned by shareholders who did not know the direction of the company and were unfamiliar with the CMA, Ministry of Commerce, SAMA and Board of Grievances.[170]

These practices prove beyond doubt that the status of shareholders, especially minority ones in Saudi Arabia, is still in the early stages compared to developed markets. There is no absolute answer to who is responsible for the lack of protection of minority shareholders. No unions or

[170] A Al-Husseini, 'Integrated Telecom Co: Minority Missed' (*Al-Eqtisadi newspaper*, 2012).

clear legal procedures to recover their rights or receive compensation for losses suffered as a result of errors by company leaders and other regulators exist. In developed countries, such incidents prompt the enactment of laws to address problems that have occurred, but many countries remain silent about such situations.

Although the CMA's 2004 Market Conduct Regulations include laws to prevent market manipulation, protection of minority shareholders is not guaranteed in the execution of laws and regulations. Small shareholders might be afraid of taking the initiatives as they do not know the risks. Therefore, the CMA, as the regulator of the financial market, should invite small shareholders to create blocs protected by a specially formed CMA special unit. This unit should be made of expert jurists familiar with the financial markets who can inform shareholders or groups of shareholders of their rights and advise them during any legal claims.[171]

For example, the CMA stopped the trading of stocks in Bisha in January 2007 because its losses reached a large percentage of its capital. The CMA asked the company to reissue its financial statements for the third quarter. Where was the board of directors when the company suffered losses in successive years? Over the past three years, as sales decreased, the company sought liquid investments in investment funds. The board of directors certainly sought any priority or initiative to improve the status of the company's primary activities. However, the company did not have a legal official at the time of the auction for the sale of outstanding shares. This created new problems with the auditor and with calculating the return on the auction revenue, and required doubling the integrity of financial systems and control.[172]

It has been proven that limiting the Governing Council which handles shareholders' money allows shareholders to claim the legal rights to determine corporate governance, control the work of the board and hold members of the council responsible.

According to the 2009 WB ROSC, Principle IVA on the adherence to the rights of stakeholders is broadly implemented in Saudi Arabia. Both Principle IVB on the effectiveness of redress for violations of stakeholder rights and Principle IVC on the development of performance-enhancing mechanisms for employee participation were found to be partially implemented.[173] Principle IVD

[171] Al-Eqtisadi, 'Chief Executive of KSB Capital Group*:* Protection of Minority Shareholders' (2007).
[172] ibid.
[173] WB (n 85) 26.

on stakeholder participation in the corporate governance process was not applicable in the Saudi Arabian context. The 2009 assessment deemed Principle IVE on the protection of stakeholder rights in the reporting of illegal or unethical behaviour not to have been implemented. Saudi Arabian law contains 'no specific whistle-blower mechanisms'.[174] Principle IVF on the existence of a complementary insolvency framework was assessed as broadly implemented.[175]

In addition, the CL does not have provisions that give stakeholders the right to provide input on matters related to company governance. The CGR, however, require that companies establish written policies organising boards' relationships with stakeholders.[176] While the CGR requires dispute settlement mechanisms between companies and their stakeholders, such mechanisms are not detailed or distinguished for different types of stakeholders. Despite the CGR requirement for written CSR policies, the assessment found that few Saudi companies included these in their annual reports. According to the 2009 ROSC, recent amendments to the Offers of Securities Regulations introduced employee share options and incentive schemes but, at the time of the report, these had not been ratified.[177]

Regarding the legal principles of disclosure and transparency in Saudi corporate governance, Principle VA outlines the standards for the disclosure of different types of corporation material information. Its sub-principles were all rated as either broadly or partially implemented, with the exception of Principle VA7. This sub-principle on the disclosure of stakeholder issues was found not to have been implemented as the CGR disclosure requirements regulating company-stakeholder relationships were still 'too new to be tested'.[178]

The 2009 WB ROSC also found that Saudi Arabia had partially implemented Principle VB on the standards of financial and non-financial disclosures, Principle VC on auditing and auditor requirements, Principle VD on auditor accountability and Principle VE on the accessibility of disclosed information. Principle VF on the disclosure of conflicts of interest by analysts, brokers

[174] WB (n 85) 27.
[175] ibid 27.
[176] I Almataz, 'A Careful Reading of the List of Corporate Governance in the Kingdom' (*Aleqt newpaper*, 2007) issue 5011 <www.aleqt.com> accessed 19 October 2011.
[177] WB (n 85).
[178] ibid 27-29. See also Aidhamed Al-Shammari, 'Corporate Governance in Saudi Arabia Reality and Ambition' (First Scientific Conference of the Faculty of Economics University of Damascus) 11, 12.

and rating agencies was assessed as not implemented.[179] Although the Authorised Persons Regulations appear to capture most core principles of the International Organization of Securities Commissions (IOSCO) Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest, the legal framework as a whole does not necessarily address these regulations.[180]

Public disclosure and periodic reporting requirements of listed companies are detailed in the CL, CML and CMA LR. However, the evaluation observes that disclosures related to beneficial ownership 'appear to be still limited in relation to intra-group relations and significant cross-shareholdings'.[181] The LR require prompt ex-ante disclosure of transactions between the company and related parties but no disclosure before such a transaction is carried out. Listed companies in Saudi Arabia must comply with local financial reporting standards issued by the SOCPA. The 2009 action plan issued by SOCPA for the International Federation of Accountants (IFAC) states that SOCPA has set as an objective the convergence of national standards with International Financial Reporting Standards.[182] It has been noted that the board of a corporate organisation, as well as its shareholders, is of crucial importance to the notion of corporate governance. What, therefore, of the legislations that dictate the actions and responsibilities of a board in a corporate organisation in Saudi Arabia?

The above analysis relates to the thesis because it outlines the generalised approaches of corporate governance. As such, the regulations realised in this section interpret the situation in relation to the Islamic sharia. The obligation that all corporate institutions have in the country require them to be transparent in terms of disclosure. The principles of Islamic laws have a fundamental principle of non-exploitation, which makes the above principles relevant to the scenario.

According to the evaluation, fiduciary duties are still emerging legal concepts in Saudi Arabia, and compliance with the CGR on the board's key functions is still in the early stages as is the effective enforcement of penalties for violations of fiduciary duties.[183] .[184] The scenario is still

[179] WB (n 85) 30-31.
[180] WB (n 85) 31.
[181] ibid 28.
[182] WB (n 85) 29.
[183] ibid 31. See also Al-Zahrawi (n 163) 45, 48.

applicable under the sharia laws, which gives the directives of the types of activities that take place. The sharia laws require that parties partaking of the fiduciary duties should observe the three fundamentals of Islamic laws. The emergence of the same concepts in the country relate to the slow rate of incorporation of the concepts into the concepts of sharia laws.

Shareholders possess the right to file liability lawsuits against directors through the redress mechanisms described in the CL. However, no laws or regulations pertain specifically to minority shareholders.[185] To date, no lawsuits involving directors' liabilities have been filed in Saudi Arabia. The evaluation finds that the CL requires disclosure of remuneration methods and thresholds but there are no specific laws or regulations on aligning the compensation of the board of directors and senior executives with long-term company and shareholder interests.[186] Similarly, the evaluation also noted a lack of provisions in the CL and CGR concerning the disclosure of board nomination procedures. The WB evaluation also observed that not all companies possessed an internal audit function. The IFC and Hawk Amah Institute for Corporate Governance's regional survey, as cited by the 2009 WB ROSC, found fairly low cross-board memberships across Saudi Arabia.

This discussion has given an overview of company law and its operation in Saudi Arabia. A related theme will now be considered: the accountability framework within the context of Saudi corporate governance.[187]

The legal protection of minority shareholders does not mean that they and their interests cannot be relegated to a position inferior to that of other shareholders. Minority shareholders rights are defined, enforced and protected by law. However, as seen in Abu Aynain's 2013 article in *Al-Riyadh*, these reforms are inadequate to protect shareholders' rights and guarantee transparency of operations. Aynain discusses a crisis involving integrated telecommunications company Almutakmilah which had a difference between the book value of its shares at SR900 million and

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[184] ibid 31. See also Al-Zahrawi (n 163) 45, 48.
[185] ibid 32.
[186] ibid 32. See also Al-Shammari (n 177) 27.
[187] Ahmed Ragab Abdel Malik Abdurrahman, 'Measuring the Extent of Transparency and Disclosure in Published Financial Reports of Companies Traded in the Saudi Capital Market Study Applied the Theory of' (King Faisal University) 8, 19.

the value at market price of SR2,430 million. This could be a distorted picture as the market increased the price of the stock shares of a firm accused of offences.[188]

The second-generation family managers of Saudi firms are not well prepared to appoint independent boards of directors and professional chief executive officers (CEO) to manage the company according to the board's decisions. Consequently, firms' financial disclosure is not sufficient, and shareholders companies do not have enough accurate information about the companies in which they have invested. Therefore, the Saudi government is encouraging firms to adhere to corporate governance practices without resorting to mandatory regulation.

Regarding the jurisdiction process, Al-Nasiry describes the SITC case in which the company lawyer revealed that the responsible bodies did not agree to bring issues to the judiciary.[189] However, the company management felt that the process was contrary to the company's interest and violated regulations. Although there was a liquidation process, its liquidation was settled by bureaucracy instead of a court of law. This situation indicates the lack of legal resort for parties involved in liquidation.

This regulatory shortcoming might result in shareholder losses during liquidation. The liquidation decision on SITC gave non-founder shareholders 9% less than the book value of their shares and nearly 60% less than market value. Bypassing the judiciary harms the voiceless shareholders who must appeal the decision in a court of law—a lengthy process because unclear regulations on liquidation might delay or deny justice.[190]

Although regulation of the liquidation process is lacking and the law modifies the term of limited companies, it is crucial to understand that Article 180 of the CL is the only statutory limitation of the doctrine concerning the separation of legal personality in Saudi Arabia. This article states that, if a limited liability company's losses exceed 50% of its share of capital, its shareholders lose their limited liability and become responsible for the company's debts.[191] At this point, dividends may not be distributed to shareholders except for net profits. If shareholders receive a

[188] F Abu Aynain, 'The Market Value of the Shares of the Integrated 2430 Million and Shareholders' Equity Fell to 900 Million' (*Al-Riyadh Newspaper*, 9 May 2013).
[189] I Al-Nasiry, 'Responsible Bodies Reject the Judiciary and the Withdrawal of the License of Historical Precedent' (*Al-Eqtisadi Newspaper*, 2013) Issue 7150.
[190] AH Omari, 'Integrated: Who Will Pay for the Mess?' (*Al-Eqtisadi Newspaper*, 2013) Issue 7154.
[191] CL (n 7) Article 180.

distribution that is not from the net profits, they can claim from shareholders the amount that exceeds the net profit. During the dissolution of a company, creditors need to be paid from profits before shareholders are. What remains is then distributed among shareholders.[192]

In addition, thirty days after the 50% limit has been exceeded, a meeting must be called to consider whether the company should continue to exist or be dissolved before the expiration of the period indicated in the company's articles of associations.[193]

Article 176 limits the company's ability to distribute profits to shareholders. This Article stipulates that a company must set up reserves and accumulate a reserve fund of up to 50% of share capital. Each financial year, companies must transfer at least 10% of their annual profits into reserves until they equal or exceed 50% of the company's share capital.[194]

4.9 Evaluation and Analysis of the Saudi Corporate Governance Framework

The Saudi Corporate Governance Framework is benchmarked against the OECD Principles of Corporate Governance, and is subject to the ROSC, a programme under the joint auspices of the WB and the International Monetary Fund (IMF). This analysis focuses on listed companies but does make country-wide observations on the general regulatory and legal framework for governance and accountability. The 2009 ROSC country assessment for Saudi Arabia noted an emerging awareness of the importance of good corporate governance as a result of the deep slump and volatile market of 2006 that was caused by a lack of disclosure and transparency among listed companies.

Since then, several initiatives to promote legal and institutional reform in the Saudi corporate governance system have been undertaken, which observers feel will ensure that companies use their resources more efficiently and will engender better relations with workers, creditors and other stakeholders. The Saudi framework includes the 2006 CGR for listed companies, guidelines on corporate governance best practices for banks and strengthened supervisory functions in the financial sector.

[192] ibid Article 180.
[193] ibid.
[194] ibid Article 176.

The CMA is responsible for regulating and managing the Saudi Arabian capital markets and other areas related to corporate governance, as defined and established in the first chapter. The CMA has a level of legal, financial and bureaucratic autonomy and answers only to the prime minister.[195] The CMA's responsibilities include the following:

(1) Setting financial rules and regulations;

(2) Ensuring that these rules are followed;

(3) Acting as an independent committee for the resolution of disputes;

(4) Ensuring the growth of capital markets and the corporate elements of the Saudi Arabian economy (including the governance of the SSE);

(5) Ensuring, through its Corporate Finance and Issuance Divisions, that any potential and actual investors are given all the information they may require to take objective decisions about their investments, and that all parties adhere to the rules and regulations, as above; and

(6) Contributing to policy ideas and implementations conducive to the growth of the Saudi economic markets and infrastructure.

To show the CMA's seriousness in enforcement, it filed a case against Muteb Bin Saeed Adullah Al-Ahmary for violating Article 49 of the CML and Articles 2 and 3 of the Market Conduct Regulations[196] when trading shares of various companies in 2008. The CMA charged him with committing fraud, manipulation and creating misleading impressions. He was banned from offering securities through his website, which was closed down. He was ordered to pay the revenue due to the CMA as well as a penalty.[197]

The CMA is chiefly responsible, within the Saudi power structure and hierarchy, for implementing the rules, instructions and procedures that amount to the implementation of the

[195] CML (n 5). See CMA, 'About CMA' <http://www.cma.org.sa/En/AboutCMA/Pages/default.aspx?> accessed 5 June 2011.
[196] Market Conduct Regulations, Capital Market Authority Board's Resolution, No 1-11-2004, dated 4 October 2004.
[197] Decision No 313/L/D1/. CMA, 'Announcement by the CMA Concerning Issue of Final Decision by the CRSD Condemning a Violator to the CMA Law and Regulations' (2008).

corporate governance regulations in accordance with the cultural (Islamic) laws of the land.[198] Unsurprisingly, there are a number of proposed recommendations which, if followed, will enable Saudi Arabia to bring its actual and proposed corporate governance closer to what is expected by international standards.[199] These recommendations include changes to the structure of the CGR and better implementation of the principles of the law in legal practice. The WB report notes that:

> The CMA is in the process of implementing a three-phase approach to improving corporate governance practices in Saudi Arabia. Phase one was completed with the publishing of the CGR and phase two, which is currently in progress, aims to educate market participants on its application. The third phase will comprise revisions to the CGR, with a possibility of making compliance with some or all of the regulation mandatory.[200]

That the World Bank, in its ROSC, could conclude impartially that the Saudi corporate governance laws, regulations and institutions 'generally reflect international good practice' is significant, particularly given the allegations of economic corruption aimed at Saudi Arabia, as discussed previously. This conclusion should encourage non-Arabic corporate organisations to carry on business in Saudi Arabia and with Saudi companies.[201]

It has been established that the CMA has the power to investigate and enforce rules and regulations within the context of corporate governance.[202] On this subject, however, one might add that, according to the 2009 World Bank ROSC, the CMA has also improved its consultative process and started more actively interacting with relevant stakeholders in developing new regulations. The 2009 ROSC found a clear division of responsibility between the CMA and the SAMA and, in general, observed a 'significant degree of cooperation between the various financial sector regulatory bodies'.[203] Both the CMA and SAMA seem to possess adequate supervisory resources and are economically independent. They work to build awareness of the importance of sound corporate governance practices amongst companies, shareholders and stakeholders.[204]

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[198] ibid.
[199] ibid 3.
[200] WB (n 85) 3.
[201] ibid 6.
[202] ibid 6.
[203] ibid 6.
[204] ibid 3.

As the legal context in Saudi Arabia is based upon Sharia law and the law is derived from Sharia principles and notions of justice, it is necessary to return to this legal framework to provide a full picture. In the early 1980s, SAMA, the central bank of Saudi Arabia, issued a document addressing the responsibilities of the board of directors of Saudi commercial banks, including the implementation of a system of accounting and internal controls.[205] A further guidance document issued in 1996 concerned the role of the board's audit committee.

In 2004, the SAMA published a circular that affected bank directors and senior managers. Until 2003, the SAMA had been in charge of regulating and monitoring market activities in Saudi Arabia. The CMA was established in July 2003 under the CML, leaving SAMA with the role of regulating banks and insurance companies. As noted earlier, the CMA issued the CGR following the 2006 market correction, when market regulators focused on legislative and institutional reforms to improve corporate governance in Saudi Arabia. The 2009 World Bank ROSC found general adherence to be low in the first year of the adoption of the CGR, applicable to listed companies on a 'comply-or-explain' basis. The SAMA is also 'drafting a corporate governance manual for banks'.[206]

This history proves how Islamic law is being affected and is evolving within the business and economic setting of Saudi Arabia. If the Saudi economy is to grow as desired, a shift from Sharia law towards more international (i.e. European and American) business laws and rules is necessary. However, this evolution must not come at the expense or alienation of the Arabic world which is itself so intertwined with the Saudi economy at a cultural and a financial level.

According to the 2009 World Bank ROSC, companies in Saudi Arabia adhere to a one-tier board system. The Tadawul serves as Saudi Arabia's Stock Exchange, which is the largest in the Arab world, with a market capitalisation of US$519 billion at the end of 2007. According to the World Federation of Exchanges, the Tadawul had 122 listed companies as of June 2008. Despite some market liberalisation in 2006, foreign investors still have limited access to investing in Saudi shares. The 2009 ROSC does note that there remains an on-going domestic debate on whether to further liberalise the market. Some of the largest companies in Saudi Arabia are not listed

[205] H al-Sayari, 'Corporate Governance for Banks in the Kingdom of Saudi Arabia' (High-Level Roundtable Discussion for Bank Executives on Corporate Governance for Banks in Saudi Arabia, Institute of Banking, Riyadh, 22–23 May 2007).
[206] WB (n 85) 2-3.

because the abundant liquidity in the market, along with well-capitalised banks, reduces the incentive to go public.

The ROSC also states that ownership tends to be concentrated in government and founding family holdings. In 2009, investor protection in Saudi Arabia was higher than the average achieved by OECD member states and well above the regional mean, as noted in the International Bank for Reconstruction and Development and the World Bank's (IBRD/WB) 2010 Doing Business Report. The IBRD/WB ranked Saudi Arabia on the Investor Protection Index, which is a subcomponent of the IBRD/WB 2010 Doing Business Indicators and consists of three dimensions of investor protection: transparency of transactions (Extent of Disclosure Index), liability for self-dealing (Extent of Director Liability Index) and shareholders' ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index).[207] The indices range between 0 and 10, with higher values indicating greater disclosure, liability of directors, powers of shareholders to challenge the transaction and investor protection. Saudi Arabia scored 9.0 on the Disclosure Index, compared to a regional average of 6.3 and OECD average of 5.9. The Kingdom scored 8.0 on the Director Liability Index, compared to a regional average of 4.8 and OECD average of 5.0. Finally, it scored 4.0 on the Shareholder Suits Index, compared to a regional average of 3.7 and OECD average of 6.6.[208]

Before looking at company law in Saudi Arabian corporate governance, the role of audit committees in the Saudi Arabian corporate sector is considered.[209]

4.10 Role of Environmental Matters and Auditing in Corporate Governance

Corporate governance practices are determined by regulations and assessed by auditing practices and environmental requirements. From the time of the commercialization, the system of Islamic corporate governance has seen a rapid rise and reached the acceptable standards globally. However, there continues to be criticism with regard to the absence of uniformity in the

[207] Word Bank Group, 'Protecting Minority Investors' <http://www.doingbusiness.org/data/exploretopics/protecting-investors> accessed 28 April 2013.
[208] ibid.
[209] J Maati, *Le Government Enterprise* (De Boeck University 1999).

application of the sharia laws. The sharia supervisory board in in charge and consequently, has the directions concerning the same concepts.

When considering the case of SITC, Aynain points out that Ministerial Decisions should address a lack of transparency in sensitive financial and market issues, holding accountable those who cause shareholders losses and consider the precedent of publishing the findings of decisions concerning the liquidation of listed companies in the capital market.[210] Aynain claims that shareholders are eager to learn whether, when a company's assets are liquidated, shareholders' funds will be returned. Investors who bought their shares in the trading market at high prices are particularly concerned.

Aynain shows that the book value of the shares amounted to SR9 and that equity fell to SR900 million. When calculating the value of shares issued according to the price of the last closing share of SR24.30, it is clear that the market value of those shares was in the range of SR2430 million. This gives a distorted picture of the market. The value of stock in companies accused of offences of incorporation rose to record levels, while the value of shares of some companies sat near their nominal prices.[211]

Moreover, Aynain shows that the SITC crisis revealed serious errors in the administrative organisation and the relationship between the ministries and bodies concerned. The multiple sources charged with issuing permits allowed errors to happen. The case of the SITC is linked to three such sources: the Ministry of Commerce, the Communications Authority and the Markets Authority.[212]

The SITC crisis also exposed the mechanism for applying the criteria for establishing companies along with other disparities in the official bodies of company founders. In addition, Aynain highlights the transparency of government ministries and agencies alongside the Financial Market Authority.[213]

He stresses that the repeated errors committed in the capital market adversely affected the Kingdom's credit status, which became less than receivable. The main cause of this classification

[210] Aynain (n 186).
[211] Aynain (n 186).
[212] ibid.
[213] ibid.

was the weakness of the capital market. He also points to specialised company classifications which seemed to be exposed after the SITC crisis. Aynain states that legal consequences continue after the decision for liquidation. The matter does not end at this point, especially if the available funds do not fulfil shareholders' rights and the responsibilities of the company's founding shareholders.[214]

Aynain stresses that the CMA is responsible for tracking restrictions on selling company shares in order to avoid disasters. The agency also seeks to find market manipulators and to force them to settle accounts. Restrictions imposed by the CMA may not be concealed. In the face of these developments, Aynain calls for the CMA to review its weak enforcement, to revise allowances and to tighten the criteria for inclusion in a manner that preserves the rights of investors and traders and restores lost market confidence. In respect of this, the issuance of permits should be performed by a comprehensive service centre in order to ensure that those who issue a statement are responsible for its consequences even though many actors are involved in the formation of the final declaration.[215]

As a result, the decision made in the case of SITC did not satisfy legal experts. Alanfa indicates that the financial market system demanded that matters be made public when publications included incorrect data about substantial matters or failed to mention substantial facts. Those who purchase securities subject to these publications are entitled to compensation for harm caused by it. Such statements or omissions are substantial if the evidence presented to the committee settling securities disputes indicates that the investor knew the impact on the price that he bought it.[216]

Shareholders must study the reasons for the withdrawal of a licence and deliberate whether their rights have been violated. They may bring a case against the responsible parties, whether company officers or others, if specific mistakes caused the withdrawal. These cases are a real test of the application of the corporate governance systems and bylaws protection of shareholders'

[214] ibid.
[215] Aynain (n 186).
[216] A Alnafa, 'Indicator of the Level of Confidence in the Market: Shareholders Must File a Lawsuit on the Instigators' (*Al-Riyadh Newspaper*, 9 May 2013) Issue 16390.

rights. These cases are an indicator of the level of shareholders and investors' confidence in the Saudi market and the reputation of companies in the Kingdom.[217]

Alanfa points to Aynain's opinion that the matter does not end at this point.[218] Stakeholders might bring the matter to judicial courts because of the loss they incurred due to the decision. Aynain emphasises the CMA's weakness and inability to ask companies about transactions, allowances and stricter criteria for trading shares. The whole matter indicates the lack of supervision and commercial regulations necessary for the CMA to monitor companies' activities and take timely actions.[219]

This discussion leads to that analysis of auditing and environmental issues. One can successfully link auditing and environmental practices when corporate governance practices are at a reasonable level. In this context, Chiang emphasises the comparative perspective for investigating and analysing the development of internal audit departments in Saudi Arabia.[220]

4.11 Role of Sharia Law in the Business Environment

Under the absolute Saudi monarchy, Sharia law forms the foundation upon which Royal Decrees are based. Sharia law is a collection of principles derived from several sources, principal among them is the Holy *Quran* and the *Sunna*. Most Saudi regulations are interpreted consistently with the law of Islam.

Generally, Saudi law follows the Hanbali School of Islamic jurisprudence, which has majority and minority views on a number of issues, and bases its approach to legal construction on justice and fairness. Other Sharia principles contrary to Western business practices are the prohibitions of *riba* (interest) and *gharar* (uncertainty) and the lack of an irrevocable power of attorney.[221]

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[217] ibid.
[218] ibid.
[219] Alnafa (n 218).
[220] C Chiang, 'Insights into Current Practices in Auditing Environmental Matters' (2010) 25(9) Managerial Auditing Journal 918.
[221] AME Info Services, 'A Guide to Doing Business in Saudi Arabia: Sharia' (18 October 2012) <http://www.ameinfo.com/guide-doing-business-saudi-arabia-sharia-314267> accessed 15 July 2013.

Islamic law is concerned with the relationship between humans and God as defined and understood by Islamic theology. Implicit in this theological relationship are dual levels of responsibility: firstly, responsibility between an individual and God; and secondly, the relationship between an individual and other humans.[222] While *ibadat*—meaning worship—relates to the first, *muamalat*—or interactions—relates to the second. Anthropologically, it is necessary for Western and non-Muslim readers to understand the importance of these notions to those involved in the Saudi business context.[223] One cannot separate the concept of accountability in business from the concept of accountability in the *Quran*, between a person and others and between a person and his God.[224] The main belief of Muslims is that all creatures will be held accountable and judged for their deeds on Doomsday. Such a belief makes believers keen to do the right things and avoid the bad ones as defined by Sharia.[225]

Basically, the principles of the Islamic corporate governance have the foundations on the teachings of religion. The most complicated part of the laws relate to the accounting system because they sharia laws guard people against exploitations that occur through financial manipulations. However, the laws that regulate the accounting systems within the same context have significant levels of influence on corporate governance.

Arguably, approximately all the principles of corporate governance have their concentration on the sustainability of the benefits of the stakeholders because they have contractual dealings with the same corporations. Such a principle is mentioned in the corporate governance are also in the Islamic perspectives as the undertaking of contracts.[226] The objective of wealth from the Islamic point of view concerns the involvement of contracts and requires all the Muslims to record information regarding their business contracts. The Muslim faith holds particular views regarding wealth. As such, they believe that Allah reveals that all that believes in the

[222] ibid; U Uddin and M Tsamenyi, *Corporate Governance in Less Developed and Emerging Economies* (Emerald Group Publishing 2008) 189-209.
[223] Quran, Surat Youse, Ayah 19.
[224] Najwa Mordhah, 'Self-Accountability: The link between Self-Accountability and Accountability in Islam' (2012) 2(5) IJHSS 240-244.
[225] ibid 241-243.
[226] Zamir Iqbal and Abbas Mirakhor, 'stakeholders Models Governance in Islamic Economy System, '*Islamic* Ecommic *Studies*, 2004,1(2) p.22.

fundamentals of Islam should write their contracts down. Allah further shows that the process should involve a scribe who should so in justice and that no scribe should refuse to do what He has thought him.[227]

Additionally, undertaking contracts focuses on fair dealings for all the parties involved in the process. For this case, Allah declares that not all those who believe in Islam should eat up their property among themselves in unjust manners except in trade between them in terms of mutual agreements and that they should not kill themselves. There is a need to base corporate governance practices on the undertakings of company managers. Therefore, according to the teachings of Islam, there is a need that the corporations undertake contacts with Muslim managers with particular reference to the Islamic laws (Sharia). Altogether, there is a need to realize that the managers are not to dominate their debtors and should respect them. Nevertheless, there is also the need to consider that contacts should consider the nature of products under the contract as well as specify the rights of both the buyer and the seller.

Under Islam, disclosure should include all information on legal and illegal activities, employee policy, resource use and environment, and this is associated with principles such as vice-regency and justice.[228] Based on the concept of accountability, it is necessary to disclose this information even when it conflicts with the company's interests.[229] Ultimately, human beings are not the owners of their surroundings but are only 'vice-regents' entrusted by God with the responsibility for such things as family, property, resources and businesses.

Therefore, humans must be honest and should use property and resources according to Sharia law and Allah's will. In this way, they can fulfil their accountability to Allah. In Islam, the principle objective of accounting is to be accountable to Allah. This differs from the business

[227] Holy Qur'an sura 2, *Ayah282*, King Fahad complex the printing of the holy Qur'an.
[228] S Myers, 'Capital Structure' (2001) 15(2) JEP 81.
[229] V Pina, L Torres and S Royo, 'Are ICTs Improving Transparency and Accountability in the EU Regional and Local Governments? An Empirical Study' (2007) 85(2) Public Administration 449.

accountability perspective in Western countries which gives stakeholders and owners priority.[230] A business owner or manager must follow Sharia law in all transactions, including avoiding dealing with interest when borrowing or lending and reporting any activities that are not compatible with Sharia law.[231] The *Quran* mentions the prohibition of interest several times and emphasises that Islamic law does not allow it.[232]

For many, there is no ambiguity in the accountability demanded in Islamic culture and business, and thus, in Saudi culture and business. Sharia instructions apply to all activities of Muslims, whether managers, shareholders or employees.[233]

4.12 Summary

This chapter has examined the Saudi legal system for the capital market and has given the historical background of the country and the Basic Governance Law. The current practices of and improvements to the Saudi corporate governance framework and regulations have been analysed. In addition, the application of the Sharia concept of accountability in the Saudi business environment has been described. This lengthy chapter provides a detailed analysis of the current practices and the improvement of the corporate governance framework in Saudi Arabia. Background knowledge of Saudi Arabia's legal structure and its development throughout the years is very important in understanding the growth of corporate governance to the present. The foundations of Saudi Arabia's legal structure are based on Islam, and the tenets of the religion fuels corporate governance. However, there are codified statutory laws, and four sets of laws laid out by the monarch have been instrumental in the creation and development of the corporate governance in the country. The Basic Law of Governance, Regional Law, Council of Ministers law and the Consultative Law are the four statutory laws that were codified in 1992. Further, the country's CMA ratified a number of changes and established a set of corporate governance regulations which was developed to be in tandem with international standards. This chapter has described the institutional infrastructure that supports the corporate governance

[230] Baker Alserhan, 'The Principles of Islamic Marketing' (United Arab Emirates University 1999) UAE.
[231] Z Iqbal and A Mirakhar, *An Introduction Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011)
[232] Quran, Surat 'Āli `Imrān Iuah (130).
[233] Myers (n 228).

framework in Saudi Arabia. The government agencies and institutions charged with the oversight and regulation of corporate activities to ensure compliance with corporate governance principles have been identified: the CMA, with its General Department of Corporate Governance; the CRSD, under which are the Securities Disputes Committee and the Securities Conflict Appeal Committee; the SSE; the Ministry of Commerce and Industry; and accounting and auditing professions regulated by the SOCPA. Finally, the Saudi ownership structure has been highlighted.

Furthermore, the chapter has introduced the CMA; its core functions in lieu of corporate governance; and its functions and other roles within the public sector. Further, the chapter engages in a deep discussion and exploration of institutional corporate governance structure, of both public and private institutions. Within the body of the chapter, the stock exchange becomes an important item of discussion with respect to corporate governance as well as an avenue for retribution in case of malpractice and issues that go against good and ethical corporate governance. Finally, the chapter provides a raft of comparisons on corporate governance practices in other parts of the world in relation to present corporate practice in Saudi Arabia.

The Islamic corporate governance structure has a similarity with the conventional structures. However, the context of Islamic models, the foundation lies on the conventions of Islam, which require that the corporations be as transparent as possible. The same rules require that the institutions take the wellbeing of stakeholders at the centre of their operations. On the contrary, the conventional apart from holding the fundamentals of transparency, has some levels of exploiting of some stakeholders. As such, the distinction lies in the manner that the Sharia supervisory board is at the centre of the regulations of the Islamic regulations.

Chapter Five

The current rights of minority shareholders in Saudi Arabia

The preceding chapter examined the legal framework of corporate governance in Saudi Arabia and the important elements of the institutional framework for Saudi corporate governance. The discussion in this chapter first focuses on government and government-regulated institutions established to enforce compliance and see that the actions of corporations are in line with corporate governance law. This chapter then examines minority shareholdings interests and rights and investigates minority shareholder protection under the CL. In addition, the board of directors is described, which controls and guides firm operations in compliance with corporate governance standards and regulations.

5.1 Outline of Minority Shareholdings

Before discussing minority shareholding in Saudi Arabia, it is first necessary to briefly describe minority shareholdings themselves. The minority does not control the firm's operations by voting (either with others or independently). Of course, the fewer shares firms or individuals possess, the less say they have in the running of the business. If a single shareholder possesses the majority of shares, this shareholder enjoys significant influence over the firm's operations. A majority shareholder can push forward decisions in general meetings and meetings of the board of directors where typically a majority vote determines decisions.[234]

One shareholder wielding significant control over a firm can give rise to serious concerns. The primary concern is that the majority shareholder's influence might result in negative outcomes for the business for which it cannot seek any remedy.[235] A firm is a separate legal entity from its shareholders, and thus if damage is done to a firm it is only the firm that may seek legal redress. If the action of a director sanctioned by the majority of shareholders causes damage, individual

[234] A Hicks and S Goo, *Cases and Materials on Company Law* (6th edn, Oxford University Press 2008) 429.
[235] S Mayson, D French and C Ryan, *Company Law* (24th edn, Oxford University Press 2007–2008) 515.

minority shareholders have no recourse to redress this wrong. A firm's actions are frequently directed by the majority shareholder through the decisions made at general meetings.[236]

Minority shareholders might also find that a majority shareholder unfairly treats or oppresses them. This situation arises when the business is operated in a manner detrimental to the minority shareholders' interests. The legal remedies offered for unfair actions of majority shareholders focus on protecting minority shareholders from such actions not on protecting the company from damage. Regardless of the fact that shareholders have a lower stake in the company than the majority shareholder, the minority shareholder also needs to be involved in the disclosure process. For instance, if the majority shareholders proceed to initiate a company project while excluding the minority shareholder, the majority shareholders may be culpable of non-disclosure. Therefore, the minority shareholder may initiate a legal process against majority shareholders based on an irregularity referred to as fraud of minority.[237] When determining whether an action against a majority shareholder can be pursued, the court considers the equitable issue of valid expectations as well as the lack of confidence between shareholders. The law must offer minority shareholders, as well as firms, potential remedies for any unfair or illegal behaviour which has negative impacts on them.[238]

5.1.1 Source of Problems and Current Remedies for the Protection of Minority Shareholders

The Gulf States have drawn a number of international investors. Indeed, a survey recently revealed that the United Arab Emirates and Saudi Arabia are the best parts of the Arab world to undertake business. In addition, Saudi Arabia is listed among the top twenty nations for conducting business globally.[239] This survey considered a number of factors: how easy it was to start a business and obtain credit; the degree of protection given to minority investors; and the

[236] A Reisberg, *Derivative Actions and Corporate Governance: Theory and Operation* (Oxford University Press 2007) 76-77.
[237] Law Commission (n 67).
[238] Hicks and Goo (n 234) 451.
[239] Saudi Arabia ranked as the top country in the Arab world and 16th overall for conducting business globally, whilst the UAE ranked second in the Arab world and 46th overall. Andrew Foxwell, 'UAE Climbs in World Ease of Business Rankings' (*The National*, 10 November 2008) <http://www.thenational.ae/business/economy/uae-climbs-in-world-ease-of-business-rankings> accessed 15 January 2009.

operation of cross-border trade.[240] Kjaer recently observed that the business model of these nations is founded on drawing in foreign investment, and thus there is an emphasis on more astute regulation. However, oil revenues and high liquidity, which lead to the quick development of businesses, are also a strong draw for foreign investors.[241]

Thus, it is fair to assume that these nations have developed comprehensive, efficient and easy-to-use systems of company law in order to protect the interests and rights of all parties. Unfortunately, this is not the case with Saudi Arabia. Despite reforms to Saudi Arabian company law, the legal system of Saudi Arabia, as it stands, does not afford adequate protection for minority shareholders.[242]

The Saudi legal system allows minority shareholders to make a complaint against the majority shareholder but not the board of directors about any unfair or illegal behaviour thought to be taking place.[243] A strict limitation on this right is that any complaint must be made before the behaviour or action that is being questioned is completed. A minority shareholder has no right to seek a review of any behaviour or actions once they have concluded. In addition, a majority shareholder may choose to sanction certain conduct after it has occurred, in which case minority shareholders have no recourse. Typically, courts will take the side of the majority shareholder in order to avoid intervening in the internal operations of a firm. Even when an abuse of power is obvious, only the majority shareholder has the authority to hold directors accountable for their actions or fire a misbehaving director.[244]

As a result, company law in Saudi Arabia does not provide adequate protection of the interests and the rights of minority shareholders. Overall, company law gives majority shareholders unlimited control over a firm's interests and gives explicit powers to minority shareholders to bring a legal action on a firm's behalf against majority shareholders or directors suspected of wrongdoing. This deficit in the protection afforded by legislation leaves it to shareholder agreements to safeguard the interests and rights of minority shareholders.

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[240] Foxwell (n 239).
[241] Jesper Kjaer, General Manager of the private enterprise partnership for MENA at the International Finance Corporation; ibid.
[242] A Naciri, *Corporate Governance around the World* (1st edn, Routledge 2008) 357.
[243] CL (n 7) Section 28.
[244] ibid Section 33(1) and (2).

In Saudi Arabia, shareholders may legally include whatever clauses and terms they wish in shareholder agreements provided that these clauses or terms do not conflict with the relevant company statutes.[245] Shareholder agreements allow shareholders to protect themselves when dealing with especially disputatious issues.[246] Serious problems can arise without a well-crafted, written agreement. An agreement can also establish exit processes in case an impasse is reached. This allows a minority shareholder to leave a firm without causing serious disturbance to its operations. In addition, express terms to prevent conflict during the removal or cancellation of the directorship of a minority shareholder can be included in shareholder agreements.[247]

5.1.2 Necessity of Protecting Minority Shareholders

The lowering of trade barriers makes it increasingly simple to invest in businesses across the world. Competition for investment is no longer confined by national boundaries but has become international. As this trend continues, Saudi Arabia has created systems catering to desirable foreign investors. The protection afforded to shareholders by the legal system is a vital determining factor in attracting foreign investment to a specific jurisdiction.[248] Both foreign and domestic investors need to feel confident that a firm is run by efficient, transparent and honest management, that managers and shareholder receive fair, equal treatment and that a reliable system of protection is in place.[249] Crucially, a system that effectively protects shareholders' interests and rights, including minority shareholders, is needed. The goal of this system should be to create a mechanism that prevents majority shareholders from misusing their influence and control. Minority shareholders must always have a way to seek relief when necessary.[250]

A number of legal scholars have investigated minority shareholder protection but mostly in relation to different exit processes and the issue of court interference. Virtually no researchers in

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[245] CL (n 7) Section 27.
[246] H Hamd Allah, *Saudi Commercial Law* (1st edn, Annahdah 2003) 259.
[247] R Cooper, 'How Do You Protect Your Shareholding?' (2005) <http://www.rtcoopers.com!pdflbenefit_oCa_well_dfrafterd shareholders agreement.pdf> accessed 18 October 2012.
[248] B Cheffins, 'Minority Shareholders and Corporate Governance' (2000) 21(2) CL 41.
[249] L Miles and M He, 'Protecting the Rights and Interests of Minority Shareholders in Listed Companies in China: Challenges for the Future' (2005) 16(7) ICCLR 275.
[250] A Boyle and J Birds, *Boyle & Birds Company Law* (6th edn, Jordans 2007) 381.

Saudi Arabia and only a rare few in the UK have explored the philosophical and theoretical reasons for the need to protect minority shareholders' interests and rights.

5.1.3 Vulnerability of Minority Shareholders

To understand how majority shareholders can abuse their influence and control, it is necessary to form a picture of how they can deal with a firm or a minority shareholder. A majority shareholder can make displays of strength in order to obtain personal benefits without any concern for the interests of minority shareholders.

5.1.4 Interests and Rights of Minority Shareholders that Require Protection

This section reviews the rights and interests of minority shareholders and how statutes should recognise and protect them. When investors provide funds to a business, they generally receive particular interests, rights and powers in return. These benefits require protection. 'Investor protection' is understood to refer to the set of laws and rules laid down to protect the interests and rights of investors. It also includes the degree to which legal organisations can ensure the enforcement of relevant laws.[251] A minority shareholder falls under the term 'investor' and thus must be afforded particular interests and rights by law, which the legal system safeguards. It is reasonable to assume that minority shareholders generally are more inclined to invest in a firm that provides mechanisms for seeking relief should their interests or rights be violated.[252] Legislation and the effectiveness of the enforcement of the law determine the interests and rights enjoyed by different shareholders and how effectively they are protected.[253] Thus, a key issue is what powers, interests and rights a shareholder, specifically a minority shareholder, actually holds when purchasing company shares.

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[251] M DeFond and M Hung, 'Investor Protection and Corporate Governance: Evidence from Worldwide CEO Turnover' (2003) 42(2) JAR 269.
[252] Miles and He (n 249) 281.
[253] R La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W Vishny, 'Law and Finance' (1998) 106(6) JPE 1116.

To fully understand the precise nature of the interests, rights and powers enjoyed by shareholders, it is first necessary to explain investors' connection to a firm and their interests and rights in it. A 'shareholder' has been defined as an investor who places funds into a firm with the expectation of receiving a return on this investment.[254] The investment does not represent a direct interest in the firm's assets but a financial interest in the firm itself. The firm is a separate legal entity to its shareholders and retains possession of its assets.[255] That is, when shareholders place money into a firm, they receive interests, rights and powers in return which can then be used in connection with the business's operations and capital.

The OECD's Principles of Corporate Governance[256] lists six essential rights that all shareholders should be afforded:

1) The right to safe ownership registration processes;
2) The right to transfer new shares;
3) The right to acquire pertinent information regularly;
4) The right to be active and vote in meetings;
5) The right to remove and elect board members; and
6) The right to share in profits.

The OECD Principles also includes two rights reserved for minority shareholders:

1) The right to take legal action against majority shareholders or directors for alleged abuses of power against the company or the minority shareholder; and
2) The right to an understandable, fairly priced exit procedure.

All these interests and rights can be assumed to be automatically bestowed upon shareholders when purchasing even a single share, save for situations in which different provisions are included in the shareholder agreement or constitution of a firm (as they exist when the shares are purchased).

[254] E Ferran, *Company Law and Corporate Finance* (Oxford University Press 1999) 315.
[255] *Salomon v Salomon & Co* [1897] AC 22 HL.
[256] OECD (n 87) 9. Another final report in consultation with the OECD was issued in 2009 but concentrated mostly on public companies.

A firm's articles of association or shareholder agreement must allow for the issuing of shares with alternate interests or rights. Rock and Wachter have argued that courts should limit and determine the right to obtain pertinent information regularly.[257] However, this viewpoint does not recognise that if this right is based in statute, it is much easier for minority shareholders to comprehend and use than if the courts must decide this issue. In addition, minority shareholders need regular updates of relevant information in order to make full use of their other rights. Therefore, legislation should expressly provide for the right to access information so that minority shareholders can enjoy it without interruption and impediment. Indeed, statutes should include all the interests and rights mentioned here to make them easier to protect and to prevent misunderstandings, oversights or lack of awareness.

5.1.5 Definition and Scope of Corporate Governance and protection of minority rights

Minority shareholders can be protected by a number of difference sources, such as ethics, statutes, external control mechanisms, the judicial system, corporate governance principles and regulations, shareholder agreements and the voluntary implementation of an internal code.[258] Nonetheless, corporate governance stands as the most valuable source of protection of minority shareholders. In addition, corporate governance provides a wide-ranging benefit system for people dealing with a firm. Despite an extensive body of literature on corporate governance, no one definition of the concept has been generally accepted by scholars. The term 'corporate governance' was first used only two decades ago, and its full meaning has not yet been thoroughly analysed. In general, corporate governance is understood to mean the system that controls and directs companies.[259] This is a very imprecise definition that does not explain the true nature of corporate governance.

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[257] E Rock and M Wachter, 'Waiting for the Omelet to Set: Match Specific Assets and Minority Oppression in the Close Corporation' (1999) 24(4) JCL 36.

[258] Themistokles G Lazarides, 'Minority Shareholder Choices and Rights in the New Market Environment' (10 July 2009) 1 <http://ssrn.com!abstract=1432672> accessed 24 February 2011.

[259] The UK Cadbury Report (1992) and the South African King Report on Corporate Governance (King Committee on Corporate Governance, 1994) tried to define corporate governance and were mentioned in J du Plessis, 'Corporate law and corporate governance lessons from the past: ebbs and flows: but far from "the end of history ... : Part 1"' (2009) 30(2) CL 43.

Du Plessis has put forward a more detailed definition of corporate governance which attempts to incorporate its various features and tasks. He explains that corporate governance is both the method for regulating and overseeing corporate behaviour and a process for balancing the interests of internal stakeholders and other parties who might be impacted by a firm's activities. According to du Plessis, corporate governance seeks to ensure responsible corporate conduct while maximising company profits and efficiency.[260] This study benefits from adopting this more precise definition which depicts corporate governance as a comprehensive system that takes into account the interests and rights of all shareholders (and other stakeholders) and makes use of diverse legal areas to ensure their exercise. For example, corporate governance can refer to contract law[261] when negotiating agreements and to company law when listing and adopting, particularly shareholders' interests and rights. Company and contract laws are vital components of corporate governance as is the ability of regulatory bodies and courts to enforce these laws.[262]

Although this definition is an improvement on previous ones, it does not provide for corporate governance to play a part in supplying legal remedies. The definition needs to be broadened in order to extend the purview of corporate governance beyond firms' internal environment. Most importantly, corporate governance cannot guarantee that it safeguards shareholders' rights and interests if it does not ensure the availability of sufficient remedies.[263] Before elaborating on the goals and functions of corporate governance, it must be stated that robust protection for minority shareholders is not essential to establishing an environment that nurtures good corporate governance practices, as some claim.[264] In fact, the opposite is true. Protection for minority shareholders is one among many elements that make up corporate governance. Corporate governance is designed to support all stakeholders, not only minority shareholders.[265] Thus, any definition of corporate governance should highlight that the concept itself supports strong minority shareholder protection.

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[260] du Plessis (n 259) 44.
[261] This has not conflicted with granting states and other parties autonomy of contract to write what they demand. Rather, it advises that the government should have states determine rights and interests regarding specific legal processes for any agreement of this kind in order to preserve and guarantee such rights of minority shareholders.
[262] R La Porta, F Lopez, A Shleifer, R Vishny, 'Investor Protection and Corporate Governance' (2000) 58(1–2) JFE 879.
[263] Miles and He (n 249) 277.
[264] DeFond and Hung (n 251) 10.
[265] Stakeholders consist of many types of parties, such as majority and minority shareholders, employees, directors, creditors, suppliers, members of the public and others.

5.1.5.1 The Role of Corporate Governance in Providing Remedies

The role of corporate governance lies primarily in protecting the goals of corporate governance. In the current context, the goals of corporate governance are to strike a balance between conflicting interests in order to protect minority shareholders and to provide remedies if disputes do arise. Corporate governance must guarantee four key elements to adequately protect minority shareholders.

1) The interests and rights of minority shareholders must be safeguarded, and minority shareholders fairly treated.[266]
2) The litigation processes and mechanisms open to minority shareholders must exist in a clear and straightforward form in law.
3) A remedy should be available for every form of abuse of power and unfair treatment.
4) Minority shareholders must be able to sell their shares at a reasonable price when they decide to exit a firm.

Of all the goals of corporate governance, perhaps the most important is to provide legal mechanisms and remedies in case unfair treatment or abuses of power occur. Corporate governance does not leave minority shareholders to the internal mechanisms of a firm but grants them certain legal remedies. To achieve this goal, the corporate governance structure needs to spread accountability and responsibility among shareholders.[267] Even so, if a minority shareholder does not have recourse to clearly delineated processes and remedies, holding a malefactor accountable for illegal or harmful behaviour might be impossible. Lazarides has argued that corporate governance must clearly delineate the interests and rights of minority shareholders and establish effective legal, judicial, penal and regulatory systems in order to ensure that minority shareholders can access these remedies and serve the overall goal of protecting such shareholders.[268]

[266] OECD (n 87) 40. Another final report in consultation with the OECD was issued in 2009 but focused on public companies.
[267] OECD (n 87) 29.
[268] Lazarides (n 258) 6.

The function of corporate governance in making available particular legal remedies benefits both minority shareholders and the courts by clarifying which remedies are available in a given situation. Courts might not be able to judge a case without restriction and find a just outcome if there are no explicit statutory provisions on the issue. The American case of *Wheeler v Pullman Iron & Steel Co*[269] is one example of the failure of statutes to deal adequately with company law. In this case, it was decided that the court did not have the power to order the winding-up of the firm in question if that remedy did not already exist in statute.[270] Inadequate or unclear statutes can change outcomes and result in deep uncertainty and doubt for judges and shareholders alike.

The lack of a statutory mechanism that clarifies legal remedies renders any corporate governance mechanism redundant.[271] Creating a list of minority shareholder rights and interests but neglecting to implement any legal remedies cannot establish a practical, effective form of corporate governance that offers any real protection. If a majority shareholder were aware that corporate governance gave minority shareholders the ability to pursue real, legal actions to redress wrongs and unfair treatment then that majority shareholder would be dissuaded from acting inappropriately.[272] Corporate governance also refers to the directions that the businesses and their leaders ought to take if they have to make the best of their existence. Such could involve the options for guidelines that lead them to the making of strategic decisions. Another concept is that of oversight in terms of leadership to institutions. The mangers in this case provide the role models for other institutions, which creates the overall concept of leadership. To conclude, it is evident that protection for minority shareholders is a significant aspect of corporate governance.

To conclude, it is evident that protection for minority shareholders is a significant aspect of corporate governance. To ensure adequate protection, corporate governance must specify litigation remedies and give the courts and minority shareholders real power in the running of a firm. There is a positive correlation between corporate governance and protection for minority shareholders; better corporate governance will likely lead to effective protection of minority

[269] III 197; 32 NE 420.
[270] In the United States, the court cannot bring justice without an actual statutory footing. Statutes should always empower the court to order winding-up when needed, as the court may not grant a remedy that is not statutory.
[271] Lazarides (n 258) 3.
[272] D Schlimm, L Mezzetti and B Sharfman, 'Corporate Governance and the Impact of Controlling Shareholder' (2010) 18(1) CGA 6.

shareholders. However, if corporate governance is not supported by statutory remedies for all forms of mistreatment and abuses of power then its efforts serve no purpose. Clearly, for any corporate governance system to be effective, it must have a broad foundation that covers all types of wrongdoing. The following section explains the present bases for bringing legal action and why they need to be broadened.

5.1.5.2 Present Bases for Bringing Legal Action Regarding Corporate Interests

Certain grounds recognised and described by statute must be satisfied for a minority shareholder to bring legal action. Fraud is the most common basis for legal action. Indeed, in jurisdictions including Saudi Arabia, fraud is the only clear basis for action by a minority shareholder. Minority shareholders are thus faced with severe difficulties when wrongdoing does not constitute fraud. As there are no specified legal remedies for other acts, such as abuse, misuse and pure negligence, a minority shareholder must prove fraud as a basis for action.

UK common law[273] provides an example of a system that in the past allowed a minority shareholder to bring an action to court solely due to fraud. UK courts established the common law legal mechanism of a derivative action. This allowed minority shareholders to bring an action on a firm's behalf but only in an obvious case of fraud.[274] Establishing fraud as the sole basis for legal action was onerously restrictive as all misconduct had to constitute a form of fraud. Unsurprisingly then, case law reveals that only rare actions were brought by minority shareholders against majority shareholders under common law.[275] The plight of minority shareholders was made all the more difficult as they did not have free access to the information that could have proven that fraud had occurred. *Pavlides v Jensen*[276] clearly indicates the importance of proving fraud. In this case, the minority shareholder did not prove that the negligent disposal of assets constituted fraud, and thus it was unsuccessful. However, in the latter case of *Daniel v Daniels*,[277] the court permitted a derivative action in which only negligence was

[273] This is no longer the case in English company law as this device has been moved to the statute under the Companies Act 2006 instead of common law.
[274] Reisberg (n 236) 337.
[275] M Almadani, 'Derivative Actions: Does the Companies Act 2006 Offer a Way Forward?' (2009) 30(5) CL 135.
[276] [1956] 2 All ER 518. Fraud affecting the minority was also seen in *Daniels* v *Daniels* [1978] Ch 406; All ER 89 Ch D.
[277] *Daniels v Daniels* [1978] Ch 406.

alleged. The judge in this case appears to have chosen to view the significant profit that a majority shareholder made at the expense of the firm's well-being as selfish negligence that could be seen as a form of fraudulent behaviour. This complex, fragile basis of fraud for a legal action was limited in scope and difficult to apply in practice, allowing numerous instances of mistreatment and abuse of power to stand.[278]

Finally, in the latter part of the twentieth century, a number of reviews[279] demonstrated that restricting the grounds for a legal action to fraud alone had negative effects. In response, a number of proposals and suggestions were advanced to broaden the scope of liability to include numerous other forms of misconduct beyond fraud. These proposals also aimed to eliminate the need to prove that a malefactor was in control of a firm in order for an action to be brought. The Companies Act 2006 incorporated all of these suggestions. The statute states that a derivative action may be brought not only in cases of fraud but also those involving a breach of trust or duty, abuse, negligence, misuse or default. Fraud does not have to be proven; each instance of misconduct, in and of itself, can form the basis of an action.

To conclude, the history of UK law should serve as a useful lesson for jurisdictions that accept only fraud as a suitable basis for a legal action regarding corporate misconduct. The need to include a broader range of bases on which a minority shareholder can bring an action should be considered because of the benefits that widening the scope of actions can bestow on firms themselves. If a wider approach is not taken, numerous examples of wrongdoing will go unpunished to the detriment of the companies involved.

5.1.5.3 Towards an Optimal Protection Model

Jurisdictions across the world overwhelmingly use one model (of only two) for protecting minority shareholders. The first model is used in civil law countries, including France, the United Arab Emirates, Saudi Arabia, the Netherlands, Italy and Spain, while the second is used in common law countries, including the UK, the US, India, and Canada. The first model is a French model, and the second is based mostly on UK law and thus is referred to as the Anglo-

[278] Almadani (n 275) 132.
[279] Law Commission Report 1997 & Company Law Review, Developing the Framework, 2000.

Saxon model. Common law nations offer shareholders relatively greater legal protection from mistreatment than civil law nations.[280] However, pre-emptive measures are more effective in civil law nations than common law jurisdictions. Pre-emptive rights[281] are designed to avoid the issue of below-market share prices and to ensure that shareholdings are not diluted. However, in common law nations, these rights are not very effective. Overall, common law jurisdictions are preferable for minority shareholders. Lazarides has argued that other legal systems cannot manage and monitor firms in the same way as common law systems and that the better protection afforded by common law jurisdictions is due to the specific legal protections they give to minority shareholders.[282]

Compared to other legal systems, common law jurisdictions offer a set of laws that provides the highest level of protection for minority shareholders—primarily their access to various legal mechanisms.[283] For example, the UK grants minority shareholders five mechanisms:

1) Personal action: Minority shareholders can bring a personal action if their rights have been violated.[284]
2) Derivative action: Minority shareholders can bring a derivative action if the interests of the company have been damaged.[285]
3) Oppression/unfair prejudice action: Minority shareholders can bring an unfair prejudice action in instances where an action by a firm damages their interests in their capacity as a member of the firm.[286]
4) Winding-up order: Minority shareholders may pursue a winding-up order when doing so is equitable and fair.[287]

[280] La Porta, Lopez-de-Silanes, Shleifer and Vishny (n 253) 1116.
[281] Preemptive rights generally give the shareholders of a particular company priority in purchasing any new shares or those of a shareholder who wishes to sell before they are made available to the public or require board approval for a transfer.
[282] Lazarides (n 258) 4.
[283] La Porta, Lopez-de-Silanes, Shleifer and Vishny (n 253) 1129.
[284] This action, in particular, is still available under English common law. See, e.g. *Smith v Croft No 2* [1988] Ch 114 and *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204.
[285] This action used to operate under English common law but was made a statutory action under the Companies Act 2006.
[286] This action used to be under Section 459 of the Companies Act 1985 but now comes under Section 994 of the Companies Act 2006.
[287] For example, see Insolvency Act 1986 Section 122(1)(g). This is the last option available to the minority shareholder who must first prove that doing so is just and equitable.

5) Investigation request: A minority shareholder may request that a firm be investigated when its operations are not being dealt with properly (this occurs most frequently in relation to public firms).[288]

A review of the forms of protection available under different jurisdictions and legal systems provides important information about the establishment of an optimal model of minority shareholder protection. The following six principles are essential to ensuring the minimum protection of minority shareholders' interests and rights.

1) When minority shareholders have a reasonable belief that their or the firm's rights have been infringed, they must have access to straightforward legal mechanisms to seek redress.[289]
2) A minority shareholder must be able to bring an action on the firm's behalf in relation to a wide variety of types of inappropriate behaviour.
3) The courts must be empowered to deal effectively with shareholder conflicts and to intervene and make enforceable decisions if needed.
4) Majority shareholders should not have decision-making control when it comes to litigation. Instead, when a firm's interests are mishandled or when a shareholder wishes to enforce the rights owed to the firm, the issue should be handed over to the courts, which can dismiss nuisance claims brought by shareholders.
5) Clear exit procedures must be put in place. These must offer a reasonable price for shares and be carried out in a timely manner.
6) The practical realities of protection for minority shareholders must be reviewed and evaluated so that any required legal reforms can be addressed immediately.

Legislators must keep in mind these principles when drafting statutes with provisions designed to protect minority shareholders. It is extremely challenging for legislators to balance minority shareholders' need for protection (and thus the ability to sometimes check majority shareholder actions) and majority shareholders' need for the room and licence to effectively operate a firm.[290]

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[288] The action has a basis in the Companies Act, Section 431(1) and (2). Some amendments were made to the Companies Act 2006 to give the power of investigation to the Secretary of State under Section 77.
[289] OECD (n 87) 40. Another final report in consultation with the OECD was issued in 2009 but focused on public companies.
[290] L Sealy and S Worthington, *Cases and Materials in Company Law* (5th edn, Oxford University Press 2001) 371.

That is, legislators constantly struggle to take into equal account all the different interests at play. A similar problem confronts the courts and judges when they decide upon disputes between different shareholders. Of particular difficulty are cases when it is not in a firm's best interests for litigation to go forward successfully but a minority shareholder has the right to bring an action.[291] The German model is applicable for this case because of its call for observance of transparency and the respect for others. The freeman's model provides principles that have similarities with the concepts of Islamic sharia.

5.1.6 Minority Shareholder Protection under Saudi Company Law

The Saudi Commercial Code is based on the French system although some scholars have argued that the system implemented by the Gulf States is an adaptation of the legal system transmitted by the Ottoman Empire that controlled this region.[292] This viewpoint can help explain why Saudi Arabian company law does not reflect the precise provisions found in contemporary French company law and why Saudi company law deals with a number of corporate bodies not present in French law or civil law jurisdictions. Egyptian legal experts made additional refinements to the French commercial system on top of the Ottoman changes, establishing the French/Egyptian model which Saudi Arabia adopted as the foundation for its company legislation.[293] Of course, Saudi Arabian law does not exactly match the French/Egyptian model as Saudi legislators selected what they considered the most appropriate provisions given the unique character of the country's commercial experience. Islamic jurisprudence, known as Sharia law, has and continues to have a dominant influence over Saudi Arabian company law. Sharia law sets down fundamental principles covering all facets of the law.[294] Thus, Saudi company law draws on a number of different sources, all of which have left their mark.

[291] H Hirt, 'The Company's Decision to Litigate Against Its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest' (March 2005) JBL 194.
[292] El Sheikh (n 101) 76.
[293] R Lewis and C Mallat, 'Commercial Law in the Middle East' (Centre of Islamic & Middle Eastern Law) <http://www.soas.ac.uklCentres!IslamiclawlMaterials.html> accessed 12 February 2013.
[294] The influence of Sharia law on the Saudi CL will be discussed in the next section.

Saudi Arabian councils (e.g. the Panel of Experts, Shura (Consultatory) Council and the Council of Ministers)[295] and legislators have focused on improving the country's commercial environment in order to make the economy more diverse and less reliant on oil.[296] The Foreign Capital Investment Law 2000[297] is a clear example of this attitude. This flexible, practical law improved the situation for foreign capital investments in the country. The primary goal of this law is to promote and facilitate foreign investment in order to make Saudi Arabia an open market for interested parties.

Saudi company law has also attempted to establish adequate protections for shareholders of public firms who now have the statutory right to seek a legal remedy against directors.[298] Sections 76, 77 and 78 of the CL state, respectively, that if the directors' handling of company operations results in abuse, wrongdoing or misuse, they are jointly liable to compensate the firm or its shareholders. A liability action[299] may be filed by the company against its directors if their actions have harmed the position of all shareholders who take this action on the firm's behalf. A liability action against the directors may also be brought by each shareholder should the directors' actions have caused specific damage to the shareholder in question. Shareholders can only bring such an action if the firm's right to litigate remains valid, and they must inform the firm that they are bringing the action.

Although the government of Saudi Arabia has pledged to reform various fields, including the field of trade, no significant changes have been made to the CL. Its efficiency continues to decline as it fails to direct attention to numerous key aspects of the rights of shareholders in listed organisations. In this situation, the Saudi legislature should make decisions to improve the Kingdom's investment environment and, in particular, to provide greater protection to investors

[295] The process of making a law starts with the Panel of Experts within the Shura (Consultatory) Council, which debates and discusses the proposed draft of the law to see if any changes or amendments are needed. Otherwise, the draft is sent to the Council of Ministers for final review and then approval.
[296] El Sheikh (n 101) 22.
[297] The Cabinet approved this law on 10 April 2000 to replace a complicated investment law that restricted foreign capital investment to certain narrow economic sectors.
[298] Sections 76, 77 and 78 of CL deal with shareholders' right to litigate against directors for a variety of reasons.
[299] 'Liability action' is the English translation from Arabic of the action available in public companies.

in joint-stock companies. Such decisions will likely encourage investment in the Saudi financial market.[300]

Despite a number of major amendments, the main limitations of the CL have not been resolved to the satisfaction of the local businessmen and foreign investors who firmly disapprove of the current law. Strongly criticised, this law now lags behind modern advances in commercial activities and is especially dissonant with the Saudi government's privatisation strategy, efforts to attract foreign investment and accession to the World Trade Organization, which demands that national laws meet the requirements of international trade. In 2007, the Saudi government developed the final draft of a new law intended to supplant the old one. However, seven years later, the new law has not been promulgated. Its ratification by the Council of Ministers is pending.[301]

The considerable attempts to amend the CL have not met substantial success for various reasons, chief among them are bureaucratic setbacks and centralised decision-making. The lack of significant changes to the law so far is confounding, especially given the pressure from numerous specialists and professionals. At the moment, the law is seriously outdated and includes an insufficient number of provisions. This renders it unsuitable for implementation. Some have claimed that the CGR addressed these limitations to a certain extent. However, the CL forms the basis of a majority of the provisions in the CGR. Moreover, the CGR are not binding or peremptory and are intended only to serve as guidance. Saudi Arabia's experience in business and trade is still limited as it is a developing country. As such, it should seek to learn from the expertise and knowledge of other countries, particularly developed countries such as the UK. When formulating laws, Saudi Arabia would do well to draw inspiration from UK laws, which provide an appropriate model for the structure and content of flexible, modern laws.

Generally, the CL specifies the rights of shareholders but does not guarantee appropriate protection or effective application of them. Therefore, it is necessary to consider a number of related factors to ensure the efficacy of shareholders' rights. Among these, the structure of company ownership, the legal system, cultural and religious customs and the political climate are

[300] Yousef Alzahrini, 'Rights of Shareholders under Saudi Company Law 1965' (PhD thesis, Brunel University 2013) 1.
[301] ibid 24.

of particular importance. These factors exacerbate the challenges and problems that affect activity in the commercial and industrial fields.[302]

The level of protection granted to the rights of shareholders is heavily influenced by the structure of ownership: the fewer the number of shareholders, the weaker the protection of minority shareholders.[303] The protection of shareholders' rights also depends heavily on the Saudi civil litigation system. A wide range of legal studies have addressed this issue. According to a comprehensive, in-depth analysis, shareholders and creditors in JSCs are more effectively protected from the tactics and manoeuvres of the company board or the majority shareholders in countries that follow a common law system.[304]

On the other hand, in countries that apply the French civil law system minority shareholders have limited power to intervene in the activities undertaken by the corporate managers.[305] This situation occurs commonly in the Saudi system where majority shareholders' powerful influence on corporate management allows them to pursue their interests without hindrance, completely disregarding minority shareholders and forcing minority shareholders to comply with their actions. Moreover, in Saudi Arabia, the majority shareholders are also usually the company owners because most listed companies began as family companies and later became JSCs.[306]

The CL clearly illustrates this situation as it grants greater control over a company to those who own a larger number of shares. It is generally agreed that the majority shareholders should be afforded greater participation in organisational management than minority shareholders. However, showing complete disregard for minority shareholders and their rights and interests is unacceptable. Considering the principles of justice and fairness, all shareholders should be given fair treatment, regardless of the number of shares they possess, and no group of shareholders

[302] Jill Solomon and Aris Solomon, *Corporate Governance and Accountability* (John Wiley & Sons 2004) 17.
[303] Nabil Baydoun, Neal Ryan and Roger Willett, 'Corporate Governance in Five Arabian Gulf Countries' (2013) 28(1) MAJ 8.
[304] La Porta, Lopez-de-Silanes, Shleifer and Vishny (n 253) 86.
[305] However, in common law jurisdictions, pre-emption rights are not sufficient to protect shareholders in regards to issuing low-price shares and dilution of their shareholdings, whereas countries that follow the French method have better pre-emption rights. Mahmoud Al-Madani, 'Reforming Minority Shareholder Protection in Saudi Arabia and UAE (Dubai): Does English Company Law Offer a Way Forward?' (PhD thesis, University of Leeds 2011) 59.
[306] Baydoun, Ryan and Willett (n 303) 7.

should be granted influence and power to the detriment of another group.[307] Although not all shareholders are equal, the equity and rights of the minority shareholders must be acknowledged and respected by the majority shareholders and not infringed under any circumstances.

Therefore, the rights of the minority shareholders must not be diminished or overlooked even though the majority shareholders possess most shares in the company.[308] In addition, majority shareholders should in no way take advantage of their status to manipulate or direct organisational decisions to serve their interests, especially when such decisions are unfavourable to the interests and rights not only of the minority shareholders but also of the company as a whole.

Thus, when they exercise their right to participate in corporate management and decision-making activities, majority shareholders should not focus on their own interests but on those of the company as it is a business operation whose purpose is to generate financial returns for the shareholders. In addition, the interests of the minority shareholders are no less valuable than those of the majority. Therefore, the majority shareholders should give due consideration to the interests of other shareholder groups, no matter how small.

Amended in 2009, the Global Corporate Governance Principles of the International Corporate Governance Network (ICGN) specify a number of points with regard to these considerations. These principles highlight the need for the fair treatment of all the shareholders of a company and the protection of the rights of all investors. Organisational boards should promote as much as possible shareholders' ability to exercise their rights whilst attempting to eliminate unnecessary obstacles.[309] Regrettably, the situation is different in many developing countries. For example, in Saudi Arabia, minority shareholders have a weak position in listed companies compared to majority shareholders who have significant influence over and can manipulate management decision-making to serve their personal interests, often without any regard for the company's interests. In these circumstances, it is necessary to emphasis the fact that, although majority shareholders have a stronger position in a company due to the large number of shares they

[307] Naveen Kumar and JP Singh, 'Corporate Governance in India: Case for Safeguarding Minority Shareholders Rights' (2012) 2(2) IJMBS 8.
[308] Yusuf Alizarin cited in Finweek, 'Shareholders' Rights' (2005) 4-5.
[309] International Corporate Governance Network, 'Global Corporate Governance Principles: Revised' (2009) 9 <www.icgn.org> accessed 28 June 2013.

possess, they have no right to abuse this position and the power that comes with it. To prevent such abuse, clear provisions must be made in related laws to keep the power of the majority shareholders in check and ensure fair treatment of all parties.

Both protection and restriction measures should be employed to guarantee justice and fairness. Provisions must protect minority shareholders against any infringement of their rights or interests even if the rights or interests of the minority have not been breached. Most importantly, appropriate legal provisions should ensure that the majority shareholders do not impose their agenda or special interests on the minority shareholders. The power granted to majority shareholders in JSCs entails a set of responsibilities and obligations and should be exercised in a way that is not detrimental to the interests of minority shareholders and the company.[310]

The economic factor also has great importance. A higher level of protection encourages minority shareholders to participate and invest in JSCs. The main interests of any shareholder, whether local or foreign, are financial security and the assurance that the investment made is put to good use by individuals whose priority is accomplishing organisational objectives, not personal interests. Investors' desire to protect their interests and rights is quite understandable. Ultimately, regardless of the length of the investment, the extent to which the company has accomplished its objectives and promoted the interests of its shareholders or favoured the interests of a specific group is always disclosed. In this respect, a company's public reputation is an effective barometer of its performance in achieving those objectives and shareholder interests.

Investors are attracted to make investments in a company for two important reasons: efficient, appropriate protection of shareholder rights and acceptable limitations on their responsibilities.[311] Although lacking controlling shares in the capital, minority shareholders nonetheless are a key source of capital for listed companies. Therefore, their input should be taken into account, and they should be granted fair treatment. Possessing a large number of shares grants great authority over organisational activities but not more rights than minority shareholders. In addition, legal provisions for the protection of the rights of shareholders aids in the development of companies by stimulating increased liquidity. Consequently, the company does not require creditor loans, thus helping it avoid financially burdensome obligations.

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[310] L Sealy and S Worthington, *Cases and Materials in Company Law* (8th edn, Oxford University Press, 2010) 519.
[311] Sealy and Worthington (n 310) 458.

Ensuring the protection of the minority shareholders is considered economically advantageous as it helps increase the national gross domestic product (GDP).[312] For instance, minority shareholders' investments consolidate and, consequently, increase their savings. When allocated to investment, these savings can stimulate further additional increases in capital. Amending investment regulations thus can improve the business environment, facilitating the flow of capital to areas of high productivity. Therefore, it can be rightly argued that economic growth depends to a significant degree on the protection granted to minority shareholders.

The idea of an inextricable link between national economic growth and the effective protection of shareholders' rights has been proposed by a considerable number of studies on the grounds that adequate protection encourages investment. This leads to improvements in the business environment, such as increased transparency and credibility, which in turn promote financial and economic stability. For instance, the good investment and business reputation of a developed country such as the UK is based in part on the high level of protection of minority shareholders against detrimental manoeuvres by company directors, as well as the existence of solid liability standards and rules. In contrast, manipulation and the pursuit of special interests are rife in countries in continental Europe and the Middle East, including Saudi Arabia.[313]

5.2 Saudi Ownership Structure

The board of directors is vested with the ultimate authority to govern corporations and is primarily responsible for monitoring company activities to verify the implementation of company objectives set by shareholders during the annual GSM. The board is accountable to the shareholders and liable for any misrepresented or falsified information reported to the shareholders and regulators. Along with the board of directors, internal and external auditors and government authorities exert monitoring and regulatory powers over management.[314]

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[312] La Porta, Lopez, Shleifer and Vishny (n 253) 137.
[313] Enriques Luca, 'The Law on Company Directors' Self-Dealing: A Comparative Analysis' (2000) 2 ICCLJ 297, 303.
[314] Mohamed Moustafa Soliman, 'Ownership Structure, Board Composition and Dividend Policies—Evidence from Saudi Arabia' (30 April 2013) <http://ssrn.com/abstract=2258399> accessed 24 July 2013.

Saudi companies have one-tier boards composed of an odd number of members, from a minimum of three to a maximum of eleven. In a JSC, the board of directors is composed of a majority of non-executive members that possess the appropriate set of skills, technical knowledge or analytical experience. Independent directors make up anywhere from 30% to 75% of the board. In most companies, the roles of chairman of the board of directors, CEO, or other executive position, such as managing director or general manager may not be conjoined in one person although it is estimated that two out of every one hundred Saudi companies have a chairman who also serves as chief executive.[315]

The CMA requires that companies annually submit a list of the names, nationalities and other pertinent details of board members and the senior management. Companies must immediately inform the CMA of changes to this roster. The controlling stake in most Saudi firms is concentrated in families, financial and industrial institutions and the government. Ownership disclosure is required, including making publicly available updated lists of major shareholders who own at least 5% of the company's equity. Shareholders also have the right to be informed of company matters, including inspecting the minutes of the GSM and the report detailing the names and amount of shares held by each.[316]

The ownership structure has implications for an organisation's dividend policies and governance. Studies have demonstrated a significant relationship between dividend declarations and firm performance based on empirical evidence that strongly support the signalling model.[317] The signalling model asserts that declarations of dividends inform investors about the company's performance and immediately affect investment behaviour involving the company. Investors are loss averse to dividend reductions relative to the reference point set by prior dividends.[318]

A study by Solomon shows that firms listed in the Saudi market also tended to confirm agency theory as evidenced by the significant, positive relationship between dividends and institutional ownership. This relationship has important implications for corporate governance. Institutional ownership through individuals or families tends to support better corporate governance because

[315] ibid.
[316] Soliman (n 314).
[317] ibid.
[318] Malcolm Baker and Jeffrey Wurgler, 'Dividends are Reference Points: A Behavioral Signaling Model' (Division of Research, Harvard Business School, 2011) <http://www.lse.ac.uk/fmg/events/capitalMarket/pdf/CMW21 M_Baker.pdf> accessed 20 October 2013.

of the higher level of transparency and disclosure and the greater number of independent members in the board. These factors taken together lead to better performance and, according to signalling theory, higher dividends.[319]

5.3 The Board of Directors in the Institutional Framework

The board of directors manages publicly listed corporations. As it leads the company, the board is accountable for the actions of the entire organisation. Board members are elected by shareholders, usually on an annual basis.

The owners are also the managers and are liable for running their businesses in proprietorships and partnerships. Shareholders own corporations but are not their direct directors because it is illogical to have large numbers of owners making decisions. A small group is needed that can meet regularly and make managerial decisions for the corporation; namely, a board of directors that represents the interests of the shareholders.[320]

5.4 The Principal Fiduciary Duties of the Board of Directors

Sometimes, boards of directors of corporations misuse their powers. Therefore, it is important to have a supervening authority to constrain such behaviour. The international corporate governance frameworks have imposed certain duties and obligations upon corporate board members to keep them working for the interests of shareholders and keep them liable to questioning under company law jurisprudence.[321]

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[319] Georges Dionne and Karima Ouederni, 'Corporate risk management and dividend signaling theory' (2010) FRL 1-10.
[320] Franklin A Gervutz, 'The Historical and Political Origins of the Corporate Board of Directors' (2004) 33 HLR 89.
[321] David Malcolm, 'Directors' Duties: The Governing Principles' in Ian Ramsay (ed), *Corporate Governance and the Duties of Company Director* (Centre for Corporate Law and Securities Regulation 1997) 61; Mustafa Kamal, *The Joint Stock Company* (Arabic edn, Undergraduate House 2001) 68.

5.4.1 General Overview

The wide-ranging powers granted by law to boards of directors create a perceived risk that these powers might be abused and board members deviate from their objective of stewarding the corporation according to stakeholders' interests. Due to the keen interest of foreign investors, emerging international governance principles have shaped a set of obligations investors expect of boards of directors.

These duties are intended to ensure that board members properly discharge their functions and direct their decisions towards the welfare of the corporation and its stakeholders. The duties of the board as mandated by corporate governance principles support the principal-agent relationship between the board and the shareholders, according to the company and commercial laws of most nations with free market economies. As agents, boards of directors have fiduciary duties to shareholders; that is, they are mandated to manage the corporation in a manner that maximises wealth creation for shareholders.

The CL and CGR make no reference to either the principal-agent relationship or fiduciary duty. This absence is consistent with empirical studies that show that the concept of fiduciary duties has not developed in the Middle East.[322] In most jurisdictions, fiduciary duties refer to three major duties: the duty of care, the duty of loyalty and the duty to act within one's powers. The OECD Principles of Corporate Governance are consistent with this concept and recognise two important aspects of the board's fiduciary duty: the duties of care and loyalty. While not explicitly mentioned, these duties are implicit in the provisions of the CGR and the CL, as shown in this section.

5.4.2 Duty of Care

The duty of care is a party's legal obligation 'to act towards others and the public with watchfulness, attention, caution, and prudence' in a manner in which a reasonable person in the

[322] Lu'ayy Al Rimawi, 'Emerging Markets of the Middle East: A Critique of Selected Issues in Arab Securities Regulation' (1999) 7(2) JFRC 160.

same circumstances would do.[323] The duty requires that the board of directors and firm executives make informed decisions by gathering all relevant facts and material, giving them due consideration and then selecting the best option.[324] The duty of care is incumbent upon board members and is their top-most priority in all matters pertaining to the corporation.

This duty is internationally recognised. For instance, under the UK Companies Act, board members are required to always act with a measure of skill and care reasonably expected of people possessing their knowledge and experience.[325] The criteria in this definition are subjective because the reasonableness of an action depends a great deal on its specific context and circumstances. The duty of the carer should meet that requirement although the response may be any one of a number of possible actions.

Unfortunately, in Saudi jurisprudence, the CGR and CL do not explicitly mention the criteria for board members' level of due care in the way that the UK Companies Act does. Therefore, unscrupulous board members can seek cover behind the ambiguity of the law, and regulators and enforcers of the 'duty of care' do not have a clear standard of measure, even a subjective one, by which to judge whether an infraction has been committed. The problem is compounded by the CL provision[326] that holds a corporation to be bound by all acts of the board of directors considered within the limits of its competence. The duty of care requisite becomes moot when determining whether the limits of competence have been violated because of its lack of definition under Saudi law. Shareholders are left to the mercy of the board's actions, even those patently negligent or careless.

The general rule is that directors are not liable for the actions of the company because it has a separate legal personality. This protection of directors is the corporate veil. However, civil law makes exceptions to this rule. Directors are trusted by the owners of a company, or the shareholders, to make decisions in their interest. These include investment decisions to increase

[323] Gerald N Hill and Kathleen T Hill, *The People's Law Dictionary* (MJF 2002).
[324] Black's Law Dictionary, 'Duty of Care' <http://thelawdictionary.org/duty-of-care/> accessed 23 August 2013.
[325] Hicks and Goo (n 234) 310.
[326] CL (n 7) Article 75.

shareholders' wealth.[327] For example, if a director pursues a business venture without consultation or research and that venture fails, he is personally liable for the loss of money.

Directors who breach their duties can be held liable if the company incurs losses. Therefore, directors need to always carefully consider whether their actions are in the best interests of the company. They must discharge their duties honestly, in good faith and in the best interests of shareholders.

5.4.3 Duty of Loyalty

The fiduciary duty of the board of directors includes the requirement to discharge the duty of loyalty. According to *Black's Law Dictionary*, this duty is the legal requirement for the board of directors and executives to perform all their actions in good faith and with the best interests of the shareholders in mind.[328] In practice, this means that the board may not engage in acts that put them in the position of a conflict of interest or engage in acts such as insider trading; whereas the 'duty of care' addresses acts of negligence, duty of loyalty deals with acts of bad faith or malice. Under duty of loyalty, board members may not place their personal interests or those of others before shareholders in the conduct of their duties as fiduciary agents.[329] Unlike duty of care, however, acts that constitute duty of loyalty are more evident and easily determinable because of their malicious intent. Duty cares relates to the requirements of sharia laws because of the obligation of the workers to maintain transparency. The law commits people to the obligation of service, which means that it will find them guilty if they neglect duty.

Duty of care was introduced in October 2006 by the CGR, whose Article 11d orders directors to serve the interest of all shareholders, not just a select group. Moreover, under CGR Articles 4a and 4b, shareholders can access all information they need to exert their rights. The CL includes redress mechanisms for shareholders who are entitled to take legal action against directors but

[327] N Saidi, *Corporate Governance in MENA Countries: Improving Transparency and disclosure* (Lebanese Transparency Association 2004) 10.
[328] Black's Law Dictionary, 'Duty of Loyalty' <http://thelawdictionary.org/duty-of-loyalty/> accessed 24 July 2013.
[329] Selah Al Ghazali, *Conflict of Interest Law: The Necessity* (Arabic edn, Kuwait Transparency Society 2008) 15.

the law does not provide such mechanisms for minority shareholders. So far, a liability suit against directors has yet to be filed.[330]

5.4.4 Conflicts of Interest among Board Members

Among board members, conflicts of interest are situations in which the neutrality of board decisions is compromised by considerations of personal interests, whether material or moral, of board members, their relatives and friends.[331] Conflicts of interest are present when opportunities for formal exploitation to serve private interests arise.[332] It must be noted that, for a conflict of interest to materialise, the board and members need take no overt action; the very opportunity for personal interest to clash with corporate interest is sufficient. At this point, compliant board members should refrain from participating in deciding the matter or otherwise acting on it.

The CL specified the meaning of conflicts of interest, and these provisions were adopted in the CGR without modification.[333] The most commonly conceived conflict of interest scenario is board members profiting from a transaction involving the use or disposition of company properties. This is the overt face of conflict of interest. However, there are more subtle situations that should, if they do not already, constitute conflicts of interest involving board members. For instance, non-executive members of the board are often considered the element that creates balance in board decisions because of the relative disinterest of outsiders to the organisational hierarchy. However, non-executive members are likely to have shareholdings not only in the corporation on whose board they sit but also in potentially competing companies. Non-executive members may even have a greater interest in other companies, even non-competitors, whose interests are contrary to those of the organisation. For example, board members could covertly be pre-empting possible lucrative contracts in their favour or in favour of their more lucrative

[330] WB (n 85).
[331] Al Ghazali (n 329) 15.
[332] Joel Demski, 'Corporate Conflict of Interest' (2003) 17(2) JEP 51.
[333] CL (n 7) Articles 68 and 69.

holdings rather than allowing the natural course of action where the transaction takes place to the benefit of the company they direct.[334]

The CL articles adopted in CGR refinement provisions enforce conflicts of interest restrictions. CGR Articles 18 (a) and (b) exhibit an intention to introduce exceptions to conflict of interest restrictions:[335]

(1) When the board member has secured annual permission from the corporation's shareholders in an ordinary general meeting to perform an act which would otherwise constitute a conflict of interest;

(2) When the board member informs the board and shareholders concerning any private undertakings or commercial contracts performed for the benefit of the corporation; and

(3) When the board member is the primary bidder in a general bidding.

The third instance raises questions about whether such a situation should warrant being made an exception because membership in the board enables one to have knowledge of the corporation's affairs that other bidders do not have, thus creating an unfair advantage.[336] In all cases, the board member involved must fully disclose to the other board members and the shareholders the full extent of personal interest in any corporate matter.

5.4.5 Disclosure of Information by Directors

Directors must regularly disclose information at least annually or when circumstances have changed. Directors must act in good faith and disclose to the board and external auditors any commercial or external interests that could create a conflict of interest:[337]

- All business interests (direct or indirect) in any other company, partnership or other business venture;

[334] Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law and Capital Markets Law* (3rd edn, Pearson Education 2009) 170.
[335] CGR (n 8) Article 18(a) and (b) corresponding to CL (n 7) Articles 68 and 69.
[336] Mohammad Prairie, *The Saudi Law of Commercial Transactions* (Arabic edn, Institute of Public Administration 2007) 224.
[337] European Corporate Governance Institute, 'Private Sector Initiatives for Corporate Governance: Principles for Corporate Governance in Kenya and a sample of Best Practices for Corporate Governance' <http://www.ecgi.org/codes/documents/principles_2.pdf> accessed on 26 September 2013.

- Membership in trade, business or other economic organisations;
- Shareholdings, share options and/or other interest in the company;
- Any interest direct or indirect in any transaction with the company; and
- Any gifts, monies, commissions, benefits or other favours extended or received from any party.

A director who decides to leaves or is removed from an organisation before the end of the term ought to release the causes of his resignation or elimination to the company's external auditors and, if necessary, to shareholders if the reasons are objection to joint fraud, corruption or other activities or conduct inconsistent with the shareholders' interests.[338]

5.4.6 Insider Dealing

Insider trading occurs when an individual uses knowledge of private information to realise a profit[339] on the sale of the firm's securities that otherwise could not have been gained. Board members' fiduciary duty requires them to fully disclose to the board and shareholders any information such a member has provided that led to any form of personal gain.[340] According to the CML, insider information has not been disclosed to the public but is obtained by an individual with legitimate internal access to the firm. If such information were released to the public in an untimely manner, it would have a material effect on the market price of securities.[341]

Insider trading is the act of making personal gains from deliberately trading on securities based on insider information. This takes advantage of the firm's shareholders and tends to destabilise the legitimate workings of the stock exchange by introducing greater volatility in market prices which distorts the true value of stock. Stock market volatility caused by inefficient information dissemination discourages legitimate stock market participants from trusting the Stock Exchange, thus harming the Saudi economy. Generally in Saudi legislation and in international

[338] ibid.
[339] Black's Law Dictionary, 'What is Insider Trading?' <http://thelawdictionary.org/insider-trading/> accessed 19 October 2013.
[340] Aaron Yoran, *Insider Trading in Israel and England* (Alpha Press 1972) 15–16.
[341] CML (n 5) Article 50(A).

markets, insider trading is considered a crime for which an individual may face fines and imprisonment.

5.4.7 Board's Duty to Act within its Powers

The wide-ranging duties of the board members directly affect corporate governance and how the firm is governed. Left unrestricted by legislation, the board's actions are not monitored within the corporation as the board itself oversees the entire organisation. This opens up the organisation to abuses at the highest levels, a vulnerability which justifies the enactment of restrictions to rein in the vast powers accorded to the board. The UK Companies Act prohibits the board from acting *ultra vires*, that is, beyond its legal power and authority. The company is a juridical person and may exist only according to its charter or constitution. It cannot exercise any power or perform any act with legal effect that it is not authorised to do so by its constitution or articles of association. So, too, the board of directors, whether acting jointly or individually, is prohibited from acting outside the powers conveyed upon it by its constitution, and these powers may be exercised only for the purpose for which they are given.[342]

The CL also limits the board's powers to the provisions in the CL, the firm's articles of association and to resolutions that are enacted during the corporation's GSM. The CL is cognisant of the power of the board to delegate to one or more of its members the performance of an act or acts within its power. Some restrictions on the board include prohibitions on selling or mortgaging property or relieving the corporation's debtors of their obligations, except when so authorised in the corporation's articles or the CL.[343]

Under the CGR, the board of directors also has the right of delegation to sub-committees, such as nomination, remuneration and audit committees.[344] The right to delegate does not minimise or absolve the board of directors of the responsibility for these duties. In so delegating the performance of these acts, the board should explicitly define the powers delegated and those reserved for itself because the sub-committees are bound by the limits of the instrument of

[342] UK Companies Act 2006, Section 171 (a) and (b).
[343] CL (n 7) Article 72.
[344] CGR (n 8) Article 13(b).

delegation which empowers them. The work delegated should be within the limits of the board's powers; any delegation beyond the board's jurisdiction is null and void.[345] Among the other limitations set by the CGR is that the company may not grant a cash loan to any board members or act as guarantor for any loan between any member or members of the board and a third party.[346] This safeguards investors' capital in the firm against abuses or commingling of funds by members of the board.

5.5 Role and Responsibilities within Board Members' Powers

The board of directors performs the crucial role of providing strategic direction for the company and monitoring management to ensure that all its actions serve the interests of the shareholders. Due to the board's broad powers and accountability to shareholders and company, Saudi regulations consider it the appropriate instrument by which corporate governance practices may be propagated within listed companies.[347] The Saudi position is consistent with the principles of the OECD and other international conventions that view the board of directors as the repository of accountability for the corporate governance of the firm. The responsibilities of the board of directors include:

(1) Fulfilling their functions according to the company's articles of incorporation, with a duty of care and in good faith;[348]

(2) Representing the shareholders and acting on their behalf and in the interest of the company, for which reason they should not detach themselves from the shareholders but closely identify with their interests;[349]

(3) Training new board members in the skills and competencies necessary to ensure performance of their functions and allow for a smooth transition and continuity;[350]

(4) Consenting to and directing the company's technical policies, such as:

[345] Sadak Al Jubran, *The Joint Stock Company Board of Directors* (Legal Publications 2006) 232.
[346] CGR (n 8) Article 18(c).
[347] CL (n 7) Articles 64-82; CGR (n 8) Articles 10-18.
[348] UK Companies Act 2006, Section 172(1).
[349] CGR (n 8) Article 11(d).
[350] ibid Article 11(f).

(a) Formulating a full set of policies for the company, including the overall work plans and risk management rules, and conducting regular assessments of these policies,

(b) Deciding on the manner by which the firm can best pursue capital formation, set the company's financial goals and ratify its budgets,

(c) Setting the strategic targets of the firm and monitoring progress towards their attainment,

(d) Conducting a periodic review of internal controls involving the financial and accounting processes in the preparation of financial reports;

(5) Formulating a written policy legitimising relationships with all groups of stakeholders and securing their rights in the company's operations.[351]

The inclusion of the fifth responsibility as an official objective of the CGR means that Saudi law, through the CGR, recognises and marks a major step towards harmonising Saudi standards with those of international corporate governance, in particular the OECD Principles.

5.6 Board Membership Categories

According to the CGR, board members fall into three categories: executive, non-executive and independent members. Executive members hold full-time administrative positions in the corporation and draw monthly salaries.[352] Non-executive board members hold neither administrative positions nor draw monthly salaries. The CGR stipulates that non-executive members should hold the largest number of board seats and regularly receive information about the corporation's submissions in a satisfactory manner so as to effectively enforce their jurisdictions.[353]

The difference in roles between the executive and non-executive board members is evident. Executive board members know how the company is run. This provides them with a grounded

[351] CGR (n 8) Article 10(B-1).
[352] CGR (n 8) Article 2.
[353] ibid Article 11(G).

understanding of how optimal corporate performance can be achieved. However, they are beholden to the company, particularly the chief executive, for their livelihood, and thus their decisions might be partial in so far as they affect personal interests. On the other hand, non-executive board members are not as knowledgeable about the company at the operational level but are not as easily influenced because they earn very little from the corporation and therefore can form more independent decisions.

The third type of board member enjoys full independence. The CGR contains strict regulations to prevent any violations of this independence. In Article 2, the CGR forbids a person from sitting as an independent board member if he/she:[354]

(1) Owns a controlling interest or holds the position of senior executive for two years in the company or in one of its subsidiaries;

(2) Owns or is a representative of a legal entity that owns 5% or more of the company or its group;

(3) Is a board member of any company within the body of the company of which such a member is scheduled to be member of its board;

(4) Has been an employee and a partner of the company or a partner of any other company, including external auditors or senior suppliers, for at least two years;

(5) Is a relative (e.g. parent, spouse or child) of any board member or senior executive of the company or one of its subsidiaries.

5.7 Board Meetings

In Saudi Arabia, board meetings are customarily open to debate in order to improve the board's discharge of its supervisory tasks in so far as they involve transactions by publicly listed corporations. Open discussions result in a full disclosure of the facts, and when malpractices or questionable dealings are uncovered, open debate provides immediate resolution of such

[354] ibid Article 2.

controversies. In addition to such customs, the CGR mandates the following practices during the conduct of board meetings:[355]

1) The board convenes meetings upon the request of the board chairman, who may convene the board for an irregularly scheduled meeting upon the written request by at least two board members.[356]
2) A record of the minutes of the meeting shall be kept, including a tally of votes by agreeing and dissenting members.[357]
3) Sufficient time should be provided for the board to adequately fulfil its duties, inclusive of preparation time for meetings and sub-committee meetings.
4) Board members should be provided documentations in a suitable and timely manner to enable them to sufficiently peruse the material before board meetings.

The CGR does not require any specific number of meetings, and this has allowed the boards of several companies to be remiss in holding meetings. This diminishes the effectiveness of boards as oversight bodies and increases the opportunities for mismanagement.[358] The CL stipulates that for the meetings of the board to be valid at least half but no less than three members must be in attendance unless the company's article of association provide for a higher number. To be adopted, the resolutions of the board must be approved by a majority of the directors present. In case of a tie, the chairman's vote decides the vote unless the articles of association state otherwise.[359]

5.8 Board Sub-Committees

Many fundamental precepts of the CGR are drawn from international corporate governance principles. Among these sources, the Cadbury report states that in order for a board to be effective it must be appropriately structured and governed by a defined set of procedures. This structure and procedures are realised by the appointment of committees tasked with specific

[355] CGR (n 8) Article 2.
[356] CL (n 7) Article 79.
[357] ibid Article 82.
[358] James Westphal and Edward Zajac, 'The Symbolic Management of Stockholders: Corporate Governance Reforms and Shareholders Reactions' (1998) 43 Administrative Science Quarterly 177.
[359] CL (n 7) Articles 79 and 80.

oversight functions, including audit, remuneration and nomination.[360] CGR Articles 12 to 15 mandate the creation of at least two obligatory sub-committees. These are discussed in the following sections.

5.8.1 Audit Committee

The idea of the audit committee as a fixture of the board of directors was first broached in 1978 when the New York Stock Exchange (NYSE) began to require all listed corporations to establish an audit committee comprised of independent members.[361] The task of the audit committee is to monitor the missions of the corporation and act as a watchdog. Its aims are to ensure accountability inside the corporation and to protect the company's investors. It does so primarily by ensuring that the corporation's accounting and auditing procedures remain consistent and compliant with standards.[362] Benefits expected from effective oversight by an audit committee include higher quality financial statements; a culture of self-control which discourages fraud; and empowerment of non-executive board members to have a constructive voice in the governance of the corporation. The CGR specifies four compulsory elements of the audit committee:[363]

(1) It must have at least three members.

(2) Members should either be non-executive or independent members. Corporation executives may not be on the audit committee.

(3) Audit committee members should be sufficiently qualified and possess the skills required in the accounting, auditing and finance professions.

(4) Members should have neither direct nor indirect interest in the submissions and contracts of the corporation.

[360] CL (n 7) Articles 64-82; CGR (n 8) Articles 10-18.
[361] Zabihollah Rezaee, Kingsley Olibe and George Minmier, 'Improving Corporate Governance: The Role of Audit Committee Disclosures' (2003) 18 MAJ 530.
[362] ibid.
[363] CGR (n 8) Article 14.

The CGR lays out the essential functions of the audit committee:[364]

1) To assist in planning a written statement to the internal audit system, control such internal audit system and confirm its usefulness;
2) To advocate to the board the discharge and appointment of external auditors with their corresponding remunerations;
3) To examine, jointly with the external auditor, the corporation's audit plans; and
4) To verify the external auditor's comments in the board's annual financial report and to issue official opinions on the basis of this report.

5.8.2 Nomination and Remuneration Committee

The nomination and remuneration committee is tasked with the following functions:[365]

(1) Advise on the appointment of new board members, determining that such board members embody honour and honesty when assuming their position on the board;

(2) Update the required capabilities and qualifications for board membership;

(3) Evaluate the strengths and weaknesses of the board and its structure and recommend possible improvements;

(4) Investigate the independence of the board's non-executive and independent members;

(5) Ensure that conflicts of interest do not exist within the board; and

(6) Formulate the procedures by which the remuneration of board members and top executives is determined.

The major task of the remunerations committee is to set the pay for executive members of the board so it risks being a self-serving committee that acts only in its own interests. Therefore, in order to guard against conflicts of interest it is mandated that the majority of its members be independent and non-executive directors. However, members of the nomination and

[364] CGR (n 8) Article 14(C).
[365] ibid Article 15(C).

remunerations sub-committee are themselves placed in their positions by the board so they might feel beholden to those executive members.

The framers of the CGR appear to have overlooked the fact that it fails to (1) specify how the sub-committee members should be compensated; (2) set a minimum number of members for the nomination and remunerations committee as for the audit committee; and (3) set a standard level of maximum executive compensation, such as linking executive compensation to the performance of the firm.[366] These shortcomings open the independence of the board up to question, and the uncertainties in the composition of the nomination and remunerations committees introduce structural uncertainties in the legitimacy of their decisions.

5.8.3 Board Members' Compensation

The payment of board members is a statutory right founded on the principle that the performance of functions must be accorded rightful compensation. Compensation levels are set in the UK through the Combined Code but not in Saudi legislation.[367] The UK Code states that the level of remuneration should be adequate to attract, retain, and motivate directors to maintain the quality of the successful company, but in no case should the remuneration be in excess of what is necessary. Most importantly, the pay of executive directors must be correlated with their individual performance, as well as that of the corporation.[368] The pay–for–performance link is a crucial corporate governance practice which has gained widespread acceptance globally, especially after the 2008 economic crisis when exiting bank executives received huge bonuses while their companies went bankrupt or took government bailouts.

In Saudi Arabia, a 1992 Ministerial Resolution limits the maximum remuneration for non-executive and independent members to the equivalent of $53,333 per member and an $800 fee for attending board meetings.[369] The majority of listed companies generally ignored the resolution. However, it did spark a debate about the matter of maximum executive compensation. The Saudi Consultative Council (i.e. the legislative body with jurisdiction over commercial and

[366] Richard Greenbury, *Directors' Remuneration: Report of a Study Group* (Gee 1995) 23.
[367] ibid 24.
[368] UK Combined Code 2008, Section 1.
[369] Ministry of Commerce and Industry Resolution, No 1071, dated 5 May 1992.

corporate rules) declared that the annual compensation for board members, including executives, should not exceed $133,333.[370]

The CGR itself sets no maximum limits on board members' compensation. Theoretically, listed companies are required to submit a written record of the proposed compensation, on which shareholders vote during the legally mandatory GSMs. The CGR also requires that the articles of association of firms describe how the compensation of board members is determined and awarded, inclusive of salaries, bonuses and other payments.[371] However, the majority, if not all, listed companies have arbitrarily set the compensation of board members. In 2011, 33 corporations paid US$32 million to their board members while their companies took a loss. These salaries also violated the CL provision[372] that companies may pay compensation to board members only after distributing a dividend of not less than 5% of the company's capital to shareholders. Companies that incurred losses could not distribute dividends to shareholders but, nonetheless, board members granted themselves substantial compensation.

5.9 Corporate Governance and Comparison

Corporate governance in countries such as Saudi Arabia is esoteric. Although awareness of it is increasing, corporate governance in Saudi Arabia is still inferior to the US and UK systems. Most Saudi firms are family controlled instead of board controlled. However, the situation has improved in the past decades.[373]

Haniffa and Cooke discuss corporate governance in emerging economies.[374] The banking sector in Saudi Arabia has been found to have the best corporate governance.[375] Good corporate governance entails financial reporting, and due to globalisation some firms in Saudi Arabia use

[370] *Aleqt Newspaper* (15 March 2011) Issue 6364; *Al-Riyadh Newspaper* (15 March 2011) Issue 15604.
[371] CGR (n 8) Article 17.
[372] CL (n 7) Article 74.
[373] M Tsamenyi & S Uddin, 'Introduction to Corporate Governance in Less Developed and Emerging Economies' (2008) 8 RAEE 1.
[374] ibid 2.
[375] ibid 4.

the internet to inform their stakeholders about their corporate governance practices, including financial reporting.[376]

Normally, business institutions in emerging markets can be understood with agency theory and the effect of CEO duality. It has been observed that CEO duality does not positively affect business organisations with large boards and low top management ownership but institutional ownership does. CEO duality can work in the context of smaller boards overseeing large management staff as the management decide on a CEO without hesitation and lengthy discussions. As a result, not only in Saudi Arabia but also in most Middle Eastern countries and Egypt, companies are reducing their boards and increasing top management ownership.

Differences exist between common law and civil law countries and between common law and Islamic law countries such as Saudi Arabia. Corporate governance is at higher levels in common law countries, and disclosure is positively associated with corporate governance.[377] The size of the capital market also decides the extent of disclosure and nature of corporate governance. Enlarging the capital market could encourage management to adhere to good corporate governance and make necessary financial disclosures. As most Saudi firms are smaller than US and UK ones, vertical growth could enhance corporate governance. In addition to the size of the capital market, the 'legal and institutional environment also plays a crucial role in shaping corporate governance'.[378]

Corporate governance also depends on shareholding patterns. As mentioned, family-owned businesses do not have the same standards of corporate governance as board-controlled businesses. In another finding, economic reforms played a role in reducing shareholding concentrations.[379] Thus, the economic reforms had, and still have, a positive effect on corporate performance in Saudi Arabia. In addition, the imposition of corporate governance regulation prompts voluntary corporate social disclosure practices. In the absence of regulation, companies have no necessity to disclose financial information.

[376] ibid 4.
[377] ibid 5.
[378] Tsamenyi and Uddin (n 373) 5.
[379] ibid 5-6.

Financial disclosure by corporate houses in Saudi Arabia has improved since 2006 and is gradually following US and UK corporate governance. However, social and cultural factors prevent Saudi Arabia from simply adopting US and UK regulations of corporate governance and disclosure practices. The conditions that existed in Saudi Arabia before globalisation are 'likely to render imported Western corporate governance models unworkable'.[380] However, globalisation has changed the situation and, due to necessity, the Saudi government has started making regulations to put disclosure and good corporate governance into practice.[381]

5.10 Summary

This chapter has examined the status of minority shareholders and their rights and duties in general and under the CL. The problems and current remedies for protection of minority shareholder have been identified. Within this, abuse of power by major shareholders to block minority shareholder's interests in the firm has been considered and the role of corporate governance in providing remedies for these has been discussed. Given its large stake in the Saudi business platform, Saudi ownership has also been considered.

This chapter also considered the role of shareholders and stakeholders in corporate governance provisions and presented the CGR. The structure of the board of directors and its principal fiduciary duties has been set out: the duty of care, duty of loyalty and duty to act within the board's powers. Board members' roles, responsibilities and powers and the determination of their compensation—a sensitive topic in corporate governance in the wake of the 2008 global financial crisis—have been discussed. As such, this comparison between the western and Islamic perspectives on corporate governance clear that the fundamentals of the two cultures with a consideration of the methods of doing business. For instance, the Islamic nations consider that there should be no price fixing as well as monopolies because of the feeling that such moves exploit people. There is a consideration that the Muslim countries value free-market economies, where there are no manipulations of the people for the benefit of a few individuals. There is also the fact that the chapter will highlight that people who engage in business should have equitability, which explores the fact that traders should not hoard goods because of the

[380] ibid 6.
[381] ibid 6-7.

exploitative nature of such acts. Unlike the Islamic nations, the western approaches have different perspectives of the same regulations. For instance, they do not consider religious attachments to corporate governance, which means that they have allowances price controls among other aspects.

Chapter Six

Issues Involving Corporate Transparency in the Saudi Capital Market

6.1 Overview

In this chapter, disclosure and transparency issues in Saudi Arabia are discussed as they pertain to the Saudi capital market. Disclosure provisions in the CML and problems that result from inadequate disclosure are examined. Insider dealing, price manipulation and possible reforms of Saudi law are addressed. Finally, a brief account of voluntary disclosure and its impact on the mandatory disclosure of financial information by SSE-listed companies is given, as well as the WB's findings on Saudi companies' disclosure practices.

6.2 Saudi Arabia's Approach to Disclosure and Transparency

From the earlier discussion of general corporate governance in Saudi Arabia, there appears to be in place a regulatory framework that sets the conditions for the adoption of effective corporate governance. However, this framework has shortcomings. The CL and the CGR, the two legal frameworks that establish corporate governance requirements for business corporations, are sometimes complementary and consistent but, in other cases, are contradictory or inconsistent and interfere with each other. This problem was discussed in the analysis of the Saudi corporate governance framework in Chapter 4.

Transparency and the disclosure of information are determinants of development and economic growth and without them economic progress cannot be sustained. The robustness of activity in a market economy depends to a great extent on complete, timely and accurate information which determines resource allocation, improves the efficiency of market activity and increases production, which drives the economy. The preceding chapters, particularly the discussion of scandals and disclosure, demonstrated that SSE listed companies still fall short of the standard of transparency desirable for an efficient market, in part because Saudi Arabia is an emerging

economy and Saudi corporate culture is still assimilating the corporate governance culture. The behaviours of individuals involved, such as board members, executives and investors, are conditioned by the customary Saudi social relations and have yet to be adjusted to the constraints of abiding by international standards that are different to accustomed behaviour.

6.3 Disclosure Provisions in the Capital Market Law

The CMA Listing Rules aim to protect investors and contribute to the development of the capital market. They are more specific and detailed than the earlier rules under the Ministry of Commerce, which were ambiguous, restricted market access and were time consuming.[382] The CML LR describe the information disclosure required for companies to list their securities in the stock market. The law also orders listed companies to abide by periodic reporting and disclosure requirements.

The CML disclosure rules meet the international standards set by the IOSCO, Basel Committee on Banking Supervision and the London Stock Exchange (LSE). The comparability of the Saudi and London stock exchanges is qualified by the innate structural differences between an emerging market only a few decades old and a developed, mature market. Emerging markets are prone to problems not present in developed markets, such as a lack of transparency and risk management, weak market infrastructure and investor misbehaviour.[383]

Another problem is the lack of predictability in the immediate time[384]—for instance, when there are insufficient counter buy and sell orders in the market then the prices of the particular stock become volatile. This major problem enables unscrupulous traders to work together to employ manipulative techniques to 'paint the tape'. This is a form of market manipulation where a group of market players conspires to influence the market price of a security by buying and selling it

[382] Abdulrahman Y Baamir, 'Issues of Transparency and Disclosure in the Saudi Stock Market' (2008) 22 Arab Law Quarterly 63.
[383] International Monetary Fund, *Global Financial stability Report* (IMF 2003) Chapter 3.
[384] Identified by the OECD as a major weakness in *Challenges for Reform of Financial Markets in MENA Countries* (OECD 2006).

among themselves. This creates the impression that there is significant trading activity in the stock and so they are able to take advantage of less savvy investors.[385]

Another characteristic of the Saudi market is the noticeably few listed companies, numbering only 113 compared to the average of 300 to 350 in other emerging markets. Consequently, the SSE is a relatively illiquid market, focusing on a small number of stocks, with trading activity concentrated on a small number of dealers. Ideally, a stock exchange has larger firms, but in Saudi Arabia the largest 20 or so companies are not listed because they are family or state owned and have no public ownership.[386]

The LR can be easily understood by investors who do not usually seek expert advice in regards to investment decisions. The language used is clear although the rules are nearly identical to those of LSE.

The concepts of disclosure and transparency are very important in the business world and financial market. When applied, the concepts ensure that information is shared publicly and the financial system is controlled. The Basel Committee on Banking Supervision and the IOSCO Technical Committee strongly recommended the adoption of such concepts by security companies and banks. They provide a logical, clear basis for all investor decision making and market discipline, which helps clarify firms' management strategies and expose their risks. Companies that practice transparency and disclosure can be evaluated easily and protect themselves from suspicions in the case of financial crises.[387] The two Committees urge firms to provide clear summaries of their activities, including quality and quantity. In addition, all risks—credit, market and liquidity—should be declared to the public, and how these factors affect them should explained. According to the Committees' recommendations, firms should detail their policies in dealing with the expected and existing risks.

For better financial comprehension, it is also important to separate trading and non-trading activities. Compared with developed countries, the Saudi CML represents a good attempt to cope with the international standards regarding disclosure of information. The CML includes

[385] Baamir (n 382) 65.
[386] ibid 66.
[387] 'Recommendations for Public Disclosure of Trading and Derivative Activities' (Consultative paper issued jointly by the Basel Committee on Banking Supervision and the Technical Committee of the International Organization of Securities Commission, 1999) <http://www.bis.org/publ/bcbs60.pdf> accessed 25 March 2014.

provisions addressing the prohibition of market manipulation, security issuers, members of management and majority shareholders.

Sufficient, adequate information has to be disclosed in order to create a full picture of investment affairs, including the issuer's financial position, securities to be issued, rights and privileges. If the information is inaccurate, the issuer or person responsible must compensate the affected investors. All these measures will help create a solid investment environment in the Saudi capital market.

Some articles in the Saudi LR mandate disclosing information about securities before issuing them. Such information has to be sufficient for an investor to assess the financial position, activities and related aspects of the company and help make decisions about it.[388] This information should also convey all aspects of the rights attached to the shares (e.g. voting, dividends, repurchase).

Moreover, the financial status of the company or the issuer and their administration body has to be clear and unambiguous.[389] In the FSA rules, Article 2.1.1 outlines the content of the necessary information, while Annex I includes the minimum disclosure requirement for shares' registration documents, similar to the Saudi rules.[390]

Through August 2006, the CMA has published 16 prospectuses which fulfilled the information requirements in annexes 4 and 5 of the LR.[391] However, the new regulations have not changed the LR's restriction of information access to only well-established corporations. In contrast, the FSA accepted 25 prospectuses in the second half of July.[392] In both cases, the authority must approve the prospectus under SSE rules before publication.

The CMA takes other appropriate steps, such as asking the applicant to appear before the authority for questioning, providing further information or undertaking relevant studies. This person has to be aware of all related matters that might be discussed when appearing before the authority in order to give adequate answers.

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[388] The Listing Rules (LR) were pursuant to CMA Board Resolution No 3-11-2004, dated 4 October 2004 and amended by a Resolution of Capital Market Authority Board No 2-128-2006, dated 22 January 2006, Article 21.
[389] ibid Annex 4.
[390] FSA, 'Article 2.1.1, General Content of the Prospectus Rules' (FSA Handbook, March 2013).
[391] Additional information must be disclosed in some sectors, such as insurance and mining.
[392] FSA, *The Listing Review and Prospectus Directive, Stock Market Regulation* (FSA 2005).

According to the SSE rules, the issue must make disclosure to the authority if the existing securities will increase by less than 10% because of the issue or if the shares are issued due to a bonus to the listed shareholders of the company. However, a prospectus is not required if the issuer's employees are granted shares or the issue is due to converting debts.[393] If no increase in the securities is expected, a prospectus is not required, following Section 1.2 of the FSA Prospectus Rules. This also applies in cases when an employer grants shares to employees.

According to the Saudi rules, the issuer must publish a prospectus fourteen days before posting it online and releasing it in hard copy offered free of charge to the public.[394] In contrast, Article 3.2.2[395] of the UK rules adopts the principle of reasonableness, requiring the prospectus to be published six days before the IPO. According to Article 3.2.3, if a major change occurs in relation to the prospectus or the documents after approval, a supplement is needed.[396] The FSA also addresses inaccurate information and mistakes mentioned in the approved prospectus.

The authority can demand a higher level of disclosure by asking for more information or requiring other obligations in sectors such as insurance.[397] Article 26 of the LR favours listed companies regarding disclosure rules:

> In the opinion of any issuer, disclosure of any matter required by these Rules would be unduly detrimental to the issuer, and omission is not likely to mislead investors with regard to facts and circumstances, essential knowledge for the assessment of the securities in question, the issuer may apply for a waiver from the relevant requirement.[398]

The rules of the LSE also allow some exceptions to the disclosure of certain business activities:

> In long-term contracts, where disclosure would be seriously detrimental to the applicant or against the public interest, a waiver from the requirement of making a material contract publicly available can be granted subject to the UKLA discretion. The waiver may be granted only for

[393] The market for debt instrument has not been developed yet; however, the introduction of *sukuk*, or Islamic bonds, saw reasonable success.
[394] LR (n 388) Article 22.
[395] The prospectus must be filed and made available to the public as soon as practicable, at a reasonable time in advance of and at the latest at the beginning of the offer or the admission to trading of the transferable securities involved.
[396] LR (n 388) Article 24.
[397] ibid Article 26; 2.1.4.
[398] ibid Article 26.

> specific parts of a contract and, generally, will not be granted merely on the grounds of commercial sensitivity.[399]

The SSE rules do not offer a justification for not disclosing information. The FSA does not consider the sensitivity of business information or exempt parts of the transaction that may affect the issuer.[400] The purpose of imposing further obligations is to guarantee the continuous release of information to treat market participants equally.[401] The LR mention such obligations, especially with regard to significant developments and the necessity to make them public.

In addition, the CMA and shareholders should be informed about interim accounts approved by the issuer's board of directors, as well as the annual accounts that must be prepared according to SOCPA criteria.[402] If a firm fails to submit such reports to the authority, it could be subject to disciplinary action, such as a fine or suspension of its securities.[403]

In addition, the authority should be informed of investors who own 5% or more of voting shares in a firm at the end of the trading day, as well as any increase or decrease of 1% or more.[404] The aim of disclosure of interest is to draw the attention of other shareholders to the new shareholder or those whose shares have increased. Such shifts in shareholding can result in significant changes in the aspects of the firm, such as its articles of association or board of directors.[405]

Furthermore, Almelhim argues that the disclosure of interest will make the shareholders aware of firms' financial status and help protect their interests. The authority requires that issuers notify it regarding their capital and changes, including those to holdings or ownership of more than 5% of the listed securities.[406] Moreover, all decisions related to company activities, such as payment or non-payment of dividends, purchases, draws, redemptions, and changes to the rights attached to any listed securities, must be reported to the CMA without delay.[407] In comparison with the UK,

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[399] Linklaters & Alliance, *The Automatic Choice for LES Listing* (Linklaters & Alliance 2002).
[400] LR (n 388) Article 18.
[401] FSA, 'Admission and Disclosure Standards' (FSA, July 2005).
[402] LR (n 388) Article 25; SOCPA (n 153).
[403] In an announcement on 20 April 2004, the CMA warned seven companies because of delays in the submission of their interim account reports and suspended trading in the securities of one company later that week. CMA, 'Chapter Seven Disclosure Article Forty Two CML' <www.cma.gov.sa> accessed 27 March 2014.
[404] LR (n 388) Article 30.
[405] Ahmed Almelhim, 'Comment on Kwuaiti Law No 2 of 1999 Concerning the Disclosure of Interest in Shares in the Light of Comparative Law' (2000) 15(3) ALQ 221.
[406] ibid.
[407] LR (n 388) Article 32.

the FSA requires that the information be published on time to help the market function properly. However, disclosure of information to the SSE has to follow certain criteria, including continuous obligations. Any activity that might influence the company shareholders must be reported, and such measures have to be in compliance with International Financial Reporting Standards, as stated by the LR.[408]

6.4 Disclosure and Transparency in Saudi Arabia

In a discussion of corporate governance, it can be argued that disclosure and transparency mean that firms release to the public their financial status, activities, decisions and any related company information that concerns investors.[409] This definition lends these concepts significant importance in capital markets in general and in corporate governance specifically, whether local or global.[410]

The first OECD Principle of Corporate Governance is:

> The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.[411]

The application of disclosure as required by corporate governance results in making public information that helps investors, shareholders and all other parties interested in a company in order for them to make their decisions regarding their investments. Such information must accurately reflect the company's real situation in the capital market in order to provide a comprehensive picture for all those interested. Disclosure includes sharing the real financial status of the company in the market with all relevant parties, which makes clear the managerial process and allows the detection of any act of fraud.[412] In addition, this supports the rights and benefits of shareholders as the board of directors' behaviours are visible, and it cannot lead the

[408] FSA Handbook, 'Rule 12.47a'.
[409] IMF (n 59) 7.
[410] It is argued whether the disclosure of financial information by a corporation ought to be regulated by the CL or CML. It seems appropriate for it to be both as it shows up the inauthenticity of the division between the two laws. See Pettet, Lowry and Reisberg (n 334) 182.
[411] OECD (n 87) 17.
[412] Oso and Semiu (n 1) 2-16.

company to achieve its interests at the expense of shareholders. Shareholders can decide whether to sell or buy shares in the company.[413]

In this context of corporate governance, the Winter Report states that:

> Disclosure can be a powerful regulatory tool; it creates an incentive to comply with best practice, and allows members and third parties to take necessary actions. Disclosure requirements can be more efficient, more flexible and easier to enforce.[414]

The Saudi CMA emphasises the concepts of disclosure and transparency in the CGR, requiring all companies listed in the market to apply them.[415] Article 9 of the CGR on disclosure in the board of directors' report declares that:

> In addition to what is required in the Listing Rules in connection with the content of the report of the board of directors, which is appended to the annual financial statements of the company, such report shall include specific disclosure requirements.[416]

Furthermore, other articles of the LR stipulate related requirements.[417] In comparison with the rules of other developed countries, the LR of the CGR have very similar requirements to the LSE.[418] These requirements are found in UK legislation: the Financial Services Authority (FSA), Disclosure and Transparency Rules, FSA Listing Rules and the UK Corporate Governance Code.[419]

In general, such requirements of corporate governance are almost identical in Saudi Arabia and the UK. The greatest similarities are in the rules applied to the listed corporations in both countries. Slight differences emerge in the level of development of the capital market in these countries.[420]

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[413] Faith Kahn, 'Transparency and Accountability: Rethinking Corporate Fiduciary Law's Relevance to Corporate Disclosure' (2000) 34 GLR 512.
[414] European Commission, 'Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe' (4 November 2002) 4.
[415] The CMA Board issued Resolution No 1-36-2008, dated 10 November 2008, making Article 9 of the CGR compulsory for all listed companies.
[416] CGR (n 8) Article 9.
[417] LR (n 388).
[418] Riyadh Chamber of Commerce and Industry, Co*rporate Governance: The Definition, the Principles, and the Saudi Experience* (Arabic edn, 2007) 56.
[419] The UK Corporate Governance Code (Financial Reporting Council, September 2014).
[420] ibid.

The Saudi CGR requires that corporations include the concepts of disclosure and transparency in their articles of association, including mechanisms to apply them to the board of directors and releasing information to all relevant bodies interested in the company.[421] The board of directors is responsible for leading the company and its activities in order to benefit all partners in the company. This aim can be achieved through disclosure and transparency.[422]

6.4.1 Annual Board Report and the Importance of Disclosure and Transparency

After the 2006 SSE crisis, it became clear that companies had ignored most disclosure and transparency requirements for annual reports, and accurate, precise information about the financial status of companies was lacking. Only a few documents, such as auditors' reports, balance sheets and profit and loss accounts, were correct.[423] The same pattern was seen during the global financial crisis (2007-2008) where no true, reliable information was shared.[424]

Under the CGR, companies have to disclose updated information and make it accessible to all interested parties. In addition, annual reports should pay special attention to shareholders.[425] The annual board reports serve as the most reliable source of information about Saudi companies although these reports are difficult to understand.[426] It seems that many shareholders are unfamiliar with the legal and financial terms used in these reports; therefore, the language should be simpler and easier to comprehend.[427]

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[421] CGR (n 8) Articles 4(A), 8 and 10(F).
[422] Joseph Carcello, 'Government and the Common Good' (2009) 89 JBE 11.
[423] Ibrahim Al Muneef, *Corporate Governance Functions and Duties and Responsibilities of the Board of Director* (Arabic edn, Dar Al Mouder 2006) 96.
[424] Susan Bartlett and Roy Chandler, 'The Private Shareholder, Corporate Governance and the Role of the Annual Report' (1999) JBL 415.
[425] CGR (n 8) Article 4(B). The CL (n 7) can be taken as the reference for enabling shareholders to obtain the corporation's board annual financial report and other information. Article 89 of the CL affirms that the board of directors should set the date of the annual GSM at least 30 days in advance and, for each financial year, prepare a company balance sheet, profit and loss account and report on the company's operations, financial position and proposed method for the distribution of net profits. The chairperson of the board of directors should sign these documents, and copies should be distributed to shareholders by the company headquarters at least 25 before the set date of the GSM.
[426] Mamdouh Ba-Owaidan, 'The Contribution of Accounting Information to Investor Decisions in the Saudi Stock Market' (PhD thesis, University of Hull 1994) 124.
[427] Braendle, Kostyuk and Apreda (n 9) 416.

As a step towards facilitating access to information and providing understandable reports, many corporations have started to use modern means of communications, such as the Internet, in order to make it easier for shareholders and interested parties to access the information they need to make investment decisions.[428] Many listed companies in Saudi Arabia have used technology to present their boards' annual reports.

Providing a clear, satisfactory board annual report needs the efforts of auditors with high levels of expertise[429] who can practise disclosure and transparency by disseminating significant information about the company's true financial status, as is required by corporate governance worldwide. The OECD Principles stipulate that:

> An annual report 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.[430]

Experienced auditors can provide good board reports which comply with the CGR provisions related to disclosure and transparency in corporate governance.[431] Some scholars argue that well-known, large companies in Saudi Arabia, such as Saudi Basic Industries Corporation (SABIC) and Saudi Telecommunications Company (STC), should disclose information and make their reports available before smaller companies do as these larger businesses already have qualified, expert auditors working for them.[432] Such large companies should also provide additional information through more regular supplements than small businesses.[433] High-level international companies frequently present their board annual reports of their activities in a specific way, including the expected risks and profits, which lower-level companies usually cannot do.[434]

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[428] CGR (n 8) Article 4(B).
[429] Sweeney Baird, 'The Role of the Non-Executive Director in Modern Corporate Governance' (2006) 27(3) CL 69.
[430] Hill (n 6) 54.
[431] Abdul Latif Bashik, 'A List of Corporate Governance and the Relationship with the Quality of Accounting Information and the Saudi Stock Market' in *Corporate Governance Conference* (Arabic edn, King Khalid University 2009) 5.
[432] Saad Al Mosa and Mohammad Al Abbas, 'Audit Delay: Evidence from Listed Joint Stock Companies in Saudi Arabia' (2005) KKUJ 7.
[433] Khalid Al Shaeed, 'The Association between Firm-Specific Characteristics and Disclosure: The Case of Saudi Arabia' (2006) 21(5) MAJ 491.
[434] Richard Morris, 'Signalling, Agency Theory and Accounting Policy Choice' (1987) 18(69) ABR 54.

6.4.2 Disclosure and Transparency Requirements of the Annual Board Report

The Saudi disclosure and transparency requirements can be found in the rules of corporate governance in many countries. These concern the sharing of firm information and the production of board annual reports. In comparison with the provisions regarding disclosure and transparency in the UK, for example, the CGR emphasises disseminating company information and board annual reports to interested parties in an accessible manner and offers recommendations on how to do so in the approved manner of listings.[435] The disclosure and transparency requirements for board annual reports of listed companies are as follows:[436]

1) A detailed description of the board's main activities;

2) The board's plans and decisions regarding the company's structure, expansion, future prospects and expected risks;

3) A statement of any material differences between the most recent and next operations;

4) An explanation of any deviation from the accounting standards espoused by the SOCPA;

5) Data about each subsidiary and its scope of business, main country of operation and assimilation;

6) An explanation of any issues related to rights that the board issues or grants, such as convertible debt instruments, options and warrants;

7) A report of the board meetings and the names of members who attended during the past financial year;

8) An account of any waivers to any rights of the board of directors. senior executives or shareholders of the listed company to dividends or compensation;

9) The annual audit results of the value of the corporation's internal control measures.

[435] The UK Corporate Governance Code (Financial Reporting Council, September 2014) 27.
[436] LR (n 388) Articles 43, 44 and 45; CGR (n 7) Article 9. Also, the CMA Board issued Resolution No 1-36-2008, dated 10 November 2008, making Article 9 of the CGR compulsory for all listed companies.

The CRSD and the CMA Board have judged many cases related to disclosure and transparency, mostly the non-application of these requirements by listed companies. Almost all such cases are subject to Article 9 of the CGR and Articles 43, 44 and 45 of the LR.[437] The CRSD and the CMA Board enforced these resolutions. These match Article 59-B of the CML:

> The Capital Market Authority Board may request the Committee for the Resolution of Securities Disputes to impose a fine upon the persons responsible for an intentional violation of the provisions of the Capital Market Law, the Implementing Regulations, and the rules of the exchange. As an alternative to the foregoing, the Capital Market Authority Board may impose a fine upon any person responsible for the violation of the Capital Market Law, the Implementing Regulations, and the rules of the exchange. The fine that the Committee for the Resolution of Securities Disputes or the Capital Market Authority Board can impose shall not be less than $2,666 and shall not exceed $26,666 for each violation committed by the defendant.[438]

Companies which did not comply with the corporate governance principles failed to include in their board annual reports the necessary information related to the practice of disclosure and transparency mandated by the CGR and LR. However, the failure of some listed companies to adhere to disclosure and transparency requirements is not uncommon. Theoretically, the rules and principles of disclosure and transparency are clear but, in practice, the application of such rules is generally weak, possibly attributable to soft follow-up by the CMA Board with fines and punishments not severe enough to be a deterrent. A better mechanism is needed to compel listed companies to fulfil the requirements of disclosure and transparency. For instance, instead of the CMA Board, the CRSD could mediate cases dealing with any violation of the rules by listed companies in order to make them pay attention to the requirements when preparing their board annual reports.

The Saudi disclosure and transparency requirements, if applied by enough companies to avoid violating the rules and suffering the consequent penalties, can enhance corporate governance in the Saudi capital market. Corporation board members and top executives must develop and apply such rules and principles. Listed companies have violated the following principles of disclosure and transparency.

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[437] Sanctions and penalties are studied first by the General Department of Corporate Governance. The author visited this Department and saw its work plan for the process for the CMA Board to consider punishment of violations by listed companies. The department examines the listed companies' article of associations, website announcements and board annual reports. Before determining violations of CGR and relevant articles of Implementation of Regulations, particularly the LR, the Department refers the decision to the CMA Board, along with proposals, recommendations for each fine and an explanation of its decisions.

[438] CML (n 5) Article 59(B).

1. The principle in Article 9-F of the CGR:

> Any punishment or penalty or preventive restriction imposed on the company by the Capital Market Authority Board or any other supervisory or regulatory or judicial body (to be mentioned in the board annual report).[439]

This principle was violated by some companies, including the Saudi International Petrochemical Company. A case was brought against it when the company's 2009 annual financial report failed to mention that the CMA Board sentenced it at the beginning of that year. Consequently, it was fined by the CMA Board.[440] In another example of a violation, the Al Ahsa Development Company did not include required information in its 2010 annual financial report and was fined $26,666 by the CMA Board.[441] These fines were imposed lawfully under Article 9-F of the CGR. The CMA Board makes an effort to ensure that listed companies abide by the CGR by following up on the application of disclosure and transparency and imposing penalties and other punishments. Thus, any sentence should be mentioned in the company's annual report. Failure to do so is considered a violation of the rules and regulations set by the CMA, CRSD and other Saudi judicial organisations.[442]

2. The principle in Article 9-B of the CGR:

> Names of any joint stock company in which the company board of directors' member acts as a member of its board of directors (to be mentioned in the board annual report).[443]

An example of the violation of this principle comes from the Al Baha Investment and Development Company. Its 2010 board annual financial report did not mention the names of those serving as board members in more than one company. The CMA fined this company $13,333. This is a typical punishment for a violation of the above principle.[444] In such cases, it is suggested that the CMA Board should warn or fine persons who are members of more for not displaying this information appropriately. This will help in dealing with conflicts of interest.[445]

3. The principle in Article 44-C of the LR:

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[439] CGR (n 8) Article 9(F).
[440] Issued Decision, dated 15 August 2010 by the CMA Board.
[441] Issued Decision, dated 24 October 2010 by the CMA Board.
[442] *Al-Riyadh Newspaper* (25 October 2010) Issue 15463.
[443] CGR (n 8) Article 9(B).
[444] Issued Decision, No. 5-32-2011, dated 23 October 2011 by the CMA Board.
[445] *Al-Riyadh Newspaper* (24 October 2011) Issue 15827.

> The company shall announce, through the electronic applications, its interim and annual accounts immediately upon approval by the board and such statements must not be published to the shareholders prior to their announcement in the stock exchange.[446]

Regarding violations of this Article, the Southern Province Cement Company was fined $13,333 by the CMA. In 2008, the company published its profits by posting the chairman of the board's speech online, which is not considered an official declaration, before informing the CMA and the Stock Exchange of its profits.[447] This decision was issued in accordance with Article 9-J of the CGR, which states that 'the stock exchange shall be immediately informed of the results of the corporation general meeting'.[448]

The fine imposed on this company is quite fair. It is in accordance with the regulations and rules set by the CMA and the SSE as they are the authorised and responsible bodies concerned with stating the behaviour of the listed corporations. Corporations must inform these official bodies of the board's annual financial report and any other important information, and not publish information before the stated time in order to ensure the fairness of the market. Conduct to the contrary constitutes legal grounds for punishment.[449]

4. The principle in Article 45-9 of the LR:

> A description of the listed company dividends policy (to be included in the board annual financial report).[450]

An example of a violation of this principle is the case involving Alahli Takaful Company. The company's 2009 annual financial report did not explain its dividend rule. The CMA Board fined it $13,333 in accordance with this Article.[451] The annual financial report must detail the distribution of dividends to all shareholders to ensure equitable treatment.

Legally, this case follows the CMA rules regarding the corporations that breach this principle. However, it is suggested that the imposed fines be increased to prevent such violations and emphasise the significance of disclosing the distribution mechanism for dividends in order to protect shareholders' rights. The means of distributing dividends is required to be stated only in

[446] LR (n 388) Article 44(C).
[447] Issued Decision, dated 1 December 2010 by the CMA Board.
[448] CGR (n 8) Article 9(J).
[449] Argaam <www.argaam.com/article/articledetail/87076> accessed 1 November 2012.
[450] LR (n 388) Article 45(9).
[451] Issued Decision, dated 16 August 2010 by the CMA Board.

the company's articles of association and ordinary general meeting and is not stipulated by the CGR or LR. Therefore, it is recommended that the CGR mandate disclosure of the dividends distribution policy.[452]

5. The principle in Article 45-21 of the LR:

> A statement of the amount of any outstanding statutory payment on account of any *zakat*, taxes, fees or other charges with a brief description and the reasons therefore (to be included in the board annual report).[453]

Saudi Fishers Company violated this principle with its 2009 annual report as it did not include the *zakat* and income tax it had paid. The CMA Board imposed a fine of $13,333 on the company according to the above principle.[454] *Zakat* is a certain amount of money deducted from the rich to be given to the poor and is one of the pillars of Islam. Paying *zakat* demonstrates that the company is fulfilling its duty towards society. Doubling this fine is suggested to act as a deterrent.

6. The principle in Article 45-11 of the LR:

> A description of any interest, options and subscription rights of the company directors, senior executives and their spouses and minor children in the shares or debt instruments of the company or any of its subsidiaries, together with any change to such interest and rights during the last financial year (to be mentioned in the board annual report).[455]

In its 2009 annual financial report, STC did not mention the interests, preferences and donation rights of its board members and top executives. As a result, it was fined by the CMA Board.[456] Since this case involved a major company, the CMA could suggest that it be arbitrated by the CRSD. STC's behaviour could be attributed to a conflict of interest among its board of directors, so the CMA might not be capable of handling it well. In such a case, it could have been presented to the CRSD.[457]

7. The principle in Article 45-3 of the LR:

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[452] Said Yahya, *The Summary of the Saudi Arabian Commercial System* (Arabic edn, The Bureau of Modern Arab 2004) 255.
[453] LR (n 388) Article 45(21).
[454] Issued Decision, dated 23 August 2010 by the CMA Board.
[455] LR (n 388) Article 45(11).
[456] Issued Decision, dated 27 June 2010 by the CMA Board.
[457] For more information see <www.argaam.com/article/articledetail/165829/> accessed 1 November 2012.

> A summary, in the form of a table or a chart, of the assets and liabilities of the company and of the company's business results for the last five financial years or from incorporation, whichever is shorter (to be included in the board annual report).[458]

Arabia Co-Operative Insurance Company provides an example of a violation of this principle. Its 2010 board annual financial report did not include accurate figures for company assets and liabilities nor did it mention any business results for the past five financial years. In this case, the CMA imposed a fine imposed in accordance with Article 45-3 of the LR,[459] which requires accurate figures describing the company's performance in the most recent five years to be provided in the annual report. The company deserved such punishment in order to encourage the application of disclosure and transparency, and to provide investors with useful information about the company's productivity and an analysis of business results in recent years.[460]

8. The principle in Article 43-A of the LR:

> A corporation must notify the Capital Market Authority and the public without delay of any major developments in its sphere of activity which are not public knowledge and which may have an effect on the corporation's assets and liabilities or financial position or on the general course of its business.[461]

In addition, Article 43-B-7 of the LR stipulates that 'the increase or decrease in the net assets of the company equal to or greater than 10% … be included in the board annual report'.[462] Al Masafi Saudi Arabian Company violated the above-mentioned principle by failing to notify the CMA and SSE about its board recommendations to increase its capital by the deadline of July 2008. For this violation, the CMA Board fined the company $26,666.[463] A company that intends to increase its capital should notify the CMA and SSE; otherwise, it will be liable to a penalty as occurred in this example.[464]

9. The principle in Article 43-B-2 of the LR:

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[458] LR (n 388) Article 45(3).
[459] Issued Decision, No. 6-28-2011, dated 18 September 2011 by the CMA Board.
[460] For more information see <http://www.argaam.com/article/articledetail/229910/> accessed 1 November 2012.
[461] LR (n 388) Article 43(A).
[462] ibid Article 43(B-7).
[463] Issued Decision, dated 1 December 2008 by the CMA Board.
[464] *Aleqt* (1 December 2008) Issue 55350.

> Any debt outside the company's ordinary course of business, in an amount equal to or greater than 10% of the book value of the company's net assets (to be included in the board annual report).[465]

In a 2011 board annual financial report, the Saudi Cement Company did not mention its debt to the Samba Financial Group. Under the above principle, the CMA punished this company with a fine.[466] Violations of this principle hide important company information and concerns from the CMA and investors. This weakens the application of disclosure and transparency. The penalty for such violations and the application of these rules should be strengthened, such as by postponing trade in shares of the violating company and informing investors about such behaviour.[467]

6.5 Problems in Cases of Inadequate Disclosure

If disclosure is insufficient, problems arise, such as a lack of transparency due to weak rules or application. Abuse will prevail in the market and securities, and investors will lose confidence in the market activities.

To meet these challenges, the CML contains provisions to enhance transparency. This law requires the publication of a prospectus for the firm to be listed. The required information in the prospectus includes the issuers of the securities, their business activities, the individuals in charge of management, the principal shareholders and any information material to assessing the risks of investing in the stock.

The prospectus is more than a mere brochure because it commits the firm to the truthfulness of all information in it. An investor who buys primary shares on the basis of the information in the prospectus may file for damages against the firm if any inaccurate material information was presented in or intentionally omitted from the prospectus.[468] In a few instances, the prospectus is not required but these are few and act more as exemptions, with the general rule favouring full disclosure in the prospectus.

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[465] LR (n 388) Articles 43(B-2).
[466] Issued Decision, No 4-23-2011, dated 3 July 2008 by the CMA Board.
[467] For more information see <http://www.argaam.com/article/articledetail/219441/> accessed 1 November 2012.
[468] Baamir (n 382) 72.

A number of additional obligations are imposed on certain sectors, such as insurance and mining, as they are associated with greater public risks. However, a gap in the rules governing disclosure favours listed companies. Article 26 allows for the waiver of disclosure requirements when, in the opinion of the issuer, the disclosure would be detrimental to the issuer, and the omission is not likely to mislead investors' assessment of the securities.[469] Application for the waiver, of course, must be made to authorities, and in the course of the application the nature of the waived information should be made evident.

This measure might be necessary, especially in highly competitive firms that maintain industrial secrets. However, the provision is also open to abuse and possible connivance between authorities and the issuer to allow more than necessary leniency for the non-disclosure of matters vital to the investor but unfavourable to the image of the issuer. This defect in the provision is highlighted by its failure to qualify in what manner the undisclosed information would be 'unduly detrimental' to the issuer. Admittedly, this description could cover a broad range of situations and even be used to exempt the disclosure of information which impinges significantly on public interest.[470]

6.6 Regulations Addressing Market Abuse

Lapses in compliance with disclosure and transparency standards are hugely detrimental to the effective functioning of the financial markets and slow down economic development. A lack of transparency can result in insider dealing, conflicts of interest and price manipulation in the stock exchange, among other adverse repercussions. Stock market regulators are aware of the possible loopholes in market regulation and have intensified efforts to eliminate irregular trading and poor disclosure in order to encourage more participants to invest in the equities market. In the SSE, most trading is conducted by retail investors who are the most vulnerable parties because of the danger of losing their life savings to unscrupulous market players.[471]

[469] LR (n 388) Article 26.
[470] ibid Article 26; Baamir (n 382) 70.
[471] Dominic Dudley, 'Riyadh Tightens Market Regulation' (May 2013) 57(27) MEED 18.

6.6.1 Market Manipulation

It has been observed that market manipulation takes place in all stock markets, even developed ones although arguably to a much lower degree. An aim of the SSE is to reduce the frequency and severity of market manipulation. Jarrow argues that only major investors can change prices to manipulate the market for their own interest.[472] He differentiates between the manipulator and the major trader and views market manipulation trading positively as it accumulates wealth without risk. Jarrow thinks that although other people believe the major trader has sensitive information and behaves accordingly, the major trader actually controls prices through the large size of his trade.[473]

However, Gale and Allen identify intentional stock price manipulation as a major issue throughout history. Market manipulation generally has been viewed as immoral behaviour since the founding of the first stock exchanges. Early brokers manipulated stock prices by quickly selling certain securities. Prices fell when fearful investors also sold them, and then brokers bought the shares back at a lower price. Early brokers also made profits by spreading false rumours about company's prospectuses.[474]

Article 49 of the CML defines market manipulation as any act which creates a false or misleading impression of the market or the prices or the value of securities. Market manipulation also includes inducing third parties to buy, sell or subscribe to securities or to refrain from doing so or to permit or prevent them from exercising the rights associated with such securities. Other methods of manipulation of securities prices include conducting false sale activities without real transfer of ownership.[475] Such behaviours prevail in Saudi Arabia due to the weak actions of the CMA and the structure of ownership.[476]

In deceptive transactions, an investor sells securities from one fund and buys the same amount from another fund which he manages. This practice creates the impression that trading in this share is active which increases in its price. Such practices are enabled by a lack of market

[472] Robert A Jarrow, 'Market Manipulation, Bubbles, Corners and Short Squeezes' (1992) 27(3) JFQA 311.
[473] ibid.
[474] Franklin Allen & Douglas Gale, 'Financial contagion' (2000) 108(1) JPE 1.
[475] CML (n 5) Article 49.c.1.a.
[476] Market abuse is not a criminal offence in Saudi Arabia, and the CML 2003 is the first regulatory step to tackle this issue.

education among investors and a scarcity of expert market makers. Tracing such practices in the Saudi market, Taher noticed that the share prices of 70 out of 81 companies traded in the market were overvalued as a result of mass speculation. Within a month, the price of the securities of some firms rose 200% despite losses, leading to a sharp price correction.[477]

Among the harmful effects of such practices are that investors who suffered losses might not be able to raise local funds later or subscribe widely to future IPOs. These practices have created social crises that have negative consequences for many people.[478]

The FSA classifies market manipulation as three offences: firstly, encouraging transactions in an investment by giving a misleading impression of the supply, demand or price to keep the price of that investment at an abnormal level; secondly, entering into transactions to trade that employ fictitious devices; and thirdly, spreading misleading information about a financial instrument.

In February 2006, a great crash in the Saudi market caused financial catastrophe, especially for small investors. Looking for the reasons behind the crash, specialists argued that market manipulation was among the main causes. Consumers started to spend less due to the financial crisis, and the CMA has fought against the negative consequences of the crash.

After a prosperous period, the SSE reached more than 20,000 points in February 2006 but then collapsed by 50%. Despite a lack of proactive measures, the CMA responded by taking steps to protect investors.[479] These measures lowered the daily fluctuation rate in the SSE from 5% instead of 10%. The CMA attempted to increase market liquidity and transparency in capital market activities and allowed foreign residents to trade directly with local exchanges.[480] In addition, the CMA aimed to prevent market manipulation. It declared that, in early February 2006, three investors had violated CML Article 49 by creating a false impression of the prices of securities of the eight firms. As a punishment, the CMA levied a large fine against the investors and banned them from working in listed firms or trading in the market for three years. However, the CMA did not give any details about how the manipulation took place.

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[477] Nehad Taher, *A Clearer Path for Investors* (2004) <http://www.thebanker.com/World/Middle-East/Saudi-Arabia/A-clearer-path-for-investors?ct=true> accessed 26 July 2014.
[478] All the IPOs in the SSE have been massively oversubscribed.
[479] The CMA did not intervene to eliminate market manipulation before the crash in February 2006.
[480] IMF (2006).

Dudley states that there 'is a widespread acknowledgement that market manipulation almost certainly happens in some corners of the Tadawul'.[481] Regulations are in place but are not well enforced by the CMA, which often resorts to charging and collecting fines from those who violate regulations. The CMA has imposed $140,000 fines on companies trading on the SSE, mostly from penalties for failing to disclose important information about companies. For instance, the Saudi Kayan Petrochemical Company was fined SR50,000 in April 2013 for failing to disclose the expected financial impact of stopping production at some units for maintenance. In May 2013, the United Cooperative Assurance Company was fined SR100,000 for not disclosing its financial results for the previous year.[482]

Despite these disciplinary actions, violations of the stock market regulations still occur. The fines are not high enough compared to companies' net profits to act as deterrents. The SR50,000 fine imposed on Rabigh Refining and Petrochemical for violating Clause (A) of Article (40) of the LR and Sub-clause (5) of Clause (A) of General Instructions was taken into account by companies in the announcement published by the SSE on 15 December 2013. It contained false information on reaching an agreement with shareholders to boost its financial performance. It claimed the agreement would have a financial impact of nearly SR1 billion of the company's revenues and SR1.3 billion in subsequent years. In future years, the financial effect will be only on the net profit.

6.6.2 Irregular Trading

Amidst inadequate disclosure, insider dealing flourishes. The practice is defined as using critical information about price in a firm before publishing it to gain financial benefits. Many countries have adopted legal measures to criminalise and prevent insider trading. According to

[481] Dudley (n 471) 18-21.
[482] CMA, 'Announcement of the imposition of a penalty' (26 May 2013), 'The Capital Market Authority announces the issuance of a CMA Board resolution to impose a penalty of SR 100,000 (One Hundred Thousand Saudi Riyals) on United Cooperative Assurance Co. Due to its violation of clause (A) of Article (45) of the Capital Market Law and clause (E) of Article (42) of the Listing Rules. The company failed to inform CMA or announce to the shareholders its annual financial statements for the period closing on 31/12/2012 within a period not exceeding Forty days from the end of the financial period covered by those statements'.

Friedman,[483] honest competition between the players in the capital market is necessary, and all players should have the same information in order to create a fair and competitive environment. No player should have access to insider information during the process of securities trading.

However, Manne[484] argues that insider trading is fruitful because it creates company value, such as new investments. Similarly, Beny[485] and Bhide[486] contend that large shareholders' access to inside information enables them to obtain greater trading profits than other shareholders, which serves as compensation for monitoring the firm's performance and guiding it to avoid risks. Carleton and Fischel[487] likewise assert that insider trading can be considered compensation for managers as they direct the company, and this motivates them to provide better management. Without the benefits of insider trading, the researchers argue, managers would less productive.

Other specialists take an opposing view of insider trading. Among them, Gilligan advocates preventing insider trading as it creates an imbalance of opportunities and perpetuates unfairness, abuse of position and confidential information, and loss of integrity and confidence.[488] He explains that insider dealing negatively affects liquidity and increases opportunities for serious abuse and crime. Rider and Ashe[489] contend that insider dealing should be controlled because it harms confidence, allows the abuse of trust and supports unfairness.

Insider trading can be seen in abnormal, unusual fluctuations in the value of a company's stock. Meulbroek[490] finds that illegal trading based on inside information caused stock price run-ups of target firms before takeover announcements.

Nevertheless, insider trading is not completely illegal, some aspects of it are legal. Some members of companies, such as managers and employees, may trade in stock in their own firms on the condition that they report their trades to the relevant bodies of the stock market. This practice is permitted even though insider trading often accompanies illegal trading of stock. In

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[483] Benjamin M Friedman, 'The use and meaning of words in central banking' in Paul Mizen (ed), Central Banking, Monetary Theory and Practice (Edward Elgar 2002).
[484] Manne H, *Insider Trading and The Stock Market* (The Free Press 1996).
[485] L Beny, 'The political economy of insider trading legislation and enforcement (Harvard Law School OLIN Working Paper, 2001)
[486] A Bhide, 'The hidden costs of stock market liquidity' (1993) 34 JEF 31.
[487] D Carleton and D Fischel, 'The regulation of insider trading' (1983) 35 Stanford Law Review 857.
[488] George P Gilligan, *Regulating the Financial Service Sector* (Kluwer Law International 1999) 217.
[489] BAK Ryder and Michael Ashe, *Financial Services Law* (Butterworths 1999).
[490] L Meulbroek, 'An Empirical Analysis of Illegal Insider Trading' (1992 47 JF 1661.

fact, illegal insider trading is considered that which occurs when buying or selling a security in violation of a regulatory rule or a relationship of trust and confidence at the time of possessing sensitive private information about the security. According to the SSE, the concept also includes misappropriation of such information.[491]

Article 35 of the LR prohibits trading by company insiders ten days before the end of a quarter or the publication date of the quarterly report, whichever is shorter, and 20 days before the end of a financial year or the publication of the interim account. The CMA used these regulations to fine more than forty insiders at thirty-five companies for insider trading during the prohibited periods. The CMA referred some insiders for investigation about the release of material information.[492]

The absence of transparency allows insider trading to flourish. In response, the CMA enacted stricter regulations, including judiciary measures seven years ago. Under these regulations, the CMA investigated hundreds of cases of the market, and referred approximately 30 to court. Some parties involved were fined and even imprisoned.[493]

In April 2013, the CMA issued a statement that it had detected 'irregular trading activity' in the stock trading of three listed companies suspected of violating the agency's rules and regulations. The named firms were Tihama Advertising and Public Relations Company, Tourism Enterprise Company and Saudi Indian Company for Cooperative Insurance. In its statement, the CMA pledged to investigate these companies but as of July none had been held accountable.[494]

The strong financial position and continuous progress of a company's operations encourage investment. Based on misleading information, these companies' securities increased, and the major shareholder sold his shares a few days later without notifying the CMA Applying Article 50(a) of the CML and Article 30 of the LR, the authority suspended all trading in the market until further notice and started investigating the case.[495] The CMA press release did not mention the names of the insiders or the amount of loss caused to other investors.

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[491] Baamir (n 382) 74.
[492] ibid 75.
[493] Tadawu, 'The Saudi Stock Market: Structural Issues, Recent Performance and Outlook' (*Samba*, 13 December 2009) <www.samba.com/GblDocs/Saudi_Stock_Market_Eng.pdf> accessed 26 June 2013.
[494] Dudley (n 471) 18.
[495] ibid 74-75.

In addition to companies, the CMA punishes individuals. In at least nine cases in 2013, the CMA fined individuals a total of SR950,000 for dealing in securities without securing the proper authorisation. The fines ranged from SR50,000 to SR200,000. Many such enforcement actions are hidden from the public, conducted in private, negotiated settlements.[496] These settlements let companies and individuals escape the notoriety of committing a dishonest act in the finance industry, which requires a reputation for honesty and integrity.

6.6.3 'Name and Shame'

In the financial industry, reputation is given much weight because of the fiduciary trust due to one's financial partners and collaborators. Consequently, a financial practitioner or institution suffers from being found guilty and fined for violating CMA regulations. Tim Please, a lawyer at the Saudi-based Clifford Chance International Law Firm, calls this the 'name and shame' penalty, explaining that 'some sanctions are never put to a name'.[497] The practice is to publicly state that the offending company broke a different rule, such as accounting regulations or filing deadlines for financial statements, which does not appear as malicious as fraud charges.

In the Saudi stock market, 85% to 90% of the trades are done in the name of retail investors, or local individuals trading through brokers. Retail investors often lack information and professional advice and typically engage in trading driven by sentiments (i.e. fear and greed), not deep analysis. Markets dominated by these investors experience volatility and market swings which sometimes gives the impression of irregular or insider trading. Therefore, it is important that the SSE develop larger investor groups (such as mutual funds) or institutions to stabilise markets driven by professional analyses, not emotional trading. Opening up stock exchanges to international investors could have the same effect. The recent appointment of Mohammed al-Sheikh as chairman of the CMA's board of governors might also help reduce volatility. Al-Sheikh, a former lawyer in Washington, DC and executive director of the WB, has expressed receptiveness to the idea of opening the market to foreign buyers.[498]

[496] Dudley (n 471).
[497] ibid.
[498] ibid 18.

6.7 Regulatory Response to the Market Crash of February 2006

A major cause of the market collapse of February 2006 was rampant market manipulation. Major speculators used their large resources in a relatively thin market to take advantage of more inexperienced retail investors trading in speculative shares. The relative inexperience of market regulators also contributed to the crash as they failed to detect market manipulation practices early enough to prevent abusive market activity.

Since the crisis, confidence in the SSE has gradually recovered although the CMA warns that a largely retail market with irregular trading patterns is prone to high volatility (i.e. sudden swings in market prices). After the crisis, a new market structure was introduced with the purpose of increasing transparency in the Saudi market by opening it to deeper, broader participation by institutional and foreign investors.[499]

6.8 Saudi Compliance with the OECD Principles of Corporate Governance

The previous section identified the three major legal issues concerning disclosure and transparency. This section examines the extent to which Saudi Arabia has complied with the OECD Principles of Corporate Governance. It evaluates specific areas that should be addressed by corporate governance principles.

6.8.1 Investor Protection

The Kingdom has complied with principles relating to basic shareholder rights. The Securities Depository Center has secured registration of shareholders[500] and made company information easily accessible to all shareholders allowed to participate in GSMs in person or by proxy. These

[499] Paul Melly, 'Regulation Restores Confidence: The Introduction of New Roles to Improve Transparency on the Saudi Stock Exchange is Increasing its Attractiveness to Foreign and Domestic investors (Saudi Arabia)' (2008) 52 MEED 40.
[500] G Vinten, 'Corporate Governance: The Need to Know' (2000) 32(5) ICT 173.

members can suggest inclusion of items in the GSM agenda, call for a GSM and nominate, vote for and remove board members.[501]

An extraordinary general assembly (EGM) is required to carry out activities, such as changing the company's articles of association, authorising large transactions and increasing authorised capital. When new shares are issued, shareholders have pre-emptive rights. Special attention is paid to the disclosure of related party transactions when the LR dictate prompt disclosure to the CMA in case any transaction is carried out between the company and a connected person.[502] Any contract between the company and a director, CEO or chief financial officer should be reported to the board. Good corporate governance ensures that companies use their resources more efficiently in a way that protects minority shareholders, leads to better decision making and improves relations with workers, creditors and other stakeholders. It is an important condition for attracting the patient capital needed for sustained, long-term economic growth.[503]

Saudi Arabia's CGR does not reference related party transactions. This absence has raised concerns among many investors and brokers that industry insiders might abuse their positions and carry out improper activities, such as market manipulation, trading insider information and improperly trading with shares in investor accounts.[504] In response to these concerns, the CMA issued a Market Conduct Regulation provision in the CML to ensure that 'insider trading' was well defined and prohibited in order to avoid market manipulation.[505]

Other liability provisions protect investors, although the general rule is that directors are not liable for the actions of the company, which is considered a separate legal person. This protection of directors, called the corporate veil, has exceptions under civil law. Directors are trusted by the owners of a company (the shareholders) to make decisions in their interest. These include investment decisions that should increase shareholders' wealth.[506] For example, if a director pursues a business venture without consultation or researching it and the venture fails, he is personally liable for the loss. Directors who breach their duties can be held liable if the

[501] Al-Amari (n 152) 71.
[502] ibid.
[503] WB (85) 3. See also Nasdaq Educational Foundation, 'Market Mechanics: A Guide to US Stock Markets Release 12' (2012) <http://www.nasdaq.com/about/market_mechanics.pdf> accessed 9 May 2012.
[504] ibid 3.
[505] CML (n 5) Articles 2, 3 and 4. See also WB (n 85) 3.
[506] Saidi (n 327) 10.

company incurs losses. Therefore, directors need to always carefully consider their actions to ensure that they are in the best interests of the company. They must discharge their duties honestly, in good faith and in the best interests of shareholders.

The recent growth in equity markets has spurred the emergence of a new class of financial intermediaries in the Kingdom, including research analysts, fund managers and investment managers. Their regulation falls under the mandate of the Authorised Persons Regulation to fulfil the major principles of the IOSCO 'Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest, 2003'.[507] The CGR motivates finance managers to disclose their voting direction or policy in the GSMs of the companies in which they invest. This disclosure helps build a good business image of corporate governance.[508]

Such an image brings benefits to the market, including increasing funds and representation of foreign investors in the boards of the firms listed in Saudi Arabia. Representation of foreign investors in the boards can transfer ideas about global corporate management to Saudi firms.[509] However, the SSE is weak and not in line with the indicators of even emerging markets; for example, Morgan Stanley assessed the SSE as having little foreign ownership of companies, lacking certain tools and procedures and not applying best practices.[510]

CMA regulations govern takeovers. A shareholder who obtains more than 50% of company shares might be required by the CMA to make a tender offer for all outstanding shares. This measure serves as a protection mechanism, especially for minority shareholders.[511]

6.8.2 Disclosure

Companies in Saudi Arabia are expected to produce quarterly and semi-annual financial statements, which include balance sheets, profit and loss accounts, notes, audited annual reports

[507] OECD (n 42) 57.
[508] ibid 3.
[509] T Fadak and H Aloiei, 'Stressing that Joining the Index Attracted Global Investors, Large Fund and Portfolios' (*Aljajarh Newspaper*, 17 June 2013) Issue 14872.
[510] ibid.
[511] WB (n 85) 3.

and cash flow statements.[512] Annual reports should describe the issuer, its business, board information, officers and issuer's staff. In addition, annual reports should include a management statement that highlights the present and future developments that are expected to have significant impacts on the firm's financial position.[513] Various Saudi companies provide this and other information on their websites.[514]

It is important to note that compliance with non-financial disclosure requirements has been described as weak. Despite the low level of compliance, the LR appears fairly complete and requires significant disclosure. Although companies are expected to disclose some important information, such as corporate objectives, dividend principles and board composition, it is clear that disclosure remains haphazard, especially in areas dealing with nomination procedures, board member qualifications and ownership benefits.[515]

The corporate governance framework calls for the disclosure of the beneficiaries but only to the CMA, not the public. A shareholder who exceeds the 5% threshold must inform the company and CMA, which may decide whether to make that information public. An online initiative called Tadawal publishes ownership information of shareholders with both more or less than 5%. Although annual reports are expected to give information about significant shareholders, public disclosure of beneficial ownership has remained a major concern, making Tadawal a noteworthy initiative.[516]

Financial statements should be prepared in accordance with local accounting standards and the financial reporting requirement. The Ministry of Commerce and Industry requires that all companies keep Arabic language accounting books and records within the Kingdom. These documents include the general ledger, daily journal and inventory book.[517] The inventory book includes a detailed trial balance of all the assets, liabilities and performance for the financial year. It should be comparable with a detailed income statement and balance sheet.

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[512] CML (n 5) Article 45.
[513] WB (n 85) 4. See also LR (n 388) Articles 43, 44 and 45. See also CGR (n 8) Article 9. Also, the CMA Board issued Resolution, No 1-36-2008, dated 10 November 2008 making Article 9 of the CGR compulsory on all listed companies.
[514] Al-Nodel and Hussainey (n 84) 13.
[515] WB (n 85) 4.
[516] ibid.
[517] Latham & Watkins (n 94) 20.

Companies operating and registered in Saudi Arabia must comply with SCOPA accounting standards. International Financial Reporting Standards can be used as a guide in cases where the SOCPA principles do not apply. However, most companies are encouraged to apply the international standards as more than a guide in order to attract investors. During a lecture entitled 'Presentation and Disclosure in the Financial Statements of Companies' given in Mecca at an Industry and the Chamber of Commerce event, the engineer Adel emphasised the importance of applying international standards. Doing so enables investors to invest in countries other than their own. The difficulties of applying and implementing different accounting standards can prevent investors from entering into a market in other countries.[518]

The following are the main accounting and auditing regulations: International Financial Reporting Standards; SOCPA standards; company regulations; income tax regulations; and additional accounting standards issued by the SAMA for financial institutions.

These statements are then audited according to the National Standards of Auditing. The SOCPA standards do not in any way converge with the International Financial Reporting Standards.[519] Although compliance with national standards has been found to be quite high, there is a strong push to converge the two standards in order to improve financial reporting and assure investors.[520] The legal basis for implementing accounting and auditing standards are quite explicit, and SOCPA's authority is generally respected. However, the quarterly reviews of the audits are considered ineffective.[521] Some have called for real-time disclosures in both Arabic and English in order to resolve 'the irregularities and abuses among traders in a fair and firm way in front of everyone'.[522]

[518] E Hjebaljmah, *Presentation and Disclosure in Financial Statements* (2012) Issue 16041.
[519] AAM Al-Twaijry, JA Brierley and DR Gwilliam, 'An Examination of the Role of Audit Committees in the Saudi Arabian Corporate Sector' (2003) 10(4) Corporate Governance: An International Review 288.
[520] Tsamenyi & Uddin (n 373) 1.
[521] Vinten (n 500) 173.
[522] M Omran, 'Stressing that Joining the Index Attracted Global Investors, Large Fund and Portfolios' (*Aljajarh Newspaper*, 17 June 2013) Issue 14872.

6.8.3 Enforcement

The CMA has the mandate to examine and take enforcement action. For example, in 2006, 83 cases were forwarded to the CMA, some through shareholder's referral reports.[523] A good number of these cases involved market manipulation and disclosure delays. The administrative remedies and penalties at the CMA's disposal are daily suspension of trading activities, warnings, penalties and cease and detest orders.[524] The CMA must present cases warranting heavy fines or imprisonment to another body.

The CMA understands the need for better corporate governance and has adopted a three-phase approach to improve the implementation of corporate governance. In the first phase, the CMA published the CGR[525] and in the second, it educated market participants about how to apply regulations. In the third phase, the CGR will be revised, and all sections of regulation made mandatory. Corporate governance in Saudi Arabia is still a promising aspect because the CMA is working to educate market players on the importance of implementing and applying corporate governance.[526]

6.9 Development of Saudi Regulations

Saudi laws, especially those related to the concepts of disclosure, transparency and listing rules, need reforms. Ways to increase the application of these concepts need to be found. The CML and LR regulations dealing with disclosure seem identical to the recommendations of IOSCO and the Basel Committee and the standards of developed countries' markets, particularly the LSE and NYSE. Jurisdictions vary between countries.

Any reforms of disclosure rules and provisions of disclosure require a good understanding of the market structure and investors' thinking. In 2004, the SSE was extremely attractive.[527] Although owners directly managed most funds in the market, most investors did not have enough

[523] WB (n 85) 6.
[524] ibid 6.
[525] ibid 6.
[526] WB (n 85) 6.
[527] A Al-Ghadeer, 'Saudi banks have conflicts of funds in the shares of loss-making companies' (2006) Issue 13994.

experience to manage their investments. This environment encouraged major speculators to manipulate the market, spreading rumours and making false transactions. One suggestion to prevent such misbehaviour and strengthen transparency is to encourage investment institutions to participate in the market in order to support fair competition based on transparency and increased, sufficient publicly available information.

Usually, the available information about the SSE is thought to be true. In an attempt to strengthen transparency and disclosure in the capital market, the CMA takes disciplinary actions to punish firms that do not publish interim accounts on time or comply with the necessary standards.[528]

Investors and interested parties can look for information about the market, securities and related issues on the websites of companies, newspapers, the CMA and Ministry of Commerce. Specialised institutions authorised by the CMA evaluate new corporations to gain objective, trustworthy information and make it available to investors.

However, insufficient company disclosure was not the main reason for price manipulation in the SSE. Among the others, the most important is small investors' lack of experience. They do not know how to manage their funds or to get and use information, and need to be educated about the conditions of the financial market and how to achieve their goals. In order to educate this type of investor, the CMA has begun running specialised programmes and bulletins on television and in newspapers to warn small investors about the dangers of rumours in securities trading. The agency also tries to explain the correct way to get credible information and encourages using investment funds. Another method of education could be to offer courses through licensed institutions to enable small investors to manage their investments and do so under market mechanisms.[529]

Another cause of price manipulation was a gap in rules disclosure regarding notification about any person who owns 5% or more of any class of voting shares or convertible debt instrument

[528] Capital Market law, chapter (7**)** Disclosure.
[529] Saudi Stock Market Objectives: (1) Operate the market effectively and efficiently; (2) Ensure market integrity, quality, and fairness; (3) Support investor education and awareness efforts; (4) Develop service excellence for customers (brokers, issuers, investors, vendors, etc) and; (5) Develop the exchange's capabilities and competencies. <http://www.tadawul.com.sa> accessed 2 September 2014.

and about any increase or decrease by 1% or more in an issuer's ownership.[530] Such notification must be given by the end of the trading day. This raises the question: What if a speculator buys and sells shares within one trading day? To address this gap, the CMA needs to control and monitor the market more strongly. It has taken some steps to do so, including establishing the Securities Depository Center. This centre controls the most important activities, namely executing transactions, transferring, settling, clearing, and registering ownership of securities traded on the SSE. Through this centre, the CMA can track all transactions, ownership transfers, security trading details and other market activities and investigate whether they are legal. The CMA thus exercises its power to prevent the illegal dealings in the market.[531]

Suspicious deals and price manipulation can be detected by comparing the amount of securities traded on the individual level by investors. Some stock exchanges use technology to issue notifications and warnings about suspected trading deals and price movements in the market. Specialist staff examine these notifications when needed.[532] In addition, false transfer of ownership—when an investor sells and buys in different funds he owns and changes prices without an actual transfer of ownership—can be detected.

It has become clear that the SSE suffers from price instability and desperately needs a solution to control the risk of price manipulation. To that end, it is proposed that the percentage of shares which must be reported to the SSE as securities when the price fluctuates during trading is less than 5% of a total class of a firm's shares. To develop possible solutions to market manipulation, the CMA has made use of the experience of developed markets, especially the UK. Despite great efforts to control mass speculation, the CMA lacks experience of doing so, and relying on other countries' experiences saves time. Price manipulation could also be stopped through jurisdiction punishments against offenders with the aim of deterrence.

To some extent, the CMA regulations are too loose and not strong and strict enough, and allow industry insiders and market manipulators some protection to achieve their goals. Fines levied by the CMA go to the agency itself[533] even though it does not suffer any damage from violations.

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[530] LR (n 338) Article 45.
[531] CML (n 5) Article 49.
[532] Securities and Exchange Board of India <http://www.sebi.gov.in/commreport/marketintegrity.html> accessed 15 September 2013. Market Integrity Disclosure, Homage of Securities Exchange Board of India.
[533] CML (n 5) Article 13(a).

Logically, the harmed investors should receive these fines as compensation for their losses and appropriate punishment of manipulators. Islam considers abusive behaviour in the market to be prejudicial and prohibits insider dealing as cheating and a criminal offence.[534]

Under the CML, major shareholders and insiders should notify the CMA about their investments, including its term, purposes of ownership, the financial source of the transaction and any changes in purpose. The law forbids insiders and major shareholders from disposing of their shares within ten days of the date of notification. As a proposal to increase the safety of safe market transactions, this period should be lengthened and these shareholders should be required to gain approval to dispose of their shares.[535]

Islamic law is flexible and can suit any place at any time. It addresses personal, social and economic issues. Almost all laws and regulations in Saudi Arabia are derived from its general guidelines and principles. The CML adopted the Islamic view of market transactions, prohibiting abuse as it harms other dealers in the market. However, the relevant bodies must revise the existing rules and laws to cope with new developments in the fields of finance and trade.

6.10 Other Issues in Saudi Arabia's Business and Legal System

6.10.1 Duplication in the Company Law and the Corporate Governance Regulations

While the CL and CGR are crucial measures in the governance framework, they overlap in certain areas, thus creating a certain amount of ambiguity in the interpretation of corporate requirements and standards. The CL is implemented by the Ministry of Commerce and Industry, and the CGR by the CMA. The CL oversees the establishment and regulation of all forms of companies allowed by law, including joint liability, limited partnerships, limited liability, professional and JSCs.[536] The CGR is enforceable against Saudi listed companies that are traded on the SSE. The overlap occurs among listed companies regulated by both the CMA and the

[534] Islamic law does not stipulate any punishment for some prohibitions, either because discretion is permitted or they do not satisfy the conditions of a clear offence; among these is price manipulation.
[535] The fashion of listing family companies in Saudi Arabia raises questions regarding their real value, profits and continuity.
[536] CL (n 7) Article 2-5, 10.

Commerce Ministry, creating a dual system of corporate governance for both the listed companies and the SSE. Compounding the dilemma is that the corporate governance provisions in the CL are not integrated under a single title but are scattered throughout the law. Consequently, the CMA and CL corporate governance provisions lack coherence and are not integrated or sufficient.

The CGR requires more stringent disclosure and transparency in corporate board annual reports than the CL.[537] The CGR demands greater details about the board nomination, remuneration and audit sub-committees. The CL and CGR also give their own definitions of shareholders' rights, including the rights to vote, attend GSMs, receive dividends and bring legal action against a board member.

Both laws also give their own descriptions of board activities, such as the conduct of board meetings, remunerations of board members and conflicts of interest among board members. In the CGR, Articles 3, 5–7, 12 and 16–18 are similar to the CL Articles 66, 69–71, 73–80, 82–84, 87, 88, 93–95, 107 and 108. An example of the similarities in the laws' provisions occurs regarding conflicts of interest (CGR Article 18-B and CL Article 69).[538] Where such Articles consistently agree, there is little controversy, but conflicting codes invite controversy. Where these two laws do not comply with another, there is the need to harmonise them and formulate a single code applying to all corporations whilst marking listed companies as having special disclosure obligations.

[537] CGR (n 8) Articles 8-15.
[538] Faleh Al Kahtani, 'Current Practices of Saudi corporate governance: A case for reform' (PhD thesis, Brunel University 2013) 93.

6.10.2 Segregation of Duties within Board Members' Powers

The distribution of powers among board members is proven to improve corporate governance, mostly due to increased disclosure and transparency to market participants. This distribution further eases and makes more efficient the board's supervisory role. The separation of the roles of chairman and chief executive, formerly unified in one individual, is also considered good corporate governance practice as it reduces the likelihood of conflicts of interest.[539]

The CL does not specifically prohibit a single individual from serving as both board chairman and CEO,[540] and many corporations still follow this model. However, the CGR has taken a step towards segregating these duties by prohibiting one individual from holding the positions of chairman along with other top positions in the corporation, such as CEO, managing director and general manager.[541] Therefore, the CGR has taken a positive step towards the adoption of international standards, increasing accountability and allaying suspicion of the board's involvement in corruption, malpractice and conflicts of interest.[542]

6.10.3 Lack of Competent Professionals in the Capital Market

The CL assumes that capital institutions employ qualified professional in the various fields. However, businesses do not always do so. Some take advantage of their autonomy to employ cheap labour with little experience. These employees then have to undergo rigorous training before they can perform their tasks. The securities commissions are expected to ensure that only qualified candidates are selected for jobs.[543]

The growth of financial institutions in Saudi Arabia has created a need for professionals that are familiar with both Islamic principles and financial products. There is a scarcity of trained professionals in the capital market who have a good understanding of Islamic and conventional finance, which some believe might hinder economic growth in Saudi Arabia. Attempts to solve

[539] Demirag and Solomon (n 148) 11; Alvaro Cuervo, 'Corporate Governance Mechanisms: A Plea for Less Code of Good Governance and More Market Control' (2002) 10 CG 84.
[540] CL (n 7) 1965.
[541] CGR (n 8) Article 12(d).
[542] Demirag and Solomon (n 148) 82.
[543] T Bos and TA Fetherston, 'Capital Structure Practices on the Pacific Rim' (2003) 10(3) RIBF 53.

this problem have fuelled the need to create educational institutions and courses that equip students with the necessary skills.

The reduction in qualified professionals in many capital market institutions has been attributed, in part, to difficulties attracting and retaining competent employees.[544] Companies often employ cheap labour to minimise costs but overwork their employees, resulting in low productivity. For example, existing employees bear an extra work burden during the training of new employees, which can decrease productivity.

To solve this problem, capital markets must hire competent individuals who possess the requisite skills, are masters in their specialty and need little training.[545] Doing otherwise, as the capital market is doing now, can be considered under-utilisation of human labour, which poses serious problems. It is important to note that, when human capital is not used properly, the desired outcomes may not be attained.[546] In such instances, companies experience significant losses and reduced effectiveness, output and customer satisfaction.

6.10.4 Implementation of Restrictions, Rules and Punishment

The CML provides general rules covering a wide range of areas, including the stock exchange. The sanctions and penalties for violations of laws do not seem to apply to price manipulation in the stock market,[547] which is a major form of market abuse. Larger traders and investors have been noted to frequently change market prices for their own advantage. Market manipulation is perhaps the easiest way for the powerful to generate wealth with minimal risk. Larger traders are well informed and, in most cases, have a say in company politics.

To reform the laws controlling the capital market and its related issues, it is necessary for the relevant bodies and authorities in Saudi Arabia to cooperate to construct rules and laws to

[544] M Trash, 'Capital Market Institutions Lack Professionals' (*Jordan Times*) <http://jordantimes.com/capital-market-institutions-lack-professionals> accessed 15 June 2014.
[545] Uma SN, 'A study on Training Importance for employees of their Successful Performances in Organization' (2013) 2(11) IJSR 173.
[546] TM Khalid, 'Financial Audit: Comparative Study about the Responsibility of An External Auditor in the Kingdom of Saudi Arabia and the United Kingdom' (Proceedings of the Second Accounting Conference on Accounting Development, King Saud University, Riyadh, 1983).
[547] Baamir (n 382) 76.

improve the investment environment. The SSE, CMA and Ministry of Justice, along with other relevant influential departments, must attempt to create as good a market system as possible. For example, the Ministry of Justice needs to reform the law to cover violations such as market abuse and manipulation of the stock market.[548]

Sanctions and punishments could include freezing assets and other judicial actions performed in cooperation with the Ministry of Justice and SAMA as the banking regulator. The first priority of reform should be to protect small investors. Next are foreign institutional investors and crafting appropriate rules for their activities once they may enter the SSE. All these efforts are necessary to fully reform the Kingdom's financial system.[549]

Major players' power to influence stock prices hurts the public while accumulating wealth for those in power. Small traders lack the knowledge and experience to take advantage of the market so only knowledgeable traders reap maximum benefits.[550] The lack of market markers has also encouraged this practice. In Saudi Arabia, market manipulation is an offence but market abuse is not regarded as a criminal offence. The CML addresses this issue, and in the wake of the February 2006 market crash,[551] the CMA has developed to protect investors. However, investment activity remains low. Policy measures and regulations effected after the crash to govern the stock market prices, particularly the CML, are insufficient simply because market abuse is not regarded as a criminal offence in Saudi Arabia.[552]

6.10.5 Lack of Disclosure of Company Information

The CL governs disclosure and emphasises the significance of auditing and accounting reports which follow SOCPA and local accounting and auditing standards.[553] Listed companies must present annual and quarterly reports with financial statements and establish audit committees. The absence of a securities regulator has made monitoring the implementation of reporting and

[548] Baamir (n 382) 81.
[549] ibid 81.
[550] ibid 78-79.
[551] ibid 80.
[552] ibid 80. See also, Mohammed Alsubaie, 'Corporate Crimes committed during the phase of incorporation of companies in Saudi Arabia: legal analysis.' (PhD thesis, Unversity of Wollongong, 2012) 144.
[553] WB (n 85) 30.

disclosure standards more difficult.[554] Regulators monitor issues related to disclosure. A study found that most Saudi firms, especially those not performing well, observe the obligatory reporting requirements but rarely disclose information voluntarily.[555] Reforms to monitor compliance with auditing standards are needed.

The presence of several authorities in the Saudi capital market allows for regulatory loopholes. Saudi Arabia, along with other nations such as Japan, has yet to harmonise its accounting standards with international accounting standards. The establishment of a Saudi Securities and Exchange Commission could play the role of monitoring and overseeing the state of disclosure in Saudi Arabia. However, there is no agreement on the model of corporate governance to be established. Current policies do not encourage companies to voluntarily disclose company information. Companies disclose information only to observe the rules.[556]

6.10.6 Government Involvement in Business Ownership and Management

Government-linked companies have a commercial objective which is controlled by the Saudi government. The government then has a direct controlling stake and the power to make important decisions and appointments, including board members and senior management members.[557] Government ownership does not necessarily translate into greater transparency. Some government-owned companies fail to comply with all the transparency and disclosure regulations.[558]

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[554] N Malhotra and D Birks, *Marketing Research: An Applied Approach* (Pearson Education 2006).
[555] Yaseen Al-Janudi, Rashidah Abu Rahman and Normah Haji Omar, 'The level of voluntary disclosure practices among public listed companies in Saudi Arabia and United Arab Emirates: using a modified voluntary disclosure index' (2012) 9 International Journal of Disclosure and Governance 181.
[556] Saidi (n 327) 82-83.
[557] G Arnold, *Essentials of Corporate Financial Management* (Prentice Hall 2007).
[558] The Daily Herald, 'Govt-owned companies largely ignore integrity, transparency' (2014). <https://thedailyherald.com/index.php?option=com_content&view=article&id=50520:govt-owned-companies-largely-ignore-integrity-transparency-&catid=1:islands-news&Itemid=54,accessed> accessed 28 September 2014.

6.11 Banking and Financial Services as Critical Sectors

Financial institutions and the banking sector play highly pivotal roles in the adoption and establishment of corporate governance principles in the Middle East and North Africa.[559] They, not capital markets, provide the primary means of business financing. Banks must improve their own disclosure and transparency policies and adhere to the twelve international standards for financial stability:[560]

(1) Code of Good Practices on Transparency in Monetary and Financial Policies (IMF)

(2) Special Data Dissemination Standard/General Data Dissemination System (IMF)

(3) Principles of Corporate Governance (OECD)

(4) International Standards on Auditing (IFAC)

(5) International Accounting Standards (IASB)

(6) The Forty Recommendations of the Financial Action Task Force (FATF) and Nine Special Recommendations on Financing Terrorism (FATF)

(7) Core Principles for Systemically Important Payment Systems (CPSS) and Recommendations for Securities Settlement Systems (CPSS-IOSCO)

(8) Code of Good Practices in Fiscal Transparency (IMF)

(9) Objectives and Principles of Securities Regulation (IOSCO)

(10) Insurance Core Principles (IAIS)

(11) Principles and Guidelines for Effective Insolvency and Creditor Rights Systems (World Bank)

(12) Core Principles for Effective Banking Supervision (BCBS)

[559] MENA- OECD Investment programme, 'Advancing the Corporate Governance Agenda in the Middle East and North Africa: a survey of recent developments'. <www.bis.org/publ/bcbs41.htm> accessed 28 September 2014.
[560] OECD (n 87) 9.

Many countries apply international accounting standards, and this aids potential investors from other countries. These standards have been harmonised among many countries, which has eliminated the obstacle of different rules and standards to foreign and even domestic investments. The lack of such standards hinders investors and economic growth, but with the implementation of an international standard countries such as Saudi Arabia reduced the difficulty of its national standards, attracted investors and supported general economic growth. However, this is only being adopted in the bank and insurance sectors.[561]

Saudi Arabia's efforts to adopt the international standards spurred a number of neighbouring countries to do so as well in order to increase economic investment in their countries and diversify their economic activities and resources. These steps will contribute to an improved economy and long-term development. This patent illustrates that disclosure of financial statements is vital for both investors and the players in a financial institution in order to identify appropriate strategies for whatever business situations arise for the investor. Disclosure and transparency gives clients access to information that reveals the true status of each financial company. The science of accounting has become an urgent necessity for JSCs where several people make decisions, unlike older firms managed directly by the owner.[562]

Capital markets should receive high priority in reform in order to nurture economic growth and national development.[563] The CMA helps govern activities that do so, especially in foreign exchanges. These activities increase trade between countries, which in the long run improves the country's economy.[564] Financial institutions are the key players in this field and, therefore, should implement and develop sound corporate governance to offer better, more responsive services.

[561] International Monetary Fund, 'Saudi Arabia: Report on the observance of standards and codes' (IMF, 18 April 2012) 6.
[562] Hjebaljmah (n 518).
[563] W Maria, 'Commercial-in-Confidence: An Obituary to Transparency?' (2001) 60(4) AJPA 92.
[564] Dimsdale N and Prevezer M, *Capital Markets and Corporate Governance* (Clarendon Press 2004).

6.12 Enforcing Disclosure: Role of Authority

The CMA is an independent body established to deal with corporate governance.[565] It is responsible for drafting and enforcing rules and guidelines that achieve sound corporate governance and for enforcing disclosure by organisations. Put briefly, corporate governance was established to guide and manage all business internal and external to companies.[566] This effort established a precise system which defines the responsibilities and duties of companies' board of directors and executive management while protecting the rights of shareholders and stakeholders of all sizes. In the CMA's 2008 annual report, the agency states its plans to create an independent department to monitor listed companies' compliance with corporate governance regulations.[567] According to the CMA's 2009 annual report, six companies failed that year to release their board of directors' reports for the preceding year in accordance with the CGR requirements compared to 11 companies in 2008.

As mentioned earlier, the CMA reserves the right to compel any organisation or company to make the required disclosures.[568] The CMA also governs the stock exchange and share prices of listed companies. The SSE works closely with the CMA to monitor the financial activities of most major companies in Saudi Arabia. The agencies aim to increase the credibility of the SSE and listed companies by enforcing clear, transparent regulations for organisations.[569]

The CMA also collaborates with the SAMA in raising awareness of the importance of corporate governance among companies, shareholders and stakeholders, and encouraging the development of director training programmes to build a cadre of qualified directors. The enhancement of corporate governance practices remains instrumental to better protect investors, improve company oversight and increase confidence in capital markets. These authorities play a major role in the implementation of reforms and in overseeing the adoption of corporate governance, which ultimately attracts more investors, spurs development and grows the economy.[570]

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[565] CML (n 5).
[566] Al-Twaijry, Brierley and Gwilliam (n 519) 288. See also CGR (n 8).
[567] Islamic Financial Service Board, 'Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services (Excluding Islamic Insurance and Islamic Mutual Funds)' (IFS, December 2007).
[568] CML (n 5).
[569] Vinten (n 500) 173-178.
[570] WB (n 85) 9.

6.13 Amending and Reforming Commercial Regulations

Commercial regulations deal mainly with restrictions and laws at a regional level. For example, under the 1962 Commercial Agency Regulations, investors who are not Saudi nationals are not permitted to act in any way as commercial agents in Saudi Arabia. Moreover, all commercial agents must be registered with the Ministry of Commerce. In 1981, the Ministry adopted implementation rules stipulating that Saudi distributors were responsible for registering the foreign investors they represented.

It is recommended that an independent body governs the establishment and implementation of laws and regulations on corporate governance principles. Such bodies include the CMA and the IMF. These draft, adopt and amend disclosure and transparency and corporate governance rules and regulations for financial sectors and other organisations.

Saudi Arabia has no single, available, complete code of corporate governance, even though the CMA has issued a code which companies are recommended to follow. However, enforcement of this code not strict.[571] It has been proven that regions and countries which implement quality corporate and public governance principles obtain improved market activities and development. This benefit is mainly associated with economic policy reforms, particularly in privatisation, trade, and investment policies. This has reduced the cost of doing business, increased economic efficiency and eliminated barriers and obstacles to diversified export growth and foreign direct investment.[572]

[571] In its annual report dated 2008, the CMA stated that it would create an independent department to monitor compliance of listed companies with the corporate governance regulations. According to the CMA annual report of 2009, 6 companies failed to comply in 2009 with disclosure in their board of directors' reports for the preceding year, in accordance with the requirements of the "Corporate Governance Regulations", as compared with 11 companies in 2008. See <http://www.tamimi.com/en/magazine/law-update/section-7/april-6/corporate-governance.html#sthash.2LIkZE1P.dpuf> accessed 12 September 2012.

[572] D Bence, K Hapeshi, and R Hussey, 'Examining Investment Information Sources for Sophisticated Investors' (1995) 26(1) ABR 1.

6.14 Guidance from Foreign Experience and International Organisations

Foreign experiences and assistance from international organisations that have adopted a corporate governance system are very helpful in resolving any doubts a company might have before implementing disclosure and transparency. These examples demonstrate the benefits of corporate governance, such as more investors and higher quality standards and development in the long run.

Countries with substantial experience in corporate governance can provide support to stakeholders in a developing market, such as the SSE and players in banking and financial institutions. This assistance reinforces organisational ethics of disclosure, accountability, responsibility and transparency. These countries could help Saudi Arabia draft disclosure laws and form agencies to monitor the implementation of reforms.[573]

Studying previous examples of countries which have implemented corporate disclosures rules can help in the enforcement of workable regulations in developing countries.[574] Saudi Arabia could borrow ideas from developed countries, such as the United States, to examine the differences in investor capacity and development between companies and organisations with and without sound corporate governance. In this context, the challenge is to transform international standards and regulations into national and regional regulations. This effort requires complete commitment from both the responsible authorities and the region attempting to assimilate corporate governance principles. Successful incorporation of these standards into a regional institutional and legal framework while modernising and reforming the latter to create the infrastructure for effective corporate governance requires keeping in mind the specific reason for implementation, including objectivity, commitment, and transparency.[575] Doing so makes it easier to implement a national corporate governance system that bears fruits.

[573] Saidi (n 327) 13.
[574] ibid.
[575] P Wong, 'Challenges and Successes Implementing International Standards: Achieving Convergence to IFRSs and ISAs' (IFAC, 2004) 4.

6.15 Transparent and Accountable Regulators and State Officials

Regulators are the authorities responsible for enforcing the restrictions and rules that govern the adoption of corporate governance principles. State officials should be transparent and accountable, setting examples for the stakeholders that are expected to adopt the corporate governance system. Such officials will also set an example of transparency for government-owned companies, some of which, as mentioned, fail to comply with all disclosure regulations.

In cases where the personnel spreading the concept of corporate governance are not accountable and responsible themselves, it will be a difficult task for others to adopt the same concept. However, adoption is easier when the regulators and state officials themselves have developed sound corporate governance.

Corporate governance entails full disclosure of information that is relevant to clients and investors. Therefore, while enforcing corporate governance regulators need to be forthright and transparent about what kind of information the organisation should disclose and to what extent. Disclosure and transparency entail a flow of timely, verifiable, reliable, economically accountable and political information about policies and outcomes involved in certain decisions and events. This information helps clients and investors to make decisions based on expectations in the information provided. This disclosure system entails a public policy framework to identify information important and relevant in the market and political processes, and to ensure that quality information is accessible to the entire public instead of a privileged few.[576]

A vital characteristic of transparency and disclosure is the importance of information as a public good. Therefore, information should be a matter of concern for the public and government officials. These officials should set public disclosure standards and regulations and ensure that companies—whether private or public—apply the recommended international accounting standards and accordingly disclose information and reports.[577] Better quality information available in the market increases resource utilisation and the economic efficiency of workers, consumers and producers.

[576] Saidi (n 327) 66-67.
[577] ibid.

Transparency and information disclosure is essential in financial fields to ensure that capital and financial resources are allocated where they are useful and most productive. The availability and dissemination of quality, timely information about companies depends on accounting practices and standards, as well as on good corporate governance. In systems with poor corporate governance, capital might be mismanaged and financial resources may not be put to their best uses.[578]

The Implementation and Regulatory Committee has two major roles in establishing corporate governance in Saudi Arabia. Its first function is to help prepare all necessary documents and information. Its second function is to work closely with the media and ensure that these documents and information reach the responsible stakeholders and audiences, thus raising awareness of corporate governance.[579] The Committee plans and runs forums and training in corporate governance principles. These duties of state officials and the regulatory body need deep transparency and accountability.

A corporate governance action plan and corporate sector reform programmes require complete information and detailed assessments in order to prioritise actions and formulate remedial government policies for dealing with hindrances and obstacles in the process. The development of the action plan involves full accountability and responsibility; thus, the regulatory body and state officials involved should uphold high standards of corporate governance and general information sharing/disclosure.[580]

A combination of these solutions is the ideal means to achieve a sound system of corporate governance.[581] To encourage transparency in the Saudi capital market and develop corporate governance standards, the CMA, in decision No 1-20-2008, dated 19 May 2008, certified a modification to Clause (a) of Article 18 of the CGR: 'A Board member shall not, without prior authorisation from the General Assembly, which must be renewed each year, have any interest (whether directly or indirectly) in the company's business and contracts. The activities to be performed through general bidding shall constitute an exception where a Board member is the

[578] Saidi (n 327).
[579] Cordella T and Yeyati EL, 'Public Disclosure and Bank Failures' (1998) 45(1) IMF Staff Papers 110.
[580] Chaganti R and Damanpour F, 'Institutional Ownership, Capital Structure, and Firm Performance' (1999) 12(7) Strategic Management Journal 479.
[581] Fairbanks, Plowman and Rawlins (n 81) 22-37.

best bidder'.[582] These steps will help to protect the rights, investments and reserves of the company, investors and shareholders.[583] Nevertheless, this improvement is only a small step, and a complete overhaul of the system is needed to develop the corporate sector and make sure there is sufficient corporate governance in Saudi Arabia.[584]

6.16 Summary

This chapter has dealt with the issues that involve corporate transparency in the Saudi capital market. Topics discussed included the Saudi approach to disclosure and transparency, CML disclosure provisions and regulations addressing market abuses, such as price manipulation, irregular trading and name and shame. The regulatory response to the market crash of February 2006 has been described, followed by the degree and manner of the country's compliance with the OECD Principles of Corporate Governance. This compliance includes investor protection, disclosure and enforcement. Shortcomings in the legal framework, such as a lack of separate regulation, scarcity of competent staff in the capital market and cultural and environmental factors, have been explained. Finally, the chapter describes the types of reform and necessary conditions for the effective implementation of the principles of corporate governance, particularly the tenets of disclosure and transparency. A discussion has also been provided on the manner that it is necessary to act should poor corporate governance occur, namely, the failures of disclosure, insider trading and the processes involved in addressing the anomalies that ensue. Naming and shaming is considered an ideal option in the Islamic world as religion is intrinsic to people's daily lives – going against the moral codes of corporate governance can be equated to going against religion and thus hurting people's confidence in the system.

Transparency and the disclosure of information are determinants of development and economic growth and, without them, economic progress cannot be sustained. The robustness of activity in

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[582] G20, 'Globalization: The Role of Institution Building in the Financial Sector—Report to Ministers and Central Bank Governors' (2002) <http://www.g7.utoronto.ca/g20/20031026_fr_mex.pdf> accessed 9 May 2012.
[583] Hermalin B and Weisbach M, 'Boards of Directors as an Endogenously Determined Institution: A survey of the Economic Literature' (2003) 3(1) FRBNY EPR 7.
[584] Fadi Dahar, 'Corporate Governance' (2011) <http://www.tamimi.com/en/magazine/law-update/section-7/april-6/corporate-governance.html#sthash.2LIkZE1P.dpu> accessed 26 September 2014. There have been various developments recently in Saudi Arabia towards increasing the effectiveness of the Corporate Governance framework.

a market economy depends to a great extent on complete, timely and accurate information which determines resource allocation, improves the efficiency of market activity and increases production, which drives the economy. The preceding chapters, particularly the discussion of scandals and disclosure, demonstrated that SSE listed companies still fall short of the standard of transparency desirable for an efficient market. In part, this is because Saudi Arabia is an emerging economy and Saudi corporate culture is still assimilating the corporate governance culture. The behaviours of individuals involved, such as board members, executives and investors, are conditioned by the customary Saudi social relations and have yet to be adjusted to the constraints of abiding by international standards which are different to accustomed behaviour. The Saudi approach to disclosure and transparency has also been examined, particularly the board annual report.

Chapter Seven

Conclusion and recommendations

The chapter proceeds to discuss recommendations on transparency and disclosure traditions that are primarily aimed at developing Saudi Arabia's stock market. This thesis categorises the recommendations into three classes: structural, procedural and substantive. Recommendations under the structural issues transverse issues and parts of the government that regulate CMA, and especially in transparency and disclosure needs that target a wide variety of sectors including the financial services sector. The substantive issues entail the contents and compliance documents; and finally the procedural issues involve governance code and regulatory bodies tasked with the oversight roles. The chapter then discusses the need for future research areas in corporate governance in Saudi Arabia. The chapter concludes with the contributions to knowledge, which it provides in six areas.

7.1 Conclusion

The most important rationale for this study was to offer a way to reform the Saudi corporate governance disclosure framework from a legal perspective. The research set out to present a common understanding of how existing corporate governance disclosure implementations are perceived by business practitioners, as well as to examine the adequacy of the current corporate governance disclosure framework.

The thesis is composed of seven chapters. The first chapter identified the research problem and its framework. It confirmed the vital role of disclosure and transparency in enhancing corporate governance in Saudi Arabia. Corporate governance is perceived as essential for leadership and participation in worldwide trade and investments, and disclosure and transparency appears to be key to corporate governance. The principal concern of multinationals and international businesses and investors is the elimination, or at least the minimisation, of risk and exposure to

loss. The assurances provided by full information shared through transparency and disclosure is vital in risk reduction.

This chapter employs critical and comparative analysis, focusing on Saudi Arabia's attempts to enhance corporate governance as viewed against international standards and practices. It also highlights the general background, significance, methodology, aims, questions, scope and limitations of the research. The chapter ends with a brief description of the thesis structure in order to provide an understanding of how it reaches logical conclusions that address the research problem and questions.

Chapter two is grounded in real states and practices. The subsequent fact-based analyses are also grounded in the practices and rules of corporate governance explained in this chapter. The definitions, ideas and their importance explained here intend to prepare the platform for a dialogue of the Saudi situation. The scope, implications, beneficiaries and models of corporate governance are presented, along with the range of theories that affected the improvement of schools of thought on corporate governance (shareholder, stakeholder and agency theory). Finally, a brief description of the development of corporate governance in foremost jurisdictions (the UK-US, Germany and OECD) is introduced to boost the basis for comparison and contrast with Saudi Arabia.

In this chapter, the descriptions, theories and models of corporate governance are presented and considered. Further to these three, international principles that are of varying importance are also discussed briefly in an attempt to derive appropriate information from them. Definitions common in the social sciences and law have comparatively different semantic interpretations, and the one at hand is not so different. Agency, shareholder and stakeholder theories have been examined in connection with the latest theories developed in corporate governance literature in the academic world. Essentially, these are Western achieved theories but they have been found to be relevant in different parts of the world. Nevertheless, it is apparent that both theories mirror differently the performance of a company, and so they embody different perspectives. However, the chapter is much more focused on the shareholder theory rather than the agency theory.

The third chapter describe the twin concepts of disclosure and transparency and clarifies how they have located a global benchmark of corporate governance. Their significance, advantages

and the principles by which they function are analysed from a theoretical perspective. Scandals and disclosures in real-world global and regional events are investigated in relation to understanding how a lack of transparency and disclosure can undermine corporate governance efforts. Information gained from this study of global disclosure and transparencies are adapted in the next section to the realities in the Saudi capital market.

In this chapter, the practices associated with these concepts in Saudi Arabia are also identified. Examples are given which recommend the extent of the application of these conceptions by listed companies and the importance of disclosure and transparency in contributing accurate information and generating a good investment environment. Moreover, disclosure and transparency requirements are described and a range of these requirements which listed companies have infringed and the fines imposed by the CMA Board are mentioned. This follows the naming and shaming approach for punishing violators.[585]

Disclosure and transparency are both valuable to a company. In this context, disclosure takes the form of accurate, timely reports to managers and employees. Managers, in particular, need information to support decision-making, especially during contingencies which require prompt, proper and decisive action. An empowered managerial structure enables the firm to build leadership traits down the chain of command, developing a group of future high-level managers and increasing the productivity, growth and profitability of operations.[586]

Disclosure to employees is imperative in matters pertinent to the conduct of their jobs and personal circumstances. Employee engagement is a vital, useful tool in employee retention and job satisfaction and can be secured only in an atmosphere of trust and open communication between firm and employee.[587] It is important that a firm not only improve communication with its workforce but also that it be perceived as doing so in good faith, with concern for employee welfare.

Chapter four has evaluated the Saudi legal structure for the capital market and has explored the historical background of the country and the Basic Governance Law. The present practices of and improvements to the Saudi corporate governance framework and regulations have been

[585] *Al-Riyadh Newspaper* (26 February 2010) Issue 15222.
[586] Wilcox (n 74).
[587] Centre for Protection of National Infrastructure (n 75).

analysed. Moreover, the application of the Sharia theory of accountability in the Saudi business environment has been identified. This lengthy chapter gives a comprehensive analysis of the current practices and the improvement of the corporate governance framework in Saudi Arabia. Background knowledge of Saudi Arabia's legal constitution and its development over the years is extremely important in understanding the development of corporate governance to the present. The basics of Saudi Arabia's legal structure are rooted in Islam, and the doctrines of the religion fuels corporate governance. However, there are codified statutory laws, and four sets of laws laid out by the monarch have been helpful in the creation and development of the corporate governance in the country. The Basic Law of Governance, Regional Law, Council of Ministers law and the Consultative Law are the four statutory laws that were codified in 1992. In addition, the country's CMA ratified several changes and instituted a set of corporate governance regulations which was to grow in tandem with international standards. This chapter has described the institutional infrastructure that supports the corporate governance framework in Saudi Arabia. The government agencies and institutions charged with the oversight and regulation of corporate activities to ensure compliance with corporate governance principles have been identified: the CMA, with its General Department of Corporate Governance; the CRSD, under which are the Securities Disputes Committee and the Securities Conflict Appeal Committee; the SSE; the Ministry of Commerce and Industry; and accounting and auditing professions regulated by the SOCPA. Finally, the Saudi ownership structure has been highlighted.

Furthermore, the chapter introduces the CMA; its core functions in lieu of corporate governance, and its functions and other roles within the public sector. The chapter engages in an in-depth discussion and exploration of institutional corporate governance structures of both public and private institutions. Within the body of the chapter, the stock exchange becomes an important item of discussion with respect to corporate governance as well as an avenue for retribution in cases of malpractice and issues that go against good and ethical corporate governance. Finally, the chapter provides a raft of comparisons on corporate governance practices in other parts of the world in relation to present corporate practice in Saudi Arabia.

Chapter five has examined the status of minority shareholders and their rights and duties in general and under the CL. The basis of problems and current remedies for protection of minority shareholders is identified in detail. Abuse of power by major shareholders to block minority

shareholder's interests in the firm is also considered. The role of corporate governance in providing remedies is discussed. Saudi ownership, given its major stake in the Saudi business platform, is also discussed.

This chapter also considered the role of shareholders and stakeholders in corporate governance provisions and presented the CGR. The chapter explained the structure of the board of directors and its principal fiduciary duties: the duty of care, duty of loyalty and duty to act within the board's powers. Board members' roles, responsibilities and powers and the determination of their compensation—a sensitive topic in corporate governance in the wake of the 2008 global financial crisis—have been discussed.

Chapter six dealt with the concerns involving corporate transparency in the Saudi capital market. Themes discussed consisted of the Saudi approach to disclosure and transparency, CML disclosure provisions and regulations concentrating on market abuses, such as price manipulation, irregular trading and name and shame. The regulatory response immediately to the market collapse of February 2006 is described, followed by the degree and manner of the country's compliance with the OECD Principles of Corporate Governance. This agreement includes investor protection, disclosure and enforcement. Shortcomings in the legal framework, such as a lack of separate regulation, scarcity of competent staff in the capital market and cultural and environmental factors, are explained. The chapter also described the sorts of reforms and essential conditions needed for the effective implementation of the principles of corporate governance, mostly the tenets of disclosure and transparency. A discussion has also been provided on the manner that it is necessary to act should poor corporate governance occur, namely, the failures of disclosure, insider trading and the processes involved in addressing the anomalies that ensue. Naming and shaming is considered an ideal option in the Islamic world as religion is intrinsic to people's daily lives – going against the moral codes of corporate governance can be equated to going against religion and thus hurting people's confidence in the system.

Transparency and the disclosure of information are determinants of development and economic growth and, without them, economic progress cannot be sustained. The robustness of activity in a market economy depends to a great extent on complete, timely and accurate information which determines resource allocation, improves the efficiency of market activity and increases

production, which drives the economy. The preceding chapters, particularly the discussion of scandals and disclosure, demonstrated that SSE listed companies still fall short of the standard of transparency desirable for an efficient market. In part, this is because Saudi Arabia is an emerging economy and Saudi corporate culture is still assimilating the corporate governance culture. The behaviours of individuals involved, such as board members, executives and investors, are conditioned by the customary Saudi social relations and have yet to be adjusted to the constraints of abiding by international standards which are different to accustomed behaviour. The Saudi approach to disclosure and transparency is also examined, particularly the board annual report.

7.2 General Findings

This section will use the findings from the thesis to answer the research questions mentioned in the first chapter.

(1) What is corporate governance as conceived in the West and as understood under Sharia principles?

In the developed markets of the West, corporate governance is seen as a pragmatic tool for reducing risks in investing and business. Its practices and principles are directed at ensuring fairness in an environment where those in power are tempted to maximise results in favour of their own interests but to the detriment of others. Corporate governance is conceived of as a legal device to protect the rights of parties who might be taken advantage of by powerful corporate boards and executives.

In Sharia law, corporate disclosure is founded on the concept of fairness and the duty to God to do what is right and just. It is more of a moral than a legal obligation. Corporate disclosure is a matter of personal morality, in which an individual acts from goodwill and honesty, not according to legal rules. This concept achieves a balance between the corporate governance common in the West and the Sharia laws applied in the Middle East, including Saudi Arabia.

(2) How is corporate governance, particularly disclosure and transparency, observed and practised in Saudi Arabia?

While fairness is expected in all dealings by Saudis, this principle is ambiguous when applied to real world controversies and concrete conflicts of interests. Presently, the statutory and regulatory enforcement of corporate governance in Saudi Arabia leaves much to be desired. The regulatory mechanisms have not reached the level of international standards, and local customs still influence the behaviours of participants in the financial and other sectors. There is every indication, however, that the efforts to professionalise industry and more effectively enforce corporate governance will make Saudi Arabia an international investment destination.

(3) How have the Saudi legal framework and practices developed regarding international standards for corporate governance, particularly disclosure and transparency?

In the development of a legal framework for corporate governance in Saudi Arabia, the CGR and CL have laid the foundation but the supporting regulations require further work. The UK Companies Act and securities legislation inspired Saudi laws but the country needs to address loopholes and amend provisions to better address the needs and issues of its emerging market economy. Concentrated shareholding companies, especially listed companies, are the main concern of Saudi law, in addition to dispersed shareholding companies, as mentioned in Chapter Three.

7.3 Recommendations

The following recommendations are suggested to achieve the level of transparency and disclosure practices which will aid the development of the SSE. These recommendations are categorised as structural, substantive and procedural.

7.3.1 Structural Issues

Structural issues affect the institutions and organs of government involved in the regulation of the CMA transparency and disclosure requirements.

7.3.1.1 Special Regulation of the Banking and Financial Services Sector

The domestic and international linkages between financial and banking institutions have increased the vulnerability of global markets to the adverse effects of contagion during global crises. These sectors, therefore, should be strengthened by reform and regulation to build structural strengths which will make the Saudi economy resilient. These rules should be transmitted to companies' stakeholders through corporate governance disclosure tools. Financial institutions and banks should be more transparent because of the vulnerability to which they subject the stock market.

7.3.1.2 Competent Regulatory Personnel

Regulators are the authorities responsible for monitoring, evaluating, assessing and applying the provisions of rules. In the case of any violation, they may issue corrective action notices and enforce compliance. Regulators formulate the rules that govern the adoption of corporate governance principles. In order to set an example for stakeholders that are expected to adopt the system of corporate governance and disclosure, these officials must be accountable and transparent and uphold the highest standard of probity when dealing with stakeholders. These behaviours will also set an example of transparency for entities affiliated with the government.

7.3.2 Substantive Issues

These issues involve the provisions and content of compliance documents.

7.3.2.1 Expanding Subjects of Breaches which Attract Sanction

The CML provides general rules covering a wide range of areas, including the SSE. The sanctions and penalties for violating laws do not seem to apply to price manipulation and other malpractices in the stock market. Price manipulation is perhaps the most common form of market abuse. It has been noted that the more seasoned larger traders and investors often shake

up share prices for their own advantage. For the powerful, market manipulation is perceived as the easiest way to generate wealth with minimal risk. More experienced, larger traders are better informed and, in most cases, can understand and voice their opinions on issues that might affect share price. Such traders might also have other sources of information and so can deal with the company politics. In most Anglo-Saxon regimes, the lack of compliance or deficiency in meeting disclosure requirements can lead to the filing of criminal charges. However, in the Saudi capital market, this is not so. Therefore, certain malpractices should be criminalised to increase confidence in the daily transactions in the stock market.

The notion of transparency is still a rule, not a hard and fast legal requirement, and the absence of transparency does not itself constitute a violation of the law deserving of punishment. The level and the lack of transparency are ambiguous and difficult to define. Disclosure pertains to the submission of specific reports and filings at a prescribed time and in a specified form. This mandate is more severe and stringent for companies listed and traded in the open exchanges because of the higher public interest and public policy in them. The obligation to be transparent should be elevated and the lack of it criminalised due to the same public interest and policy considerations. To do this, all breaches must be codified so that they can lead not only to civil remedies but also to criminal prosecution.

7.3.2.2 Legislative Reform Supporting an Independent Code

Even with well-constructed laws, issues arise where there is a failure of enforcement. Non-compliance renders disclosure requirements moot and ineffectual if they remain merely suggestive or adopted on a ‘complain or explain’ basis. General awareness of the importance of transparent dealings by corporate managers should be increased. Regulatory authorities, state officials and the media should all be well versed in transparency as they play vital roles in its enforcement. Chapter 5 showed that these institutions scrutinise and evaluate corporate behaviour, seeking accountability and integrity which serve the common good. Although promoting the concepts of disclosure and transparency in Saudi Arabia might not be easy, the government needs to exert great effort through legislation or a separate code to encourage companies to adopt disclosure and transparency rules, especially in the stock market.

7.3.2.3 Codify the Rights and Interests of Minority Shareholders

Saudi law relevant to minority shareholders reveals a great deal of overlap and interaction among provisions; this has resulted in ambiguity and conflicting rulings. Numerous problems, including abuse, negligence, fraud, infringement, expropriation, oppression and misuse, are not dealt with explicitly in statutes but can be expected to arise in private firms. The courts' role in handling minority shareholders' claims is also vague. Most literature on Saudi legislation relating to the protection of minority shareholders takes an economic, political or legal viewpoint and concludes that Saudi law displays little concern for the minority shareholder.

Legal provisions that explicitly address minority shareholders in private companies and their rights are rare, and those that do exist are uneven and vague. These provisions give majority shareholders ultimate authority in the vast majority of situations and allow them to make the final decision in nearly all matters. These provisions do not give minority shareholders any explicit right to pursue legal action in the case of conflict, offering minority shareholders minimal real protection. Put simply, Saudi Arabia lacks clear, comprehensive regulations regarding minority shareholder protection. The current laws appear to hand over unlimited authority to majority shareholders, which can lead to disastrous consequences for the firm and its minority shareholders.

The general belief is that the optimum remedy for this problem is to codify the rights and interests of minority shareholders and the remedies they may seek. Any codification should largely follow the example provided by UK statute.

A key failing in Saudi Arabian company law is the lack of statutory recognition of minority shareholder interests and rights. Therefore, it is suggested that a non-exhaustive list of minority shareholder interests and rights be included in legislation:

- A list of the issues which may be ratified only unanimously;
- The rights to be present at all meetings and to be active in company decision making;
- The right to access data, reports and other information and papers relevant to the company;
- The right to a clear exit procedure ensuring that shares are bought at a reasonable price;
- The right to bring legal action on the firm's behalf, when necessary.

7.3.2.4 Complementary Reform Proceedings and Commercial Regulations

Commercial regulations in Saudi Arabia exist mainly at the regional level and are not seen as compatible with the legal process, as seen in the case of SITC discussed in Chapter 4. Reforming and amending these regulations will make adopting them easier for organisations and companies and encourage the implementation of corporate governance, transparency and disclosure principles.

7.3.3 Procedural Issues

Upon the successful introduction of a corporate governance code and regulatory body, problems may still arise from improper definitions of redress procedures. These issues are procedural and worth mentioning.

7.3.3.1 Regional and International Cooperation

A market economy, such as Saudi Arabia's, can attain a world-class reputation only by performing well internationally. Regional and global alliances, therefore, are crucial to support Saudi Arabia's efforts. Multilateral agreements with institutions that possess reputations for superiority or excellence in corporate governance regulation will enable Saudi Arabia to expeditiously make the needed changes. A favourable reputation for the Saudi economy in general will positively affect the stock market. These relationships are important because the close-knit regional economy exhibits great volatility during times of crisis.

7.3.3.2 Access to Redress

Presently, the redress methods for parties to challenge the content of listed companies' mandatory reports are incoherent. There should be a trouble-free way to raise issues with the regulatory body. Members of the public should be able to raise issues through whistle-blowing provisions. Such redress will serve two purposes. Firstly, it will ensure that corporations do not

become inured to malpractice and that corruption in public office is exposed. Secondly, easy access to information (e.g. outside the prescribed period) will ensure that corporate managers do not see their obligation only as drawing up a report once a year but as an ongoing, year-round matter. If needed, the court could be burdened with the task of permitting waivers for certain disclosures involving sensitive personal liberties.

7.4 Future Research

In Saudi Arabia, a public awareness campaign about corporate governance is needed to inform about the importance of adequate disclosure and transparency to companies regulated by the CMA. Future research could pursue the following aims.

(a) A comparative study of Saudi Arabia and GCC companies. A thorough study of the prevailing structural situation in these countries will be useful in understanding the possibility of harmonising regional corporate governance practices. These steps could help align Saudi corporate governance with GCC countries, which have nearly identical political and banking systems. Any positive experience could help bridge the gaps in Saudi corporate governance.

(b) Research on the various institutions within the corporate governance regulatory framework to determine whether they efficiently meet the economic requirements of Saudi Arabia, especially the stock market.

(c) Research on minority shareholder rights, especially under family ownership. In addition, future study should examine the advantages and disadvantages of adopting an independent, mandatory code for disclosure and transparency in the stock market.

7.5 Contributions to Knowledge

Upon a careful consideration of all the outcomes of this research, I identify the following contributions to knowledge.

(a) The first contribution of this thesis is highlighting the gap in the literature regarding a legal perspective of the present role of disclosure and transparency in enhancing corporate governance and its principles in Saudi Arabia.

(b) The second contribution is the suggestions for the implementation of corporate governance practices, particularly disclosure and transparency, as observed and practised in Saudi Arabia.

(c) The third contribution is the recommendations for the development of the Saudi legal framework and practices based on international standards of corporate governance, particularly regarding disclosure and transparency.

(d) The fourth contribution is the description of the Islamic perspective of corporate disclosure and transparency, which can result in better corporate performance.

(e) The final contribution is identifying internal and external factors that influence the efficiency of corporate disclosure provisions in Saudi Arabia which inform investment decisions.

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