CURRENT PRACTICES OF SAUDI CORPORATE GOVERNANCE:

A CASE FOR REFORM

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

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Declaration

I declare that the work presented in this thesis is my own except where it is stated otherwise.

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Abbreviations Used

CGC	Corporate Governance Code
CL	Company Law
CML	Capital Market Law
CRSD	Committee for the Resolution of Securities Disputes
CSR	Corporate Social Responsibility
UK	United Kingdom
US	United States of America
UN	United Nation
OECD	Organisation for Economic Co-Operation and Development

Abstract

One of the most debated issues is that of corporate governance. The topic has been investigated by scholars from several scientific fields including the legal. Indeed, corporate governance has been examined by a great number of law scholars, with particular regards to the improvement of various aspects. For example, effective corporate governance focuses on protecting and advancing aspects related to shareholders' rights, the board of directors and corporations' internal and external audit systems.

The main objective of this research is to suggest reformation to the Saudi corporate governance framework in order to achieve satisfactory corporate governance practices. The second purpose of the research is to investigate the current practices involved in Saudi corporate governance arrangements. The final aim is to determine how a Saudi corporate governance framework would most benefit corporate governance from the Islamic perspective. This study intends to provide a regulatory analysis to influence those regulations that should be implemented to adjust corporate governance practices as they affect the Saudi capital market.

The researcher found that Saudi corporate governance has been promulgated in accordance with principles of on-going international corporate governance. Alternatively, the Islamic perspective on corporate governance has been debated more recently, as an idea that needs to be progressed in order to provide associated benefits to the corporate governance framework in Saudi Arabia. Therefore, Saudi corporate governance provisions can be seen as based largely on positive man-made laws. The researcher further discovered that Saudi corporate governance as an institutional framework is divided between several institutions, whether internal or external, which might result in some ambiguity when it comes to implementing good corporate governance practices. However, the research results revealed that Saudi corporate governance provisions have to be reformed in accordance with popular worldwide corporate governance principles, namely the UK Corporate Governance Code, the UK Companies Act and the OECD principles of corporate governance produced.

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Chapter One

Introduction

1.1 Preamble

With the advent of globalisation and economic liberalisation, it has become increasingly difficult to ignore the fact that corporate governance mechanisms are an essential contemporary tool for which a need has emerged.[1] In recent years, interest in corporate governance has increased within both developed and less developed countries. Following the economic collapse and financial crisis experienced by various countries within East Asia, Latin America, Russia and the US, as well as an increase in the number of company catastrophes, such as those of Enron and WorldCom, corporate governance provisions have been seen to be the most important legal entities involved in restructuring corporations at the overseas level.[2] These collapses were not only due to a failure in investor confidence, but were also due to the lack of structured corporate governance and corporate transparency and disclosure.[3]

As a result of this interest, conferences have been held, specialised books have been published and research has been conducted. Moreover, corporate governance has been studied from different angles by scholars from a variety of disciplines; including law, finance, economics and management.[4] In fact, lawyers and economists were among the earliest groups of researchers to write about corporate governance.[5] Such studies indicated the prominence of corporate governance and the extent to which it influences various economic, social and legal aspects, in consideration of the objective of the comprehensive reform of corporations.[6]

1 Obaid Al Mutairi, 'Apply the Procedures Governing the Companies in Saudi Arabia', *Arab Journal of Administrative Sciences*, Arabic edition, 2003, 10, p. 15.
2 Istemi Demirag and Jill Solomon, 'Guest Editorial: Developments in International Corporate Governance and the Impact of Recent Events', *Blackwell Publishing*, Oxford, 2003, 11, p. 1. Alvaro Cuervo, 'Corporate Governance Mechanisms: A Plea for Less Code of Good Governance and More Market Control', *Corporate Governance*, Blackwell Publishing, 2002, 10, p. 84.
3 Simon Ho and Kar Wong, 'A Study of the Relationship Between Corporate Governance Structures and the Extent of Voluntary Disclosure', *Journal of International Accounting, Auditing and Taxation*, 2001, 10, p. 139.
4 Pallab Biswas and Hamid Bhuiyan, *Corporate Governance and Firm Performance: Theory and Evidence from Literature*, pp. 1-29.
5 Gary Herrigel, 'Guest Editor's Introduction: A New Wave in the History of Corporate Governance', *Oxford University Press*, New York, 2007, p. 476.
6 Mohammad Solomon, *Corporate Governance and the Role of Board Members and Executives*, University House, Alexandria, 2008, p. 7.

In the context of Saudi Arabia, it was the Saudi exchange collapse at the beginning of 2006 which prompted the Saudi regulator to take steps to protect the securities market and investors as a precautionary measure, in case of further unpredicted future collapse. For this reason, one of the essential steps that was applied by the Capital Market Authority Board was to instate a Corporate Governance Code (hereinafter CGC), which had to be satisfied directly by Saudi listed companies.[7]

Thus, the Saudi policy-maker has been seen as pioneering, among Arabic countries in light of his approval of corporate governance regulations. These regulations are agreed to have been the most important of the recent legal, finance and administrative regulations prepared in Saudi Arabia, due to their associations with the external institutional framework for corporate governance on one hand, and the relationship with the corporation's board of directors, top management and shareholders on the other.[8]

1.2 Research Significance

Currently, in order to support corporate governance worldwide, it is necessary to develop principles of corporate governance, which can provide the key to avoiding risk and guaranteeing the benefits of all stakeholders' groups (including shareholders, employees, lenders, customers, the environment and local communities) against mismanagement.[9] Corporate governance provisions have described the importance of the connection between shareholders' and other stakeholders' groups, the board of directors and the top management of corporations. As a result, the corporation regime has produced a variety of considerations for regulators, relating to its effectiveness for employees, the environment, local communities and shareholders.[10]

The contention is that developed and less developed countries have split into two groups in terms of their perspectives on the corporate governance system. While some countries follow the Anglo-American shareholders' model, other countries are guided by the Continental

7 It was issued by the Capital Market Authority Board Pursuant to Resolution, No. 1-212-2006, dated 12 November 2006.
8 *Supra* note 1 at 13.
9 Robert Monks and Nell Minow, *Corporate Governance*, Blackwell Publishing, Oxford, 2004, p . 2.
10 Jill Solomon and Aris Solomon, *Corporate Governance and Accountability*, John Wiley & Sons, Chichester, England, 2004, p. 3.

European and Japanese stakeholders' model.[11] Apparently, corporate governance regulations in Saudi Arabia follow the Anglo-American shareholders' model, as will be discussed later in this study.

Arguably, the importance of corporate governance as a tool by which to develop and control businesses is obvious. This is because corporate governance calls for principles such as fairness to exist between shareholders, also encouraging disclosure of the corporation's information, aiding society, fighting wrongdoing, which can be done by the board of directors and chief executives. Indeed, various factors suggest the importance of corporate governance. A significant point stressing the importance of corporate governance is that a shortage of adequate regimes and control strategies has negatively influenced the business of international stock markets across the entire world.[12]

Additionally, provisions of corporate governance are not only significant for local corporations, but are also essential for withdrawing foreign investment in order to ensure a powerful economy and the quality of a country's institutions of governance.[13] Consequently, there is much discussion about what comprises effective corporate governance and its significance when attracting external investment and ensuring the sustainable development of the country's economy as a whole. In this regard, Classens admits that good corporate governance has a strong association with the performance of corporations as follows: Firstly, good corporate governance encourages external investment in corporations; secondly, it diminishes the cost of capital; and thirdly, it prompts reform, thereby achieving good operational performance. Finally, it would reduce the danger of contagion from financial distress.[14] Moreover, Oman provides the significance of corporate governance as being:

> Corporate governance matters not only because the health of a country's corporate sector matters for the country's entire economy but because the quality of a country's institutions of governance matters greatly for national development. The ability to move from heavily relationship based to

11 Ruth Aguilera, Cynthia Williams, Joun Conley and Deborah Rupp 'Corporate Governance and Social Responsibility: A Comparative Analysis of the UK and the US', *Corporate Governance and Social Responsibility*, 2006, 14, p. 147.
12 Mohsin El Khudery, *Corporate Governance*, Arabic edition, Arab Nile Group, Egypt, 2005, p. 10.
13 Ibid, p. 11.
14 Wafik Grais and Matteo Pellegrini, 'Corporate Governance in Institutions Offering Islamic Financial Services: Issues and Options', *World Bank Policy Research Working Paper*, No. 4052, 2006, p. 5.

> predominantly rules based institutions of corporate as well as public governance is central to the success of the long term development process in all countries.[15]

It is now understood that international economics (including the Saudi economy) has had to address a diversity of expected and unexpected circumstances, one of which is the attendant pressure exerted by globalisation. It is becoming increasingly difficult to ignore the effect of globalisation on individual economies and financial markets, since globalisation has placed many developed and developing countries under pressure (including Saudi Arabia). The process of globalisation, especially the global integration of financial markets, has allegedly generated pressure that has encouraged the national systems of corporate governance to converge.[16] As a result, the pressure to open up the market to transparency in a company's operations has necessitated good corporate governance practices.[17] For this reason, these countries have been trying to implement good corporate governance practices, because they desire their markets to be efficient and viable. Developing countries, in particular, have struggled with the propaganda generated by globalisation, which has influenced their restructuring plans, and consequently such countries have had to alter their economies to make them more attractive prospects for investment.[18]

In general, therefore, it seems that globalisation has become a subject of concern from the perspective of developing countries'. This also applies to the Saudi economy, which is also influenced by globalisation process. Therefore, good corporate governance practices have become a subject for Saudis to address to ensure the growth of the economy and the improved value and competitiveness of its corporations and financial market.

1.3 Research Problem

The main research problem is to

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15 Charles Oman, Steven Fries and Willem Buiter, 'Corporate Governance in Developing, Transition and Emerging-Market Economies', *OECD Development Centre*, Policy No. 23, 2003, p. 8.
16 Mary O'Sullivan, 'Corporate Governance and Globalisation', *Annals of the American Academy of Political and Social Science*, 2000, 750, Dimensions of Globalisation, p. 154.
17 Kami Rwegasira, 'Corporate Governance in Emerging Capital Markets: Whither Africa', *Corporate Governance*, 2000, 8 (3), p. 259.
18 Ibid, p. 258.

Analyse and evaluate the current practices of the Saudi corporate governance framework, and ascertain the level of curiosity to reform these practices, in accordance with best practices as specified under the UK corporate governance regulations and the OECD Principles of Corporate Governance.

Sub-problem 1

Identify the lack of literature regarding the Saudi corporate governance framework.

Sub-problem 2

Determine whether the Saudi corporate governance framework can derive advantages from the Islamic perspective of corporate governance.

Sub-problem 3

Ascertain whether the Saudi corporate governance provisions regarding the shareholders' rights, the board of directors' responsibilities', and disclosure and transparency requirements are adequate or in need of urgent improvement.

1.4 Research Methodology

The research method used by the researcher uses two approaches, both critical analytical and comparative methods. Firstly, a critical analytical approach will be applied, involving reviewing different bodies of literature, laws and regulations in addition to providing an overview of the Saudi corporate governance legal framework, and then suggesting possible reform. More specifically, decisions issued and established by either the Capital Market Authority Board or the Committees for the Resolution of Securities Disputes, regarding the themes of corporate governance will be examined. This study is based on a specific case study of Saudi Arabia, and so significant consideration is necessary regarding the regulations of Saudi Arabia, with specific attention being paid to the official Capital Market Law (hereinafter CML) and Implementing Regulations. In addition to written sources, first-hand experience is fundamental, and accordingly this was obtained through a visit to the Capital Market Authority and Committees for the Resolution of Securities Disputes. The intention behind this was to enable the author to meet numerous officials and obtain details regarding the decisions issued, to ascertain how those bodies are fulfilling their responsibilities to encompass and encourage good corporate governance practices.

Secondly, a comparative approach will be used to achieve the aims of this research. A comparison will be carried out between the Saudi corporate governance preparations and those specified in UK regulations and OECD corporate governance principles, in reference to the development of corporate governance structures. One of the potential benefits of the comparative approach is that it defines explanations to particular or novel legal problems encountered in other jurisdictions. Indeed, regulators across the entire world appreciate the role played by the comparative approach when transplanting laws and regulations from industrialised nations. This is because the major target of the comparative approach is to improve the scope of laws.[19]

In this regard, it is relevant to discuss cross-cultural legal adaptation or transplantation. Legal transplantation has been defined by many scholars. One of these is Watson, who defines legal transplantation as ‘the moving of a rule or a system of law from one country to another, of from one people to another’. He continues, saying that ‘rules-not just statutory rules-institutions, legal concepts and structures that are borrowed, not the spirit of the legal system’. In particular, he confirms that ‘as a practical subject comparative law is a study of the legal borrowings or transplants that can and should be made … an investigation into the legal transplants that have occurred: how, when, why and from which systems have they been made, the new circumstances in which they have succeeded and failed and the impact on them of their new environment’.[20]

Legal transplantation is commonly understood as the transfer of laws and institutional structures across geopolitical or cultural borders. It can be voluntary, encompassing entire legal systems or single legal principles and integrating similar or different cultures. Within host countries, legal transfers may permeate state and non-state social institutions, or in the case of many developing countries, they may reside in state law, superimposed on indigenous legal structures. Such transference is increasingly linked to international legal harmonisation projects sponsored by large trading nations and international donor agencies.

19 Jonathan Hill, ‘Comparative Law, Law Reform and Legal Theory’, *Oxford Journal of Legal Studies*, 1989, 9, p. 102.
20 Alan Watson, *Legal Transplants*, Scottish Academic Press Ltd, Edinburgh, 1974, p. 21.

There is a diversity of factors associated with the development of the cross-cultural legal transplantation. The first reason is the need for authority. Watson establishes that ‘In the absence of legislation, which typically has been scarce for private law, law making is left to subordinates- judges and jurists- who, however, are not given power to make law. They must justify their opinion. It will not do to say- this is my decision because I like the result. They must seek authority’.[21]

The second reason for the development of the cross-cultural legal transplantation is one of prestige and imposition. In this respect, Sacco argues that ‘There are two fundamental causes of imitation (legal transplantation): imposition and prestige. Every culture that has faith in itself tends to spread its own institutions. Anyone with the power to do so tends to impose his own upon others. Receptions due to pure force, however, are reversible and end when the force is removed’.[22]

The final reason for the development of the cross-cultural legal transplantation centres on the political, economic and reputational incentives from the countries from which the laws are drawn. Schauer suggests that ‘The transitional and cross-border spread of law and legal ideas is not, as it may be for scientific, technical, and economic ideas, largely a matter of the power and value of the ideas themselves, but may instead be substantially dependent, both on the supply side and on the demand side, on political and symbolic factors that may have more explanatory power in determining how law migrates that do factors that relate to the intrinsic or instrumental value of the migrating law itself’.[23] It is estimated that distinctions between developed countries and transitional or less developed countries can be stated herein. Mattei pronounces that there is a ‘recognised pattern of weakness of professional law in developing and transitional countries of Africa, Latin America and Eastern Europe means that the professional law cannot be considered the hegemonic pattern of social rulemaking in these legal systems. In the pattern called rule of political law, the legal process is often determined by political relationships. In those social contexts we cannot consider a sporadic pathological distortion that the outcome of litigation depends on who is who in the political world. This is particularly the case when the clash occurs between the government and individual rights.

21 Ibid, p. 25.
22 Rodolfo Sacco, ‘Legal Formants: A Dynamic Approach to Comparative Law (II)’, *the American Journal of Comparative Law*, 1991, 39 (2), p. 398.
23 Frederick Schauer, ‘The Politics and Incentives of Legal Transplantation’, *CID Working Paper No. 44,* Centre for International Development at Harvard University, p. 2.

The very notion of limiting powers by formal law is completely inconsistent with the philosophy of rulemaking in those countries.'[24]

Undeterred by a growing body of literature showing the difficulties with transferring commercial legal models across cultural, political and economic borders, there is a largely US discourse that postulates an 'end of history' in reference to competing legal systems.[25] For example, in discussing international corporate governance laws, some authors assert that 'over time, then, the standard US model is likely to win the competitive struggle… because no important competitors to the standard model of corporate governance remain persuasive today'.[26] They dismiss longstanding European corporate governance regimes that privilege worker and stakeholder representation on their boards of directors as less economically efficient than the deregulated US model. As a corollary, they assert that the US corporate governance model should form the basis of an international standard.

Commentators querying legal harmonisation point to evidence that the corporate governance regimes in Britain, France and Germany function effectively within their different legal, political and economic logics.[27] Further challenging the globalisation thesis, recent comparative studies suggest that, after an initial period of convergence, transplanted corporate regimes increasingly diverge from their original template.

1.5 Research Aims

The primary aim of this research is to examine whether Saudi corporate governance preparations follow the international principles of corporate governance, and to consider the capacity of the Saudi corporate governance framework. However, the research has a variety of additional aims as defined below:

1. To investigate the current practices of Saudi corporate governance.

24 Ugo Mattei, 'Three Patterns of Law: Taxonomy and Change in the World's Legal Systems', *American Journal of Comparative Law*, 1997, 5, p. 28.
25 Brian Cheffins, 'Current Trends on Corporate Governance: Going from London to Milan via Toronto', *Duke Journal of Comparative and International Law*, 1999, 10, p. 10.
26 Henry Hansmann and Reinier Kraakman, *Toward a Single Model of Corporate Law*, Oxford University Press, New York, 2002, p. 50.
27 Curtis Milhaupt, 'A Relational Theory of Japanese Corporate Governance: Contract Culture and Rule of Law', *Harvard International Law Journal*, 1996, 37 (1), p. 37.

2. To suggest improvements to Saudi corporate governance provisions in order to reach satisfactory corporate governance practices in line with international standards of corporate governance.
3. To discover how Saudi corporate governance would benefit from corporate governance from the Islamic perspective.

1.6 Research Questions

The research questions have been carefully selected to suggest reform to the current Saudi corporate governance practices. In other words, each question will be expanded on throughout chapters of the thesis. This expansion on the questions will assist us in more fully answering the main research questions regarding dealing with, amending and resolving current Saudi corporate governance practices. This means, the research questions have been selected in accordance with the lack of Saudi literature dealing with the subject, as well as in line with previous reading and observation by the researcher. In addition to achieving the research aims, the researcher intends to answer the following questions:

1. Do the principles of corporate governance supplemented in Islamic law attain the standards of worldwide corporate governance principles and of Saudi corporate governance framework?
2. How has the Saudi corporate governance framework been developed?
3. What is the Saudi external institutional framework for corporate governance?
4. Are current (board of directors', disclosure and transparency and shareholders' rights) practices in the Saudi corporate governance framework appropriate or in need of reform?

1.7 Research Scope and Limitation

The focus of this research is based on research questions and involves evaluating corporate governance from an Islamic perspective, the development of the Saudi corporate governance framework, the Saudi external institutional framework of corporate governance and the current practices of equality (board of directors, disclosure and transparency and shareholders' rights) as manifest in the Saudi corporate governance framework. This research is limited to the aforementioned corporate governance areas, and is carefully limited regarding its discussion of an Islamic perspective on corporate governance, since this subject is far reaching, and can be studied from a variety of perspectives including law, finance, management and economics. This research excludes unrelated Islamic finance subjects, for instance, the religious board or data regarding scholars from within Islamic financial institutions, Islamic finance contracts. As a result, the focus of this work is on how Islam can benefit in terms of corporate governance practices.

1.8 Research Structure

To investigate the research questions fully, this thesis is divided into ten chapters. The current chapter has presented an introduction to the study, defined the significance of the research and formulated the research methodology, aims, scope, limitation and questions.

Chapter Two will provide background information about Saudi Arabia and the Saudi legal structure. The chapter is divided into several sections detailing the Basic Law of Governance in the form of the constitutional law in Saudi Arabia and an account of the country's executive, legislative and judicial authorities.

Chapter Three offers an account of corporate governance in literature. Topics that will be covered in this chapter include definitions of corporate governance, the international efforts towards establishing principles of corporate governance, the corporate governance models and corporate governance theories.

Chapter Four will consider whether the principles of corporate governance supplemented in Islamic law meet the intent of worldwide corporate governance principles. In accordance with this, it will discuss whether the Saudi legislator can adopt corporate governance from the Islamic perspective, to suit the Saudi corporate governance structure, since Islamic legislation is the main source of law in Saudi Arabia. A variety of themes will be included in this chapter such as the definition and the origin of *Shari'a*, the objectives of *Shari'a*, and the vision of *Shari'a* in terms of values.

Chapter Five will review developments affecting the Saudi corporate governance framework. Therefore, this chapter will identify some of additional challenges, such as the Corporate Governance Code between pilot and assessment, the duplication of applications across

Company Law and Corporate Governance Code and the role of listed corporations' self-regulatory corporate governance policies for improving Saudi corporate governance framework.

Chapter Six will investigate the Saudi external institutional framework for corporate governance by focusing on those institutions that have been responsible for activating corporate governance arrangements. Thus, the Capital Market Authority, the Committees for the Resolution of Securities Disputes, the Stock Exchange, the Ministry of Commerce and Industry, the accounting and auditing profession, the Saudi Organisation for Certified Public Accountants and the Saudi National Anti-Corruption Commission will be examined in this chapter.

Chapter Seven will analyse the current board of directors' practices in regards to Saudi corporate governance. A range of issues related to the board of directors such as board duties, board responsibilities, board creation standards, the separation of board members' powers, board membership categories, board meetings, the board's sub-committees and board members' compensation packages will be introduced in this chapter.

Chapter Eight will examine current disclosure and transparency practices as applied within Saudi corporate governance. In addition, the significance and prerequisites of disclosure and transparency for board annual reports will be evaluated in this chapter.

Chapter Nine will study current shareholders' rights and practices as applied to Saudi corporate governance. Shareholders' rights (both financial and administrative) will be considered in this chapter, such as shareholders' dividend rights, shareholders' rights as related to general meetings, voting rights, shareholders' rights to appoint and remove board members and their rights to litigate board members.

Chapter Ten will conclude the research with a conclusion and make recommendations from the study, which will aim to reform good corporate governance practices in Saudi Arabia. Suggestions for future research and identification of the key contributions of the study will be included in this chapter.

Chapter Two

Background to Saudi Arabia and the Saudi Legal Structure

2.1 Introduction

This chapter aims to explain the multiple issues that must be fully understood as they relate to the forthcoming chapters. It covers background information on Saudi Arabia and the Saudi legal structure and is divided into several sections. The first section provides a broad overview of Saudi Arabia, offering a critical review of existing regulations that control the Saudi legal structure; the second section covers constitutional law in Saudi Arabia. Section Three examines the state's scope of authority by evaluating its executive authority, legislative authority and judicial authority. A summary is provided at the end.

2.2 Common Overview of Saudi Arabia

The location of Saudi Arabia is in the South West of Asia, comprising an area of 2.25 million km, with a population of around 28 million. The territory of Saudi Arabia is divided into thirteen provinces (*mintaqah*), and each province is headed by a royal family member.[1] *Riyadh* is the capital city of the kingdom, and Arabic is the official language. Moreover, the political system is an absolute monarchy and the King fills the roles of both the head of state and the prime minister.[2]

Saudi Arabia holds a position of particular religious significance amongst other Islamic countries, because Muslims know it to be the birthplace of Islam (in the seventh century). Saudi Arabia is also the location of two holy sites: *Makka*, which is the direction of prayer for more than two billion Muslims, and *Medina*, which is the city of the mosque and grave of the Prophet Mohammad. In this respect, Menoret maintains that:

> Islam is inseparable from Saudi consciousness and national pride, not only because Arabia houses the holy places of *Makka* and *Medina* but also because it

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1 Saudi Annual Statistics Book of 2011, Published by Central Department of Statistics and Information, p. 10.
2 Basic Law of Governance 1992, Art. 1, 5 (A) and 5 (B).

> was the centre of the first indigenous Arab-Muslim resistance to foreign domination.[3]

In addition, the Islamic religion has a major impact on all areas of daily life in Saudi Arabia. In accordance with article 23 of the Basic Law of Governance:

> The state shall protect the Islamic creed, apply the *Shari'a*, encourage good and discourage evil, and undertake its duty regarding the propagation of Islam (*da'wa*).[4]

In fact, this privileging of the role of religion in Saudi Arabia, goes back to the foundation of the country, when *King Abd al-Aziz Al Sa'ud* (the establisher 1876-1953) agreed with *Al Akwan* (the nomadic tribes and fighters) to form a united country that accepted *Shari'a* legislation. According to Al Farsy:

> In unifying the Arab States into a cohesive nation, it is Islam, which like a spinning wheel, moves the various Arab people together in one strong fabric. It was the tie of faith rather than anything else which enabled the *King Abd al-Aziz* to found his kingdom.[5]

2.3 Basic Law of Governance

Saudi constitutional law has emerged through the scattered written constitutional norms that accumulated prior to 1992, when *King Fahad Al Sa'ud* (1921-2005) approved the reform of the constitutional law. The King specifically affirmed that there were four significant laws, namely the Basic Law of Governance, the Consultative Council Law, the Regional Law and lastly the Council of Ministers Law.[6] The Basic Law of Governance is the most crucial piece of legislation of the above-mentioned laws and comprises nine chapters with eighty-three legal clauses.

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3 Pascal Menoret, *The Saudi Enigma: A History*, Zed books, London, 2005, p. 100.
4 Basic Law of Governance 1992, Art. 23.
5 Fouad Al Farsy, *Modernity and Tradition, the Saudi Equation*, Channel Islands: Knight Communication Ltd, 1997, p. 17.
6 The Basic Law of Governance, Royal Order, No. A-90, dated 1 March 1992. The Consultative Council Law, Royal Order, No. A-91, dated 1 March 1992. The Regional Law, Royal Order, No. A-92, dated 1 March 1992. The Council of Ministers Law, Royal Order, No. A-13, dated 20 August 1993.

Furthermore, the first section of the Basic Law of Governance deals with the country's construction, its religion, its language and its capital city.[7] The second part explains the inheritance of the Saudi throne by the sons and grandsons of the country's founder.[8] The third part addresses the foundations of Saudi society,[9] stressing the importance of education to every Saudi individual, if they are to become successful individuals.[10]

The Basic Law of Governance covers economic affairs, and maintains that the government owns all natural resources.[11] The Basic Law of Governance discusses the country's general financial statements[12] and supervisory governmental bodies (either financial or administrative) are specified in the Basic Law of Governance.[13] Specifically, the Basic Law of Governance suggests that the government should be run pursuant to justice, consultation and the equity of citizens.[14] The Basic Law of Governance additionally reports that the government should protect human rights, civil liberties and freedom, so no citizens or residents should be arrested or trapped without any legal indications.[15]

It is argued that there is no constitutional law in Saudi Arabia because its legal constitutional structure is based on the *Qur'an* and the *Sunna*. This is supported 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'.[16] Even so, there is a constitutional law, which is the Basic Law of Governance; the term 'constitutional' in the Saudi methodology does not mean the same as it does in universal law. In reality, from the Saudi perspective the term refers to the platform of all aspects of life in Saudi society. Others consider that constitutional law has existed since the declaration of the Basic Law of Governance. Hence, it can be said that the Basic Law of Governance maintains the main principles of the constitution, to serve as true constitutional law.[17] Therefore, there should be

7 Basic Law of Governance 1992, Art. 1, 2, 3 and 4.
8 Basic Law of Governance 1992, Art. 5 and 6.
9 Basic Law of Governance 1992, Art. 9 and 10.
10 Basic Law of Governance 1992, Art. 13.
11 Basic Law of Governance 1992, Art. 14.
12 Basic Law of Governance 1992, Art. 72 and 76.
13 Basic Law of Governance 1992, Art. 79.
14 Basic Law of Governance 1992, Art. 8.
15 Basic Law of Governance 1992, Art. 26 and 36.
16 Basic Law of Governance 1992, Art. 1.
17 Abd Rahman Al Shalhoub, *Constitutional Order in Saudi Arabia between the Law and Comparative Law*, Arabic edition, 1999, p. 91.

no conflict between the acceptance of the Basic Law of Governance as the Saudi constitutional law and the principal sources of Islamic law, which are the *Qur'an* and the *Sunna*.[18]

2.4 The State's Authorities

2.4.1 Executive Authority

The notion of authority in Saudi Arabia derives first from the Saudi executive branch, which contains the King, the Council of Ministers, local government and public independent and quasi-independent administrative bodies. Thus, a supplementary explanation of executive authority has been articulated in the Basic Law of Governance and arranged as follows:

Firstly, the King's executive insists that the King is the head of the state and also the prime minister of the council of ministers. The King is also the country's first representative in terms of international political relationships. In addition, the King's executive responsibilities are: to manage the citizens' attitudes; to supervise *Shari'a* and general policy implementation; to ensure the country's security and defence; to receive other countries' presidents, ambassadors and representatives; to nominate the ambassadors to other countries and to appoint and dismiss the members of the Council of Ministers, the Consultative Council and the Armed Forces Council.[19]

In particular, the King wields executive, legislative and judicial powers and, with respect to other executive, legislative and judicial entities, the King has the ultimate authority and the final verdict.[20] Furthermore, the King also holds religious authority in accordance with Islamic statecraft (as *caliph, sultan and imam*), which tolerates one individual as the religious and political leader of a country.[21]

The Council of Ministers represents another instant executive authority; led by the King as the prime minister and including the deputy prime minister, ministers with ministerial

18 Basic Law of Governance 1992, Art. 8.
19 Basic Law of Governance 1992, Art. 55, 57 (A), 60, 63 and 68.
20 Basic Law of Governance 1992, Art. 44.
21 Maren Hanson, 'The Influence of French Law on the Legal Development of Saudi Arabia', *Arab Law Quarterly*, 1987, 2, p. 283.

portfolios, ministers without ministerial portfolios and the King's consultants.[22] The members of the Council of Ministers are appointed by the sovereign every four years and traditionally include many royal family members. Accountable for achieving several objectives, the Council of Ministers:[23]

1. Carries out the country's internal and external interactions, such as overseeing economic principles, financial affairs, defence and education;
2. observing the laws and implementation of the ministries' resolutions;
3. generating public services organisations;
4. tracking the application of the inclusive improvement strategy;
5. establishing investigations' committees regarding the governmental organisations' affairs; and
6. Giving permission for franchising and investing in any of the country's natural resources.

Thirdly, there is local government, which has executive authority, working within Regional Laws to develop administration, to certify safety and order and guarantee civil liberties. In addition, the local government is responsible for developing provinces infrastructure and resolving citizens' and residents' pleas.[24]

Finally, public independent and quasi-independent administrative bodies have executive authority since they have been created to deal with several social and economic improvements. These bodies are categorised as follows:[25]

1. Economic organisations, for instance, the Saudi *Arabian* General Investment Authority and the Royal Commission for *Jubail* and *Yanbu*;
2. Educational training and consulting organisations, for example, Technical Education and Vocational Training and the Saudi public universities;
3. Social welfare organisations including the Pension Services Agency and the Social Administration Security;

22 Council of Ministers Law 1993, Art. 12.
23 Council of Ministers Law 1993, Art. 19.
24 Regional Law 1992, Art. 1.
25 Hani Khashoggi, *Local Administration in the Kingdom of Saudi Arabia: Concepts, Foundations and Applications*, Arabic edition, Dar Al Khuraiji for Publishing and Distribution, 2007, p. 25.

4. Investment and financial organisations, such as the Saudi Industrial Development Fund and the Capital Market Authority.

2.4.2 Legislative Authority

The Basic Law of Governance identifies how legislative authority deals with the formulation of new regulations on behalf of the country's approaches, pursuant to *Shari'a* legislation.[26] There are, nevertheless, numerous Saudi legislative bodies including the King, the Council of Ministers, the Consultative Council and the Board of the Senior Council of *Ulama*.[27] Therefore, clarification is expressly covered below.

Firstly, the King has legislative command, since he has an independent role in terms of rule making. In other words, as stated earlier, he has the authority to make the final decision.[28] This means the King can revoke, ratify and modify any piece of legislation by issuing royal orders. These royal orders do not have to be agreed by the Council of Ministers and the Consultative Council.[29] This means that they become effective, providing that they have been enacted and publicised. Overall, the King has legislative authority that should be respected, as

26 Basic Law of Governance 1992, Art. 67.

27 In recent times, debate on the Saudi legal structure has increased in terms of legislative command. This is because the Saudi legislature is divided between many collections including the King, the Council of Ministers, the Consultative Council and the Board of the Senior Council of *Ulama*. There is a contrary point of view regarding the absence of particular Saudi legislative institution. This basically reveals that scattered legislative bodies are observed as being pointless in terms of Saudi legislation. It additionally shows that the Saudi legislative is ambiguous and so problematic in terms of outsider analysis and evaluation. As Layish argues there is no one-united legislative authority in Saudi Arabia. However, the competent (*fuqaha*) play a major role in explaining the law and *Shari'a* legislation. See, Aharon Layish, 'Saudi Arabia Legal Reform as a Mechanism to Moderate Wahhabi Doctrine', *Journal of the American Oriental Society*, 1987, 107 (2), p. 279.
In addition, religious scholars (*fuqaha*), and specifically the Board of the Senior Council of *Ulama* members, can be pointed out as representing the significantly weak aspect of the Saudi legislative authority. That is to say, these scholars are memorable in Islamic studies, instead of within the current man-made positive laws that are in operation, inside the Saudi legal structure. As Sfeir assumes, the absence in Saudi Arabia of a legislative body to counter balance the influence of the religious scholars and legitimate major shifts in the legal system has left the Saudi legislator with no alternative but to adopt a reactively piecemeal approach to law reform, the declared purpose of which has invariably been to supplement rather than to supplant *Shari'a*. See, George Sfeir, 'The Saudi Approach to Law Reform', *American Journal of Comparative Law*, 1988, 36, p. 734.
As a result of this, it is supposed that religious scholars refusing new regulations adapted by the Saudi legislator, is a normal but also an unacceptable decision. To illustrate, the most likely cause increasing the number of quasi-judicial committees within the Saudi judicial authority is the rejection of religious scholars of the operation of the adapted regulations under the *Shari'a* court system. This rejection has forced the Saudi legislator to create a variety of quasi-judicial committees that are noted to actually be the most ineffective of the Saudi legislative division. See, Joseph Kechichian, 'The Role of the *Ulama* in the Politics of an Islamic State: The Case of Saudi Arabia', *International Journal of Middle East Studies*, 1986, 18 (1), p. 53.

28 Basic Law of Governance 1992, Art. 44.

29 *Supra* note 25 at 25.

long as it is based on *Shari'a* legislation. To this purpose, the Basic Law of Governance affirms that:

> The courts will apply the rules of *Shari'a* in the cases that are brought before them, in accordance with what is indicated in the *Qur'an* and the *Sunna*, and statutes decreed by the ruler which do not contradict the *Qur'an* or the *Sunna*.[30]

Secondly, the Council of Ministers has incredible legislative authority.[31] Its legislative tasks are to approve and amend, if necessary, the country's laws and international conventions.[32] The legislative method, which is applied when approving laws, international treaties and agreements is that the Consultative Council first reviews these, laws and then submits them to the Council of Ministers to obtain a royal decree.[33] Nevertheless, the King's approval shall be sought prior to dispensing royal decrees.[34] Royal decrees are specifically produced in order to resolve the country's temporary legal issues and to improve the Saudi legal structure.[35]

Thirdly, the Consultative Council, identified as *Majlis Ash-Shura*, has legislative supremacy whereby it articulates its views on common policies referred to by the Council of Ministers.[36] In addition, the Consultative Council consists of 150 members who are consistently nominated and appointed by the King to serve a four-year term and their legislative obligations cover the following points. The Consultative Council members:[37]

1. Argue in favour of proposals for economic and social development;
2. Examine and restrict, if necessary, laws, international treaties and agreements; and
3. Consider governmental institutions' annual reports and budgets.

Finally, the Board of the Senior Council of *Ulama* has legislative power when offering religious opinions (*fatwa*) with respect to the legal case submitted by the government. The Board of the Senior Council of *Ulama* was established in 1971, and comprises approximately

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30 Basic Law of Governance 1992, Art. 48.
31 Council of Ministers Law 1993, Art. 19.
32 Council of Ministers Law 1993, Art. 20-21.
33 Basic Law of Governance 1992, Art. 70.
34 Council of Ministers Law 1993, Art. 7. Also, Consultative Council Law 1992, Art. 17.
35 David Karl, 'Islamic Law in Saudi Arabia: What Foreign Attorneys Should Know', *George Washington Journal of International Law and Economics,* 1991, 25, p. 142.
36 Basic Law of Governance 1992, Art. 70.
37 Consultative Council Law 1992, Art. 15.

forty religious scholars who activate religious authority. The Basic Law of Governance defines that the main reference to *fatwa* is both the *Qur'an* and the *Sunna*.[38]

2.4.3 Judicial Authority

The Saudi judicial authority has three forms, the *Shari'a* courts system, the Board of Grievances and quasi-judicial committees. Firstly, the *Shari'a* courts system operates across four kinds of court, namely the supreme judicial council, the appellate courts, general courts and summary courts.[39] That is to say, these four completely differ from each other in terms of their hierarchal structure and their own disputes. Definitely, the supreme judicial council is responsible for directing *Shari'a* courts and looking into urgent legal cases as requested by the King or the Minister of Justice.[40] The cabinet of the council contains eleven members presided over by a chairman.[41]

Secondly, the Board of Grievances, known as *Diwan Al Medhalim*, was established in 1955 and then reconstructed in 1982.[42] The Board of Grievances was entirely different to the above-mentioned *Shari'a* courts system. In other words, the Board of Grievances consists of a variety of civil tribunals whose jurisdictions fall outside the *Shari'a* courts system and obligations.[43] In addition, the circuits of the Board of Grievances are in hierarchal order, namely the board of appeal circuits and the first instance circuits.[44]

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38 Basic Law of Governance 1992, Art. 45.

39 Law of Judiciary 1965, Art. 5. Also, Basic Law of Governance 1992, Art. 51. Furthermore, the discussion of the *Shari'a* courts system would occupy a large space in this research without being relevant. As this section is purposed as giving an overview of the Saudi Judicial authority, it could be desirable for the sake of the study to concentrate on the main legal institutions, leaving other minor aspects without further discussion.

40 Law of Judiciary 1965, Art. 7.

41 Article 6 of the Law of Judiciary insists that 'The Supreme Judicial Council shall be composed of eleven members in the following manner: Five full-time members of the rank of Chief of the Appellate Court, who shall be appointed by Royal Order. Said members shall constitute the Permanent Panel of the Council which shall be presided over by the member having the longest service in the judiciary. Five part-time members who shall be the Chief of the Appellate Court or his deputy, the Deputy Minister of Justice, and three of the longest service Chief Judges of the General Courts from the following cities: *Makka*, *Medina*, *Riyadh*, *Jeddah*, *Dammam*, and *Jazan*. Together with the members referred to in the preceding paragraph, they shall constitute the General Panel of the Council, which shall be presided over by the Chairman of the Supreme Judicial Council'.

42 The Board of Grievances was established pursuant to Royal Decree, No. 2-3-8759, dated 1955, and then reorganised pursuant to Royal Decree, No. M-51, dated 1982.

43 *Supra* note 35 at 144.

44 Ahmed Al Ghadyan, 'The Judiciary in Saudi Arabia', *Arab Law Quarterly*, 1998, p. 243.

Moreover, the missions of the Board of Grievances intend to examine administrative decisions; whereby the government and its institutions have engaged in appraising applications for the executive of foreign judgements to decide upon the circumstances of rewards, as filed by bodies concerned about the government and independent public corporate institutes subsequent to their activities. This makes it possible to analyse cases related to their rights as provided for by the civil service and pension laws for government staff and independent public institutes.[45] It is worth noting that the Board of Grievances and the Ministry of Commerce and Industry (Committee for the Resolution of Corporation Dealings) is responsible for case law resulting from Company Law (hereinafter CL) applications that fall outside the Capital Market Authority's Committees for the Resolution of Securities Disputes obligations.

In particular, the Saudi policy-maker has required the Board of Grievances to be connected with the King straight away.[46] This trend has been followed because the resolution of grievances in Saudi Arabia can be fulfilled by the King, in accordance with his judicial authority. This trend also shows the effectiveness of the statecraft of old-fashioned Islamic leaders' in terms of resolving grievances and protecting society from the abuse of power.[47] To illustrate this trend, the Basic Law of Governance states that:

> The King's court shall be open to all citizens and to anyone who has a complaint or a plea against an injustice. Every individual shall have a right to address the public authorities in all matters affecting him.[48]

Finally, the quasi-judicial committees represent the third stage of the Saudi judicial authority.[49] Particularly, the major reasoning behind establishing quasi-judicial committees is the disagreement of religious scholars and *Shari'a* courts' judges with the operation of the commercial court regulations that were adapted from the *Ottoman* Code of 1850, since these regulations were not in line with *Shari'a* principles.[50]

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45 Board of Grievances Law 1982, Art. 8.
46 Board of Grievances Law 1982, Art. 1.
47 Mohammad Jaafar, *The Mandate of the Grievances and its Applications in Saudi Arabia*, Arabic edition, Dar Al Nahda, Cairo, 1988, p. 66.
48 Basic Law of Governance 1992, Art. 43.
49 *Supra* note 35 at 147.
50 *Supra* note 44 at 247.

Thus, there was a strong need to create an alternative tribunal system that could fill the gap within the Saudi judicial structure. A diversity of quasi-judicial committees have been founded by the Saudi regulator. For instance, the Saudi regulator created the customs committee, the labour disputes committee and the settlement of banking disputes committee.[51] Significantly, the Capital Market (quasi-judicial committees) have been established in accordance with the reason above.

However, it is argued that the immense number of quasi-judicial committees can be seen as by the Saudi regulator and executive authority as having had a negative influence on judicial independence.[52] It is important to note that the independence of the judiciary system is a critical element that has been thought of under the Saudi Law of Judiciary. This idea proceeds from the Islamic legacy, whereby Muslim leaders (*caliph, sultan and imam*) were detected as interfering in the judiciary and its performances.[53] Accordingly, the Law of Judiciary stresses that:

> Judges are independent and in the administration of justice. They shall be subject to no authority other than the provisions of *Shari'a* and laws in force. No one may interfere with the judiciary.[54]

2.5 Summary

This chapter has provided background to Saudi Arabia and the Saudi legal structure. This chapter attempted to answer the research question regarding how the Saudi legal structure works. In the second section, specific information about Saudi Arabia was given, detailing the special position of Saudi Arabia in the Islamic realm and the world as a whole. Particularly, the Basic Law of Governance and the country's executive, legislative and judicial authorities were examined respectfully and briefly in Sections Three and Four, thus guiding understanding of these particular issues, which will assist in defining how this legal

51 *Supra* note 44 at 248.
52 See Al-Riyadh Newspaper, October 7, 2007, Issue 14349.
53 Mohammad Abu Zahra, *The Origins of Islamic Jurisprudence*, Arabic edition, Dar Al Nahda, Cairo, 1970, p. 42.
54 Law of Judiciary 1965, Art. 1. Also, article 46 of the Basic Law of Governance suggests that 'The judiciary is an independent authority. There is no control over judges in the dispensation of their judgments except in the case of *Shari'a'*.

structure affects both the Saudi external institutional framework for corporate governance and Saudi corporate governance arrangements.

Chapter Three

Corporate Governance: Definitions, International Standards, Models and Theories

3.1 Introduction

In order to achieve the research aims we have to, firstly clarify and extend our understanding of corporate governance and investigate previous completed research to help us to provide a background framework for the current study. For the purpose of this endeavour, the current chapter is divided into a number of sections. The first section will provide an analysis of the definitions of corporate governance. The next section will emphasise international efforts for establishing corporate governance standards. The third section will analyse corporate governance laws. Corporate governance theories will be examined in Section Four. Finally, a summary will be provided.

3.2 Definitions of Corporate Governance

There is a diversity of definitions for corporate governance. It is recognised that corporate governance definitions can be distinguished from each other depending on which corporate governance model has been adopted by a country's regulator. In other words, the various definitions depend on the model of corporate governance and, in addition, take account of specific characteristics of corporations and national distinctions of the country or the jurisdiction where these corporations function. For instance, the definition would focus on the shareholders corporate governance model if the definition were to follow the model applied in Anglo-Saxon countries. The definition would also concentrate on the stakeholder's corporate governance model if the definition were to pursue this model, which is applied in Continental European countries and Japan.

However, during the last few years, different points of view regarding the definition of corporate governance have emerged in the course of the formation and development of corporate governance in different corporations and countries. This methodology leads us to an understanding that there is, without doubt, a wide range of definitions of corporate governance and these vary hugely. In researching corporate governance, many scholars have attempted (and are still attempting) to categorise the definitions of corporate governance.

Below, we will consider some of the available definitions of corporate governance, which we will aim to base our discussion on.

One of the most used and earliest definitions of corporate governance was that presented by Sir Adrian Cadbury, head of the Committee on the Financial Aspects of Corporate Governance in the UK. In his report, he defined corporate governance as the system by which companies are directed and controlled and through which boards of directors are responsible for the governance of their companies. He also interpreted the shareholders' role in governance as being to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.[1] This report was later designated the 'Cadbury Report', which became famous for setting out requirements for corporate governance to be adhered by UK listed corporations. Apparently, this definition was accepted at the time, but much has changed since, and the nature of corporate governance has taken on additional perspectives. Sir Adrian Cadbury's definition was extended, and he stated that:

> Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.[2]

The pioneers of corporate governance, the economic scientists Monks and Minow defined corporate governance in their book as the relationship between various participants (chief executive officer, management, shareholders, and employees), believed to be crucial in determining the direction and performance of corporations.[3] This definition also focuses on the relationship between corporate governance participants, but corporate governance has additional aspects that determine the performance of the corporation, such as financial and social aspects, which have been omitted in this definition.

1 Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance*, Gee Publishing, London, 1992, p. 19.
2 Magdi Iskander and Nadereh Chamlou, *Corporate Governance: A Framework for Implementation*, The World Bank, 1999, p. vi.
3 Robert Monks and Nell Minow, *Corporate Governance*, Blackwell Publishing, Oxford, 2004, p. 20

Blair described corporate governance as covering the entire set of legal, cultural and institutional arrangements that determine what publicly trading corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are to be allocated.[4] As can be seen, this definition describes corporate governance in reference to publicly trading corporations. However, it is known that corporate governance determines the legal, cultural and institutional arrangements not only of the publicly trading corporations, but also of non-public corporations, including closed corporations and state-owned corporations.

A more advanced definition by Shleifer and Vishny sought to be more specific in relation to the provision of finance, considering the protection of outside investors against expropriation of their financial resources by companies. They argued that:

> Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. How do they make sure that managers do not steal the capital they supply or invest it in bad projects? How do suppliers of finance control managers?[5]

Another definition by scientists John and Senbet stated that corporate governance deals with mechanisms by which the stakeholders of a corporation exercise control over corporate insiders and management in such a way that their interests are protected.[6] Unquestionably, corporate governance is a mechanism, and this definition concerns the external mechanism of corporate governance. However, we ought not to forget that there are additional internal mechanisms that imply that control and management lie within the corporation.

According to Ticker, corporate governance in terms of the role of governance is not concerned with the business of running the company, but with providing overall directions to the enterprises. It functions by overseeing and controlling the executive actions of management, also satisfying legitimate expectations for accountability and regulation according to the interests beyond the corporate boundaries; that is to say, all companies need

4 Margaret Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century*, The Brookings Institution Press, 1995, p. 388.
5 Andrei Shleifer and Robert Vishny, 'A Survey of Corporate Governance', *Journal of Finance*, 1997, 52 (2), p. 737.
6 Kose John and Lemma Senbet, 'Corporate Governance and Board Effectiveness', *Journal of Banking and Finance*, 1998, 22, p. 372.

governing as well as managing.[7] This definition, as we assume, describes the term to some extent, by demonstrating the difference between corporate governance and running a company business, which is predominantly expressed in relation to corporate management, emphasising oversight and control over the company's management while also directing the enterprise.

Solomon and Solomon described corporate governance as a system of checks and balances (both internal and external) that are applied to companies to ensure that they discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business.[8] The definition is perfect for our purposes, but we have to take into account the fact that in today's business environment not all companies are accountable to their stakeholders and not all act in a socially responsible way, especially those conducting their business activities in developing and transitional countries.

Another scholar, Rossouw, stated that the term 'corporate governance' is generally understood to mean the system by which a company is controlled and managed. Corporate governance is therefore defined as a system that certifies that the board of directors and management of corporations obtain a balance with the interests of their stakeholders.[9]

Plessis defines corporate governance as:

> The process of regulating and overseeing corporate conduct and of balancing the interests of all internal stakeholders and other parties…who can be affected by the corporation's conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation.[10]

7 Mahmut Yavasi, 'A Socio-Legal and Economic Introduction to Corporate Governance Problems in the E.U', *Company Lawyer*, 2001, 22, p. 162.
8 Jill Solomon and Aris Solomon, *Corporate Governance and Accountability*, John Wiley& Sons, Chichester, England, 2004, p. 40.
9 G.J. Deon Rossouw, 'Balancing Corporate and Social Interests: Corporate Governance Theory and Practice', *African Journal of Business Ethics*, 2008, 3, p. 29.
10 Jean Plessis, 'Corporate Law and Corporate Governance Lessons from the Past: Ebbs and Flows, but Far from "The End of History" Part1', *Company Lawyer*, 2009, 30, p. 44.

As is apparent, the last two definitions are formulated with the intent to balance the interests of all corporate participants, including external stakeholders. Hence, it can agreed that corporate governance should create a system within a corporation that facilitate the interests of all stakeholders, both internal and external.

In 1998, the Organisation of Economic Co-Operation and Development initiated a document unifying the corporate governance norms and providing a single definition of corporate governance. Thus, the document, the OECD Principles of Corporate Governance was promulgated, asserting that:

> Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring.[11]

This definition serves as an international benchmark for understanding and addressing corporate governance. Even following acceptance of this standardised definition of corporate governance, it is suspected that it was probably still not comprehended fully as great corporate scandals continued to occur resulting in the collapse of a number of large international corporations.

Within the framework of this research, as carried out in the field of law, we made an attempt to define corporate governance from a legal perspective. Thus, for the purpose of this research, we propose the following definition of corporate governance; defining it as the process by which it is possible to ensure compliance with norms, restrictions and standards that regulate interrelations between a corporation and its external environment, as well as among the principal corporate participants operating inside the corporation (initially between

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11 Organisation for Economic Co-Operation and Development, *OECD Principles of Corporate Governance*, 2004, p. 11.

shareholders and management) in order to protect their legitimate rights and interests and to optimally resolve problems concerning separation of control (ownership) from management.

In light of it is important to note that the CGC is a newly enacted code within the auspices of the Saudi corporate and capital market system. It was thought that this code was promulgated by the Capital Market Authority Board in line with other international corporate and capital market standards. Notwithstanding, the Capital Market Authority Board was not concerned with the significance of the definition contained for corporate governance. Consequently, the code was transplanted inside Saudi corporate and capital market system in accordance with widespread international corporate governance standards, but in the absence of a comprehensive definition. It is to be recalled that corporate governance as a terminology is a relatively recent phenomenon, accordingly numerous scholars are of the opinion that many institutions and individuals who are not well familiar with the terminology itself. In particular, this factor has invigorated authors to announce their own definitions of corporate governance, to be utilised by either the Saudi Capital Market Authority Board or other Saudi institutions involved in corporate governance. Thus, the elements that shape the author's definition draw on other scholars' definitions and corporate governance theories, such as the agency theory, shareholder theory and stakeholder theory, and will be included later in this chapter.

Again, when it comes to the Saudi context, the definition of corporate governance and the concepts it covers are unclear. This is because corporate governance is a recent addition to the Saudi legal framework.[12] Additionally, the term 'corporate governance' when translated into Arabic is '*hawkama'*, which has an ambiguous meaning.[13] This ambiguity is derived from the lack of Arabic literature in the field that deals with the subject of corporate governance, the development of existing corporate governance regulations and actual

12 It should be pointed out that the term 'corporate governance' derives from an analogy between the government of cities, nations or states and the governance of corporations. But, perhaps, the first documented use of the term 'corporate governance' was by Richard Eells, denoting 'the structure and functioning of the corporate polity'. It is thought that corporate governance came into existence in the 1990s, but its modern form dates to the 1960s. Marco Becht, Patrick Bolton, Ailsa Roell, 'Corporate Governance and Control', *Finance Working Paper,* No. 02-2002, 2005, p. 2. Also, Richard Sedric Fox Eells, *The Meaning of Modern Business: An Introduction to the Philosophy of Large Corporate Enterprise*, Columbia University Press, 1960.
13 Mofakk Al Yafi, 'The Separation of Powers and the Powers of the Board of Directors and Corporate Family', *A Working Paper to the Conference of the Requirements of Corporate Governance and the Arab Capital Markets,* Arabic edition, Egypt, 2007, p. 138. It is worth noting that the Academy of the Arabic Language accredited the translation of the terminology 'corporate governance' to be in Arabic '*hawkama'* in 2003.

applications. It also comes from a misunderstanding of the word (governance), since some think that corporate governance represents the interference of the government in the corporations; likewise the interference of the government in privatising institutions.[14]

However, it is argued that although the Capital Market Authority Board has encompassed the CGC, this code still does not include a definition of corporate governance.[15] It is therefore considered that adding a definition of corporate governance to the Capital Market Authority Code represents an urgent need that should be addressed swiftly. The reason for this is that the CGC has been in existence for seven years and to date half of the CGC provisions have been made mandated on listed companies' submissions. For this reason, it is thought that it would be undesirable to leave the CGC without a determined definition, as the Saudi definition of corporate governance should be indicated.

Thus, it is supposed that the Cadbury report and the OECD principles of corporate governance are the most well-known definitions and as such may be suggested for use. Specifically, these definitions are the most prevalent forms of international corporate governance. Significantly, the Cadbury report would be advised as an example, since it was the first corporate governance report which was received with respect domestically in the UK and internationally. It is undisputable that the Cadbury report, as a piece of regulation covering corporate governance themes has distinct and admirable criteria. Indeed, the Cadbury report was the paramount UK corporate governance committee giving suggestions and valuable recommendations to regulate numerous essential corporate governance issues, including shareholders' rights, the board of directors' duties and responsibilities as well as the board of directors' sub-committees.

On the other hand, World Bank affairs regarding corporate governance focus on the OECD principles of corporate governance in regards to sustaining shareholders' rights, the action of stakeholders, transparency and disclosure requirements and the responsibilities of the board of directors. In addition, the procedures of the World Bank in encouraging corporate governance practices are visible in its efforts in gathering information about each country's corporate governance practices as well as when providing the institutional framework of

14 Obaid Al Mutairi, 'Apply the Procedures Governing the Companies in Saudi Arabia', *Arab Journal of Administrative Sciences*, Arabic edition, 2003, 10, p. 15.
15 Riyadh Chamber of Commerce and Industry, *Corporate Governance: The Definition, the Principles, and the Saudi Experience*, Arabic edition, 2007, p. 29.

corporate governance for each country. Information is then exploited to develop national corporate governance regulations and practices in each country by improving work plans, academic conferences and the levels of practical support required by each country. In particular, the Saudi corporate governance outlook was built on, and now concentrates on, OECD principles of corporate governance in terms of promulgating and implementing provisions of corporate governance. Accordingly, it would be recommended that the Capital Market Authority Board should draw on this definition when formulating its own definition.

3.3 International Efforts for Establishing Corporate Governance Standards

Corporate governance, much like other humanitarian subjects, has been developed through well-intentioned international efforts. These international efforts have been prescribed by law committees and through the efforts of academics at special conferences and seminars. Therefore, international work towards establishing corporate governance standards seems to be vested in the UK corporate governance committees, the American Public Company Accounting Reform and Investor Protection Act and the OECD Principles of Corporate Governance. Indeed, other international and national bodies have advanced corporate governance. However, because of the limitation of this research, it focuses on the most noteworthy of the previously mentioned attempts only.

3.3.1 UK Corporate Governance Committees

Corporate governance in the UK has been subject to a variety of financial scandals that have affected UK corporations. These scandals appear to be a result of the failure of London Commonwealth, BCCI, Maxwell, Polly Peck and Coloroll corporations.[16] These scandals have caused a public lack of confidence in the financial statements and reports from these corporations. Consequently, they forced the London Stock Exchange and other authorities to respond by issuing special regulating reports. This has led to an accumulation of recommendations and codes of best practice being introduced over a period of many years.[17]

16 Austin Mitchell and Prem Sikka, ‘Taming the Corporations’, *Association for Accountancy & Business Affairs, Essex*, UK, 2005, p. 7.
17 Andrew Chambers, *Tottel’s Corporate Governance Handbook*, Tottel Publishing, London, 2005, p. 217.

Initially, the Council of the stock exchange, the Accountancy Profession and the Financial Reporting Council created a Committee on the Financial Aspects of Corporate Governance, which later introduced its report, the Code of the Best Practice, in 1992.[18] As mentioned above, this was widely recognised as the Cadbury Report.[19]

The major focus of the Cadbury Report concentrated on the board of directors at UK corporations, suggesting a principle of 'comply or explain'. This means that corporations, especially their governing bodies, should apply the recommendations of this report. If not, they should clarify by disclosing why they cannot or do not wish to implement these recommendations; this was deemed necessary even though the Cadbury Report was not obligatory in law.[20] It is thought that the most crucial aspect of the Cadbury Report was its dependence principally on self-regulation. It has been commented that:

> The Cadbury Report was not a report which produced a long list of recommended changes to the law and which thereby postponed the resultant hoped-for improvements until some remote future date after the legislature had acted on the recommendations. The Cadbury report took effect swiftly and without reliance on the law. Sometime after the report was issued by the London Stock Exchange added force to the recommendations of the report by amending the Listing Rules so as to require listed companies to make a statement about their level of compliance with the Cadbury Code of Best Practice and give reasons for non-compliance.[21]

It is said that soft-law incorporates elements of flexibility which hard-law does not. In particular, soft-law is identified as rules of conduct, which are initially non-binding, but at the same time have practical effects. When it comes to the implementation of the soft-law, in terms of the rules of conduct, it is stated that the implementation should rest in particular on

18 Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance*, 1992, p. 5.
19 *Supra* note 11 at 44.
20 *Supra* note 18 at 218.
21 Ben Pettet, John Lowry and Arad Reisberg, P*ettet's Company Law: Company Law and Capital Markets Law*, Pearson Education Ltd, 3rd ed, 2009, pp. 193-194.

the good-will of those approving and affected by it. If the good-will is absent, soft-law would result in undemanding compliance.[22]

Accordingly, ‘comply or explain’ can be defined as empowering monitors to work efficiently to determine whether the factor provided for non-compliance are adequate. Institutions should clarify their activities concerning any statute from which they have diverged. Comply or explain marks the threshold of a majority current global corporate governance codes. Compliance or non-compliance with the corporate governance codes should be stated clearly in board of directors’ reports and any other published formats.[23]

Moore suggests that the soft-law approach or ‘comply or explain’ principle, as presented in the Cadbury report is reasonable. This is because a compulsory set of principles would be anticipated to ensure a mechanical procedure for the obedience of corporations with the smallest possible standard. Thus, boards of directors and their legal experts would intentionally aim to gratify the stringent notelet of the law when conveying board’s sub-committees fundamental strategy objectives.[24]

Specifically, the main corporate governance objectives of the Cadbury Report cover the procedure of the board of directors, the process and significance of accounting, and auditing sub-committees of the board of directors, the importance of the duty of the executive directors and the contribution of shareholders’, namely institutional investors as the principal powerful group.[25]

Following this the Greenbury report was produced in 1995; this deliberately concentrated on direct remuneration, including procedures for remuneration committees, directors’ remuneration and remuneration policies, in order to apply for admission. The Greenbury report, nevertheless, illustrates the role of nomination and remuneration committees in relation to compensation packages for the executive, non-executive and independent board

22 Paul Sanderson, David Seidl, John Roberts and Bernhard Krieger, Flexible or Not? The Comply or Explain Principle in UK and German Corporate Governance, Centre for Business Research, University of Cambridge, *Working Paper No. 407*, 2010, p. 1.
23 Ibid, p. 2.
24 Marc Moore, ‘The End of “Comply or Explain” in UK Corporate Governance’, *Northern Ireland Legal Quarterly*, 60 (1), p. 88.
25 Christine Mallin, *Corporate Governance*, Oxford University Press, New York, 2004, p. 21.

members and disclosure of board members' compensations, service contracts and compensation policy.[26]

The Hampel committee was also formed in 1995; this established, in a special report, numerous aspects of corporate governance, such as the composition of the board, the shareholders' role, financial reporting and auditing and internal controls. In addition, the Hampel committee was intended to reassess performance based on the Cadbury and Greenbury reports, specifically, to shun any exercises that merely require box ticking by the corporations.[27]

In 2001 the Miners Report was delivered by its respective committee, and developed connections between firms and institutional investors to be performed at an annual general meeting. It also established the promotion of greater shareholder activism.[28]

Fifthly, the Turnbull Report, which was issued in 2003, dealt with internal control and risk management systems. The Turnbull committee affirmed that the board was responsible for ensuring that an internal control structure should be in place and would then be required corporations to report on their internal control and risk management regimes.[29]

The Higgs committee in 2003 made efficient suggestions which related to the role of non-executive directors, recommending that corporations should contain their annual financial reports within the number of the board meetings held, major committees established, the presence of board members' records and an evaluation of board performance to be fulfilled at least once a year.[30]

Also in 2003, the Smith committee was created to examine the audit committee's role, specifically, to enquire how to make certain that financial reports and internal controls might be in the best interest of shareholders.[31]

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26 Richard Greenbury, *Directors' Remuneration: Report of a Study Group*, 1995, p. 9.
27 Ronnie Hampel, *Committee on Corporate Governance: Final Report*, Gee Publishing Ltd, 1998, p. 6.
28 *Supra* note 18 at 218.
29 *Supra* note 18 at 218.
30 Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors*, The Stationery Office, 2003, p. 21.
31 Robert Smith, *Audit Committees Combined Code Guidance*, The Financial Reporting Council Ltd, 2003, pp. 3-17.

Finally, in 2008 (following an original 1998 report also revised in 2003), a Combined Code was again published which consolidated all the previously issued committee reports and developed common corporate governance regulations for UK joint stock companies. The revision in 2008 of the Combined Code covers the following areas: directors, remuneration, accountability and audit, relations with shareholders and institutional shareholders.[32] In addition, the Combined Code introduced new requirements regarding non-executive board members, requiring at least one-third of any board to be non-executive members, or at least half of the board members to be independent in some way. The Combined Code also advocates that there should be no convergence of power in one or two individuals.[33]

3.3.2 The American Public Company Accounting Reform and Investor Protection Act

The Public Company Accounting Reform and Investor Protection Act (hereinafter the Sarbanes Oxley Act) is the United States federal law which sets out corporate governance standards for US public companies.[34] This act was created in response to a number of corporate and accounting scandals that affected big US corporations; i.e. Enron, Tyco International, Adelphia, Global Crossing and WorldCom.[35] The Sarbanes Oxley Act comprises eleven sections relating to a variety of corporate governance auditing and accounting professional themes, including the designation of corporate board duties, external auditors' independence, corporate responsibility, and the internal control evaluation and enhancement of financial disclosure.[36]

In addition, the Sarbanes Oxley Act encouraged the Securities and Exchange Commission to apply polices on request to fulfil its articles, as well as to persist in supervising public companies. However, the Sarbanes Oxley Act also established a new quasi-regulatory public body that is a Public Company Accounting Oversight Board that is concerned with supervision, regulating, examining and disciplining accounting and auditing companies (domestic and international) in their functions as auditors of public listed companies.[37] This

32 *The Combined Code on Corporate Governance*, Financial Reporting Council Ltd, 2006, p.5.
33 Ibid, pp. 3-18.
34 *The Public Company Accounting Reform and Investor Protection Act*, 2002, p. 1.
35 John Coates, 'The Goals and Promise of the Sarbanes-Oxley Act', *Journal of Economic Perspectives*, 21 (1), 2007, p. 91.
36 *Supra* note 23 at 33-34.
37 *Supra* note 23 at 33-34.

board is also responsible for recruiting auditors to impose laws to deal with theft and deception committed by corporate board members and managers.[38]

The Sarbanes Oxley Act prevents auditors from giving confident consulting services to their consumers. It also instructs chief executive officers and chief financial officers to verify the correctness of corporate financial reports and persuades companies to create internal controls in order to assure the accuracy of internal financial information. The Sarbanes Oxley Act further advises that companies should disclose cleared off balance-sheet submissions. Significantly, the Sarbanes Oxley Act prevents companies from giving personal mortgages to the board members.[39]

There is debate regarding the Sarbanes Oxley Act in terms of its benefits and expenses. However, it is an essential act, since it has participated in practically refurbishing municipal assurance in the nation's capital markets by enforcing corporate accounting and auditing standards.[40] Koehn and Vecchio focus on the advantages of the Sarbanes Oxley Act, pointing out that it has certain advantages, including its affirmative impact on audit committee actions, its influence on private firms that are required to display fulfilment with internal control and its increase in the capacity for corporate governance disclosure.[41]

However, it is debatable whether the Sarbanes Oxley Act has effectively reduced America's international economic boundaries to foreign financial services by launching an excessively composite authoritarian environment into US financial markets. Specifically, the majority of small investment companies in the US have confirmed that the Sarbanes Oxley Act's regulations have made conducting business very difficult because of attendant costs.[42]

Although the Sarbanes Oxley Act is considered very costly, it is also rewarding. The Sarbanes Oxley Act has spurred companies to spend money on internal controls, specifically centred on a growth in audit costs. However, the Sarbanes Oxley Act has connected such growth in audit costs to a variety of long term advantages. In particular, investors not only

38 *Supra* note 34 at 91.
39 Brian Kim, 'Recent Development: Sarbanes-Oxley Act', *Harvard Journal on Legislation*, 2003, 40, p. 236.
40 *Supra* note 21 at 33-34.
41 Jo Koehn and Stephen Vecchio, 'Ripple Effects of the Sarbanes-Oxley Act', *CPA Journal*, 2004, 74(2), p. 36.
42 Nikki Swartz, 'Small Firms Seek Different SOX Rules', *The Information Management Journal*, 2006, p. 7.

encounter reduced jeopardy of losses from deception and stealing, but they also benefit from the issuance of trustworthy financial statements, disclosure and transparency.[43]

3.3.3 OECD Principles of Corporate Governance

In 1998, the Organisation for Economic Co-Operation and Development was one amongst many international organisations, as well as international governments, that were concerned with corporate governance in terms of enforcing the OECD principles of corporate governance.[44] In 2004, a revised version of corporate governance principles was enacted by the OECD to guarantee the foundation of an efficient corporate governance structure. The revised 2004 version of the OECD principles of corporate governance covered the following six areas:[45]

1) Ensuring the basis for an effective corporate governance framework
2) Rights of shareholders and key ownership functions
3) Equitable treatment of shareholders
4) Role of stakeholders in corporate governance
5) Disclosure and transparency
6) Responsibilities of the board

The OECD principles for corporate governance affirm that board members are accountable both to shareholders and to corporations. The scope of accountability to shareholders advises equivalent treatment of majority and minority shareholders. Meanwhile, the scope of accountability to the corporation indicates that board members should ensure that the corporation complies with existing laws, including their labour, health, taxation, safety, environmental and composition aspects.[46]

It is indicated that the OECD principles of corporate governance, which have been influenced by stakeholder value, have concentrated on the following aspects: financial issues that play an

43 *Supra* note 33 at 91. Subsequently, the adoption and implementation of Sarbanes Oxley Act in the US eventually caused its equivalent laws and acts to be enacted in countries in the rest of world in forms such as Bill 198 in Canada, J-SOX in Japan, CLERP9 in Australia, Financial Security Law in France, Clause 49 in India, and TC-SOX 11 in Turkey.
44 Tarek Abdel Aal, *Corporate Governance: Concepts, Principles, Experiences*, Arabic edition, University House, Alexandria, 2005, p. 40.
45 *Supra* note 12 at 7.
46 *Supra* note 12 at 24.

important role in the way corporations are managed, information irregularities between stakeholders, and that administration should be disqualified and an organisational contractual structure should be widespread within the corporation.[47]

Nowadays, the OECD principles of corporate governance serve as a basis in the sphere of international corporate governance having become a specific benchmark for corporate governance issues. The OECD principles of corporate governance are even now being used by other international organisations, such as the Financial Stability Forum and the World Bank, to improve corporate governance in regards to the specific countries they cooperate with.[48]

3.4 Corporate Governance Models

One of the most significant current discussions of corporate governance is that which focuses on corporate governance law. More specifically, two main corporate governance legal systems have been formed, which can be distinguished by means of models. The first is the Anglo-American shareholders' corporate governance model, and the second is the Continental European stakeholders' corporate governance model. In addition to these, there are other corporate governance models in operation. In particular, the government ownership of firms, including those in the financial sector can be categorised as a third corporate governance model. Furthermore, the model which is dispersed in developing countries is that of the family owned-businesses.[49] However, in this research, there will be more discussion about the Anglo-American shareholders' corporate governance model.[50]

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47 Jackie Krafft and Jacques Ravix, 'The Governance of Innovative Firms: An Evolutionary Approach', *Economics of Innovation and New Technology*, 2005, 14 (3), p. 10.

48 *Supra* note 42 at 45. For example, the World Bank affairs regarding corporate governance focus on the OECD principles of corporate governance in regards to sustaining shareholders' rights, the action of stakeholders, transparency and disclosure requirements and the responsibilities of the board of directors. In addition, the process of the World Bank for encouraging corporate governance practices can be seen through its efforts in gathering information about each country's corporate governance as well as providing the institutional framework of corporate governance for each country. Then, information is exploited to develop national corporate governance regulations and practices in each country by improving the work plans, academic conferences and the level of practical support required by each country.

49 Neil Fligstein and Jennifer Choo, 'Law and Corporate Governance', *Annual Review Law*, 2005, p. 70.

50 As the continental European and Japanese corporate governance models are not considered in Saudi corporate governance arrangements it has been decided to write about the Anglo-American corporate governance model, without going into specific detail, because such explanations are not related to the main title of the study and would not be worthwhile as they are outside the limits of the study.

Additionally, it is becoming increasingly difficult to ignore the usefulness of the Anglo-American model of corporate governance, since, as Barca states, it has become an international model for assessing national corporate governance regimes and developing methods by which to reorganise them.[51] Cuervo points out the more complex features of this model covering the corporate legal structure, as follows:[52]

1) The strong legal protection of shareholders
2) Resilient transparency and disclosure requirements
3) A very diffused ownership structure except for institutional investors
4) A strange bankruptcy and insolvency legislation
5) The corporation's control is vested in the board of directors
6) The non-executive board members have more power in terms of monitoring role
7) The capital markets are extremely liquid
8) The corporate control and takeover markets are developed

The Anglo-American shareholders' corporate governance model, nevertheless, consists of three ordered elements, namely those of shareholders, directors and executives. In addition, executives' power is derived from directors' power. Significantly, although the corporation's capital is dispersed among shareholders, they do not have the right to make straightforward decisions concerning corporations. Shareholders may incomprehensibly proceed throughout the board of directors to adjust executives' approaches and resolutions.[53]

The Anglo-American shareholders' corporate governance model has been argued for in some corporate governance literature. The most significant argument, put forward by Hansmann and Kraakman, is that the central premise, which has dominated Anglo-American thought, is that shareholders are those who should specify their rights above other stakeholders, namely employees, creditors, suppliers and society in general.[54]

51 Fabrizio Barca, 'Some Views on US. Corporate Governance', *Columbia Business Law Review*, 1998, 1, p. 1.
52 Alvaro Cuervo, 'Corporate Governance Mechanisms: A Plea for Less Code of Good Governance and More Market Control', *Corporate Governance*, Blackwell Publishing, 2002, 10, pp. 85-86.
53 Oliver Hart,' Corporate Governance: Some Theory and Implications', *The Economic Journal*, Blackwell Publishers, 1995, 105, p. 680.
54 Henry Hansmann and Reinier Kraakman, *Toward a Single Model of Corporate Law*, Oxford University Press, New York, 2002, p. 57.

A very early study theorised that corporate governance relations in firms has essentially argued for the prevalence of stakeholders' rights over shareholders' rights in the corporation. This study assumes that stakeholders' groups are able to achieve their rights by depending on their contractual agreements, which would be anticipated in advance; while shareholders on the other hand would remain insecure because corporate governance practices and actions would be expected to be in arrears.[55] This feature has been presumed to be the basic foundation of the Anglo-American shareholders' model of corporate governance. Moreover, this feature assists recognition of the reason behind the refusal of the Anglo-American shareholders' model of corporate governance to implement association-based stakeholders, which is the model of corporate governance implemented in some European countries (i.e. Germany).[56]

Notwithstanding, it is interesting to note that some scholars working on the Anglo-American shareholders' corporate governance model, in terms of the legal concepts, have disputed that managers are not independent and function in response to the investment of the shareholders and the board members. In addition, corporations should be run as a going concern on behalf of their shareholders.[57] For instance, Blair, having studied the topic of shareholder value, proposed that corporations ought to try supervising corporate governance actions on behalf of shareholders by enhancing the profits of their investment.[58]

The focused attention of shareholders under the Anglo-American model does not necessarily mean disposing of other groups' interests, namely stakeholders' groups. As an illustration, Hansmann and Kraakman emphasise that:

> Asserting the primacy of shareholder interests in corporate law does not imply that the interests of corporate stakeholders should go unprotected. It merely indicates that the most efficacious legal mechanisms for protecting the interests of

55 Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure', *Journal of Financial Economics*, 1976, 3, p. 307.
56 *Supra* note 52 at 67.
57 Eric Gedajlovic and Daniel Shapiro, 'Management and Ownership Effects: Evidence from Five Countries', *Strategic Management Journal*, 1998, 19, p. 534.
58 Margaret Blair, 'Shareholder Value, Corporate Governance and Corporate Performance: A Post- Enron Reassessment of the Conventional Wisdom', 2003, 10, p. 11.

> non-shareholders constituencies or at least all constituencies other than creditors lie outside of corporate law.[59]

This assertion supports the afore-mentioned argument that all the beneficial stakeholders' groups containing employees, suppliers, creditors, and the whole community should not be controlled by corporate governance law, since these groups would obtain their rights depending on their contractual agreements with corporations, which are concluded from corporate law. Accordingly, this presumption showcases how various laws associated with corporate governance are basically intended to concentrate on essential topics that include corporate ownership structure and the board members' and top executives' responsibilities, leaving obligations linked to the stakeholders' groups without clarification.[60]

On the other hand, the Continental European stakeholders' corporate governance model contains four elements: namely shareholders, directors, executives and employees. This model presents a regime involving administration. The Continental European stakeholders' model originates from the principle that business risk is subordinate to shareholders rather than employees. The employees, in particular, would not spread their investment collection; instead, they would create proposals for the board of directors in addition to decreasing jeopardy. It may be observed that this model embraces employee involvement in corporate governance through the institution of the board of directors, and is applied in Continental European countries, mainly in Germany.[61]

It is also alleged that the Continental European corporate governance model appears to be similar to the Anglo-American corporate governance model in some specific aspects of corporate governance. This has been pointed out by Cuervo, who examines the transformation of the Continental European form of corporate governance towards the Anglo-American form of corporate governance. As he asserts, the first cause of this transformation is the globalisation of markets and the need to discover governance forms to improve effective competition in the marketplace. The second cause is the push from institutional investors to make the transformation towards the Anglo-American corporate governance regime. The final cause is the standardisation of information across firms in response to

59 *Supra* note 52 at 64.
60 *Supra* note 52 at 64.
61 *Supra* note 51 at 681.

entering international capital markets.[62] However, this allegation is disputed, because even if there is a globalisation of markets, European corporate laws continue to maintain stakeholder's interests, and to assert that institutional investors are pushing companies to transform into an Anglo-American corporate governance regime has not been confirmed thus far.

From the above discussion, it appears that the Anglo-American corporate governance model is focused on shareholders' rights, although stakeholders' rights are also considered. More specifically, the Anglo-American corporate governance model has been executed by the majority of international capital markets to determine best corporate governance provisions. Currently, some capital markets have chosen to combine provisions of corporate governance from the Anglo-American and Continental European corporate governance models; this includes Saudi Arabia. The following section will clarify corporate governance theories as related to the Anglo-American and Continental European corporate governance models.

3.5 Corporate Governance Theories

3.5.1 Agency Theory

Over the last century, there has been a dramatic increase in interest in agency theory, which explains the problems affecting companies to be due to the separation between company ownership and the company administration.[63] Agency theory can be defined as the sustained deliberation between managers and owners, and is known to accomplish a contract between them which results in benefits for both sides.[64] Moreover, agency theory has been understood to represent the first step towards understanding corporate governance from a theoretical framework.[65]

The historical origins of debate on company ownership began with Adam Smith, who wrote about how ownership is divided between shareholders, the board of directors and chief executives as principal-agents. He argued that managers of joint-stock companies would not

62 *Supra* note 50 at 91.
63 *Supra* note 47 at 70.
64 Simon Learmount, 'The Process of UK Corporate Governance Reform', *Director & Legal Affairs*, 2002, 92, p. 4.
65 Margarita Baird, 'The Role of the Non-Executive Director in Modern Corporate Governance', *Company Lawyer*, 2006, 27, p. 67.

look after the company or its wealth or their own companies and their own wealth.[66] He stated that:

> The directors of such joint-stock companies, however, being the managers rather of other people's money than their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.[67]

Berle and Means claimed that separation between company ownership and management is ineffective. They commented that management controls companies to create investments by preferring development to income. In other words, managers pursue less hazardous investments to reserve their careers rather than making advantages for themselves.[68]

Thus, agency theory is considered imperative, due to the acceptance of owners or shareholders of the agency problem and development due to ownership needs and the company's management growth.[69] It is said that corporations are striving to increase adequate money to make products and obtain economic advantages. The company's owners or shareholders would not control the company's themselves due to a lack of financial experience, technical operations or interest in running the company.[70] Therefore, owners would provide money to agents (the managers) so that those managers would then be in a position to make returns and to reassure owners of supreme revenues on their money. As a result of this, those owners or shareholders who provided money and who have a lack of financial experience would be at their managers' mercy.[71]

As a consequence of this agency, it appears that top executives would sometimes exercise unlawful activities in order to comply with either their corporation's interests or their own interests. For this reason, executives have plenty of authority when it comes to essential

66 *Supra* note 8 at 162.
67 Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, An Electronic Classics Series Publication,1776, p. 606.
68 Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property*, Originally Published in 1932, by Harcourt, Brace & World, Inc, p. 50.
69 G J Deon Rossouw, 'Balancing Corporate and Social Interests: Corporate Governance Theory and Practice', *African Journal of Business Ethics*, 2008, 3, p. 30.
70 Kamalpreet Kaur and Mandeep Kaur, 'Corporate Ownership Structure and Control: Evidence from India', *Lcfai University Journal of Corporate and Securities Law*, 2009, 1, p. 53.
71 *Supra* note 47 at 65.

company issues, while at the same time they display a lack of accountability to board members and owners.[72] Significantly, owners would not acquire profits according to their operational shares because top executives' conduct intends to make decisions for their own benefits, as they become owners of these corporations by increasing their own shares. This philosophy simply means that judicial owners and shareholders lose control over their own wealth, whereas top executives take control over wealth that they do not really own.[73] In addition, those executives might commit numerous wrongdoings using the company's capital rather than reforming, owing to practical difficulties and a focus on attaining only short-term performance objectives, since these are manageable and achievable in comparison to long-term performance objectives.[74]

On the contrary, agency theory encourages an administrative practice that provides top managers with the opportunity to run their corporations based on their personal interests rather than those of the owners. For managers, there is always an opportunity to manage a corporation in accordance with their own purposes and interests, and for owners there is always a risk that a negligent use of their property by managers might occur if the managers' capacity to dispose of company resources was privileged over profits on investment. That is why, under the auspices of agency theory the interests of managers and company owners do not always coincide.[75]

In fact, Cheffins indicates an important element of the agency problem in relation to corporations' executives, noting how they fulfil their obligations as well as taking a certain amount of money as remuneration and adding personal expenses to the company account. In particular, he reports that:

> Company executives can shirk their responsibilities by carrying out more desirable activities. Alternatively, they might engage in looting or diversion of corporate assets by constructing unnecessarily lavish offices, by carrying out exotic business travel, by providing high-paying jobs to family members, or by squandering funds on ill-conceived pet projects. Moreover, senior executives

72 James Westphal and Edward Zajac, 'The Symbolic Management of Stockholders: Corporate Governance Reforms and Shareholders Reactions', *Administrative Science Quarterly*, 1998, 43, p. 128.
73 *Supra* note 68 at 53.
74 Mark Roe, Political Determinants of Corporate Governance: Political Context, Corporate Impact, Oxford University Press, New York, 2003, p. 20. *Supra* note 70 at 130.
75 *Supra* note 53 at 308.

> might use their influence in the boardroom to ensure that the board awards them overly generous salaries and excessive bonuses.[76]

Agency theory can lead to a problem because of the need for monitoring agents, as this can be costly. Specifically, Jensen and Meckling concentrated on the fact that agency costs are affected by the contractual preparations between owners and a corporation's top managers. These scholars identified agency association as an agreement under which the principals appoint another individual as a manager who will then accomplish some tasks on their behalf that indicate some decision-making ability to the manager. These scholars additionally suggest that agency expenditure then occurs because those managers who are agents would not act in the paramount interests of the principals, who are the owners.[77]

Thus, the solution to such an agency problem lies at the centre of this theory, and involves developing long incentive contracts; this might involve offering a share of ownership and stock options to agents (managers) and principals (owners), which is considered to be one such solution. Nevertheless, there are a variety of solutions to the agency problem. Firstly, boards of directors have a fiduciary duty to owners and shareholders to oversee executives. Secondly, independent directors and accountants might carry out significant tasks when monitoring managers. Thirdly, executives' rewards would be secured by company performance, thus supporting their curiosity with that of the owners. Finally, disclosure and transparency regulations would necessitate appropriate particles of operative and presentation outcomes to present and future owners.[78]

3.5.2 Shareholder Theory

Shareholder theory mainly implies and addresses the protection of a corporation's shareholders' rights and concerns by providing equitable treatment. Notably, this theory focuses on shareholders' rights, which have to an extent been discussed under international corporate governance principles as the primary group of rights requiring protection. To

76 Brian Cheffins, 'Current Trends on Corporate Governance: Going from London to Milan via Toronto', *Duke Journal of Comparative and International Law*, 1999, 10, p. 15.
77 *Supra* note 53 at 308.
78 *Supra* note 47 at 65.

illustrate, the OECD principles of corporate governance affirm that 'The corporate governance framework should protect and facilitate the exercise of shareholders' rights'.[79]

It is recognised that the corporate governance framework is directed towards giving the shareholders, the board of directors and top executives the right to advance the corporation's objectives. The shareholders, nonetheless, should have the rights to manage the company in order to enhance the profitability of their investment.[80] However, shareholders generally do not pursue their rights, since they usually give full power to top executives to lead the company. In addition to this, shareholders frequently abandon their voting rights in favour of board members and top executives.[81] Despite this assertion, it can be stated that shareholders always have legitimate rights as specified in the company's articles of association (or other corporate regulations), and can realise these rights through general meetings intended for shareholders. Moreover, board members and top executives are responsible for observing shareholders' rights.

It is relevant also if shareholders are either majority or minority shareholders. In addition, it should be considered that majority shareholders might be single individuals or a group of shareholders, known as majority shareholders because they control more than fifty per cent of a corporation's shares. Minority shareholders are those individuals who hold less than fifty per cent of a corporation's shares.[82] Shareholder theory is based on the above-stated shareholder groups, namely majority and minority shareholders. Identifying these two groups is vital if their rights are to be fully ensured; this is especially true of minority shareholders. To this end, the OECD principles of corporate governance state that:

> The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders

79 *Supra* note 12 at 18. The OECD principles of corporate governance have also accounted for the shareholders' rights as follows: The shareholders' rights shall contain the right to secure methods of ownership registration; convey or transfer shares; obtain relevant and material information on the corporation on a timely and regular basis; participate and vote in general shareholder meetings; elect and remove members of the board and share in the profits of the corporation. *Supra* note 12 at 34.

80 *Supra* note 8 at 163. See, Joseph Heath and Wayne Norman, 'Stakeholder Theory, Corporate Governance and Public Management: What Can the History of State-Run Enterprises Teach us in the Post-Enron Era?', *Journal of Business Ethics*, 2004, 53, p. 249.

81 *Supra* note 8 at 164.

82 Alan Dignam and John Lowry, *Company Law*, Oxford University Press, New York, 2010, p. 200.

should have the opportunity to obtain effective redress for violation of their rights.[83]

In this review, shareholder theory is seen to cover relations, not only between company shareholders and boards of directors and managers, but also among the shareholders' themselves. The criticism levelled at majority shareholders previously, has centred on their abuse of authority in regards to minority shareholders, especially in relation to the voting process that takes place during the company's general meeting and depends on cash rather than rights.[84] In addition, majority shareholders would fight against the implementation of a corporate governance framework emphasising corporate compliance, since the framework is intended to protect minority shareholders.[85] Specifically, it can be seen that in many developed and less-developed countries corporate governance provisions can be maintained in terms of protecting minority shareholders' rights. In the Saudi case, the CGC defines shareholder groups and gives minority shareholders more opportunities, as will be argued in Chapter Nine.[86]

3.5.3 Stakeholder Theory and Corporate Social Responsibility

Stakeholder theory is specifically understood to mean that the stakeholders' groups including customers, employees, suppliers, creditors and the local community should be the main beneficiaries of a corporation's submissions. This theory is often viewed as associating the incompatibility of a corporation's interests with those of society. In addition, the theory states that corporations should be managed on behalf of all associated groups instead of just the shareholder group.[87] The stakeholder has been defined thus: 'A stakeholder in an organisation is any group or individual who can affect or is affected by the achievement of the organisation's objectives'.[88] Stakeholder theory divides a corporation's stakeholders into two groups. The first group being direct stakeholders who have formal and contractual agreements with the corporation; such as its employees, creditors, customers and suppliers.

83 *Supra* note 12 at 20.
84 *Supra* note 50 at 89.
85 Istemi Demirag and Jill Solomon, 'Guest Editorial: Developments in International Corporate Governance and the Impact of Recent Events', *Blackwell Publishing*, Oxford, 2003, 11, p. 4.
86 Corporate Governance Code 2006, Art. 2.
87 Gerald Vinten, 'Shareholder Versus Stakeholders – is there a Governance Dilemma?', *Corporate Governance*, Blackwell Publishers, 2001, 9, p. 37. Roberta Phillips, 'Stakeholder Theory and a Principle of Fairness', *Business Ethics Quarterly*, 1997, 7, p. 52.
88 Edward Freeman, *Strategic Management: A Stakeholder Approach*, Boston, Ballinger, 1984, pp. 31-32.

The second group contains indirect stakeholders and includes the government, local communities and environmental groups.[89]

Nevertheless, opponents of Anglo-American shareholders' corporate governance model observe that corporations would fulfil their role more fully as far as the stakeholders' interests are protected.[90] For instance, Gibson points out that the corporation needs to consider all the beneficial stakeholders' groups that are influenced by the corporations' operations.[91] According to Smith, managers, when making decisions, should consider the stakeholders' rights since managers should act as the agents for the benefit of all stakeholder groups.[92] Coffee also reports that the Continental European stakeholders' corporate governance model is beneficial to stakeholders' groups. As an example, corporate employees in Germany have the right to charge half of the board members, as responsible for controlling their corporations and ensuring they do well.[93] Thus, from this perspective it can be supposed that within the realm of stakeholder theory the corporation, particularly its managers, should have certain liabilities affecting not only the shareholders but also various stakeholder groups.

It is clear that a good corporate governance framework should include alternative sources that would then protect stakeholder groups' rights.[94] In consideration of this, it is assumed that even when stakeholders' rights are not established by law they must be recognised on the basis of mutual agreements and contracts. In this regard, the OECD principles of corporate governance remark that:

> The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.[95]

89 Kevin Gibson, 'The Moral Basis of Stakeholder Theory', *Journal of Business Ethics*, 2000, 26, p. 245.
90 Simon Archer and Rifaat Abdel Karim, 'Corporate Governance: Market Discipline and Regulation of Islamic Banks', *Company Lawyer*, 2006, 27, p. 134.
91 *Supra* note 87 at 245.
92 Jeff Smith, 'The Shareholders vs. Stakeholders Debate', *Mit Sloan Management Review*, 2003, p. 86.
93 John Coffee, 'The Future as History: The Prospect for Global Convergence in Corporate Governance and its Implications', *North Western University Law Review*, 1999, 93, p. 659.
94 Igor Filatotchev and Brian Boyd, 'Taking Stock of Corporate Governance Research While Looking to the Future', 2009, 17, p. 258.
95 *Supra* note 12 at 21.

Various studies have revealed the distinctions between the two stakeholder and shareholder theories. The main features that distinguish stakeholder theory from shareholder theory are, as some scholars assert, that all the stakeholder groups should have the right to contribute towards the corporation's decisions, in particular those associated with them as well as the corporation's board members and top executives, who are able to act on behalf of all groups including the shareholders group.[96] However, in our opinion, it would seem debatable that the corporation should act on behalf of the stakeholders, so this research highlights the importance of the corporation acting on behalf of its owners and shareholders, while allowing a consideration of its stakeholders' interests.

One of the criticisms of stakeholder theory is that investors may become restless concerning their investments when the target of the company is to achieve balance between stakeholders' interests and shareholders' interests, instead of maximising shareholder capital. Therefore, the stakeholder theory undermines the corporation's goal that is the maximisation of shareholders' capital.[97]

Once again, stakeholder theory has been debated; however, it seems somewhat idealistic when connected to all stakeholders' groups. The major debate within stakeholder theory is that this theory is impractical principally, and would not provide any improvements to the corporate governance legal system. This is because this theory is almost always generated by management and business experts and it typically contradicts owners' and shareholders' goals and interests. In particular, it is significant to note that this theory threatens the fundamental goal of most corporations, which is increasing their shareholders' wealth. However, the supporters of the stakeholder theory have argued this point by providing that balancing the interests of the shareholders with those of other stakeholders' groups would not diminish the maximization of shareholders' interest.[98]

On the other hand, there are numerous remarkable subjects that reflect the role of corporate governance in literature, one of which relates to corporate social responsibility (hereinafter CSR). This subject is linked to stakeholder theory and can be traced back to Dodd's concept.

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96 Zamir Iqbal and Abbas Mirakhor, 'Stakeholders Model of Governance in Islamic Economic System', *World Bank*, p. 5.
97 Elaine Sternberg, *Corporate Governance: Accountability in the Marketplace*, Institute of Economic Affairs, London, 2004, p. 130.
98 Ibid, pp. 126-127.

According to the corporation's social responsibility theory, which he developed in 1932, the corporation does not depend only on shareholders but also on its employees, creditors, customers and those who play a role in making decisions within the corporation, as decision making eventually concerns their interests as well. His theory demonstrated that the decisions made by corporations are pertinent to society, and therefore corporations should not make decisions that are damaging to society. In addition, he claimed that the subsistence of the corporation as a body can be taken apart by the persons who compile it. This means that a corporation would be envisaged in the same way as an individual permeated with a sagacity of social responsibility.[99]

This approach, in our view, allows a corporation to operate not only as a profit-making mechanism, but also as an essential part of society. For example, CSR has challenged some important features, such as avoiding damage to the environment, looking after employees, being ethical in business actions and supporting the positive attitudes of the local communities.[100] Other examples show that CSR commonly signifies a calculating assurance given by a corporation to suggest that it will perform ethically and donate to economic expansion, while also cultivating the quality of life of its employees and the local community.[101]

Corporations should fulfil a diversity of obligations in order to sustain an ethical and social corporate framework. Arjoon specifies these obligations as follows. At first, a corporation should create an ethical written policy that would then be applied. Secondly, corporations should resolve ethical dilemmas. Thirdly, they should avoid harming others. Finally, corporations should make and keep honourable agreements.[102]

Nevertheless, a substantial number of studies have found that the conception of CSR ought to demonstrate a consideration of the social contract, which operates between society favourites and the corporation. Significantly, because a corporation is a branch of society and has a crucial social contract with that society, it should act accountably in regards to several social

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99 Merrick Dodd , 'For Whom Are Corporate Managers Trustees?', *Harvard Law Review*, 1932, 45 (7), p. 1161.
100 Asyraf Dusuki and Nurdianwati Abdullah, 'Maqasid Al *Shari'a*, *Maslahah* and Corporate Social Responsibility', *The American Journal of Islamic Social Sciences*, 24 (1), p. 27.
101 Adam Lindgreen and Valerie Swaen, 'Corporate Social Responsibility', *The International Journal of Management Reviews*, Blackwell Publishing Ltd, 2010, p. 3.
102 Surendra Arjoon, 'Corporate Governance: An Ethical Perspective', *Journal of Business Ethics*, 2005, 61, p. 349.

expectations and needs rather than to its shareholders. Therefore, a corporation should behave in accordance with acceptability to society in general by avoiding activity that would generate interference and disorder in people lives and needs.[103]

CSR does not wholly refer to donating to stakeholders' groups out of the corporation's profits, since this relates to environmental and social interactivities. Therefore, it can be accepted that CSR is part of the corporate process and should be agreed on by stakeholders' groups.

Jamali et al. examined the link between corporate governance and CSR, and concluded that neither should be independent of the other. Their study also found that the link between corporate governance and CSR would be stated as in the following points:[104]

1. Corporate governance involves responsibility and due respect to the desires of all fundamental stakeholder groups.
2. Corporate governance ensures that corporations are accountable to all stakeholder groups.
3. The stakeholders' attitude towards CSR insists that companies are at the heart of a difficult web of stakeholders' associations and have a duty to these different stakeholder groups.
4. Internal elements of CSR state that companies must accord due diligence to their accountability to internal stakeholders, stating aspects with regard to skills and education, place of work security, working conditions, human rights, equal prospects and workers' rights.

It has been assumed that corporations, mainly those in less developed countries rather than those in highly developed countries, perform unlawful business activities that breach their CSR and human rights enjoinment. It is also the case that unlawful business activities take place in developed countries, or in companies owned within developed countries operating elsewhere in the world. Sadly, a contemporary example is that of the BP Company which was responsible for an environmental disaster in the Gulf of Mexico in 2011 when an oil spill

103 *Supra* note 9 at 47. Also, *supra* note 97 at 29.
104 Dima Jamali, Asem Safieddine and Myriam Rabbath, 'Corporate Governance and Corporate Social Responsibility Synergies and Interrelationships', *Corporate Governance*, 2008, 16 (5), p. 446.

killed birds and fish, and damaged the marine environment and consequently people's livelihoods.[105] In this regard, the most critical recommendation of the Stockholm Declaration, which took place in 1972 and was ratified by approximately a hundred countries, specified the right to a healthy environment as a basic aspect of human rights, as well as preventing the State's public and private sectors from endangering people's leisure needs.[106]

Having said that protecting the environment is one of the missions of CSR; in Saudi Arabia the extent to which this is practiced is disappointing. There are many petrochemical industries inside Saudi cities that are causing extensive damage, even though they belong to highly regarded companies that are most certainly aware of the dangers of damaging the environment. To demonstrate, *Jubail* City has many petrochemical industries, with roughly 352 manufacturers who belong to numerous listed corporations. These manufacturers cause a great deal of pollution, which without doubt harms both the environment and the health of local people; this has forced the local government to hold international symposiums and conferences to try to overcome this problem.[107]

Another classic case of unlawful business activities that can lead to the abuse of CSR involves the employment of women and children workers. In fact, in many developing countries employees' rights have been disregarded, whether by local or international corporations. For example, the employment of women and children in jobs with unsatisfactory salaries, as well as failure to cover them for social security and health, or provide adequate safety precaution is in opposition to CSR.[108]

It is assumed that work that has been done, by international governmental and non-governmental bodies, to establish and develop CSR protection as the first step towards encouraging corporations to put in place human rights protection and avoid any breach of these rights regardless of circumstances. A report presented by the Human Rights Council, which underwrites the UN framework for business and human rights, advocates that:

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105 Interestingly, corporations that might have a negative impact on their neighbouring areas have not been allowed to launch their business affairs in many countries worldwide. To cite an example, corporations were required to establish whether they produced any harmful or polluting substances in their host community in the US a few years ago. *Supra* note 85 at 42.

106 Denis Arnold, 'Libertarian Theories of the Corporation and Global Capitalism', *Journal of Business Ethics,* 2003, 48, p. 164.

107 See, the link, available at: http://www.jubailenviro.com/, [Accessed 1 November 2012].

108 Ozay Mehmet, 'Al *Ghazzali* on Social Justice: Guidelines for a New World Order from an Early Medieval Scholar', *International Journal of Social Economics*, 1997, 24, p. 1214.

> The corporate responsibility to respect human rights which means to act with due diligence to avoid infringing on the rights of others, and to address such adverse impacts as may occur; and greater access by victims to effective remedy, judicial and non-judicial.[109]

However, there may be methods that can be suggested, that are related to a corporate governance legal structure, which can then enforce corporations to respect CSR. Because of this development, it appears that institutional investors, namely operators of pension funds, investment managers and insurance companies, would have a significant task in constructing a chain of protection and support of human rights. This rests on their investment decisions as well as their contributions to corporations.[110]

It has been argued that, due to the demands for CSR in the CGC,[111] a small number of Saudi listed corporations have adopted this valuable principle, although they maybe unclear as to precise direction. This ambiguity results from countless disadvantages, including the lack of an explanation by the CGC and the ignorance of the listed corporations' boards as to this valuable principle.[112]

It is clear, following a review of the boards' annual reports and websites that a substantial number of Saudi listed corporations do not refer to CSR. Among these listed corporations are, for example, the Saudi Ceramics Company and *Al-Babtain* Power and Telecommunication Company.[113] A small number of listed corporations, nevertheless, do have some understanding of CSR, such as Kingdom Holding, the Saudi Research and Marketing Group

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109 John Ruggie, *Corporate Law Project: Overarching Trends and Observations*, The UN Reports, 2010, p. 15.

110 Rory Sullivan, *Business and Human Rights: Why Investors Need Rules not Principles*, Available from: http://www.ethicalcorp.com/content.asp?ContentID=6954 [Accessed 1 November 2012].

111 Corporate Governance Code 2006, Art. 10 (E). Saudi CSR has been additionally introduced by the Saudi Arabian General Investment Authority. This semi-governmental body is in charge of the Saudi Arabian responsible competitive index that calculates the top Saudi listed corporations in accordance with several measures including corporation scheme, corporation management, stakeholder appointment methods and the social and environmental performance regimes. *Supra* note 105 at 12.

112 Interestingly, the current Saudi King advocated, at the commencement of the Saudi CSR Conference in 2009, that Saudi public and private sectors should take CSR into account in their commercial submissions. This change can be seen as evidence of serious efforts to enforce this principle by high ranked officials there. See, Al-Riyadh Newspaper, February 1, 2009, Issue 14832.

113 See the Official Website of Saudi Ceramics, available at: http://www.saudiceramics.com/index.php?lang=en, [Accessed 1 November 2012]. Also, see the Official Website of *Al-Babtain* Power &Telecommunication Company, available at: http://al-babtain.com.sa/WebSite/UserPagesEnglish/HomePage.aspx, [Accessed 1 November 2012].

and the Saudi *Zain* Company.[114] To illustrate, the Saudi Research and Marketing Group is concerned about organ transplantation and donation, Alzheimer's disease, care of orphans, the challenges of disability and residential services. The company declares that:

> The Saudi Research and Marketing Group has given utmost care to, and has carried out, the support and care for social and charitable events that can clearly be seen in what the group has provided for numerous charitable societies and organisations that are active in social work in Saudi Arabia.[115]

Because of the growing number of corporations and the high percentage of infringements in the social arena, including regarding the environment and civil liberties of people, which may be endangered by the activities of corporations, CSR should be taken into account. In particular, CSR policy must be explained fully in the company's articles of association and their self-regulatory corporate governance code, since justification of CSR does not only benefit companies themselves, but also all of the individuals in society who directly or indirectly interact with a corporation.

3.6 Summary

This chapter has debated the definitions of corporate governance, international standards, models and theories. The purpose of this chapter has been to provide an introductory chapter offering a review of corporate governance literature. Accordingly, the definitions of corporate governance have taken up considerable space in this chapter, since the CGC does not yet have an agreed definition. It is recommended that the Capital Market Authority Board should add a definition from other successful worldwide corporate governance ideologies, for example the OECD principles of corporate governance or those in the Cadbury Report.

The international efforts for establishing corporate governance standards were underscored by focusing on three successful attempts: UK corporate governance committees (e.g.

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114 See the Official Website of the Kingdom Holding Company, available at: http://www.kingdom.com.sa/en/CorpCocialRes_KF.asp, [Accessed 1 November 2012], the Official Website of the Saudi Research & Marketing Group, available at: http://www.srmg.com/socialresponsibility, [Accessed 1 November 2012], and the Official Website of the Saudi *Zain* Company, available at: http://www.zain.com/muse/obj/lang.default/portal.view/content/Social%20Responsibility/Saudi%20Arabia, [Accessed 1 November 2012].

115 Annual Report of the Saudi Research & Marketing Group of 2011, p. 25.

Cadbury Report, Greenbury Report and the Combined Code), the Sarbanes Oxley Act, and the OECD principles of corporate governance. Corporate governance models were analysed concentrating on the Anglo-American shareholders' corporate governance model and the Continental European stakeholders' corporate governance model. In addition, corporate governance theories were evaluated through explanations of agency theory, shareholder theory and stakeholder theory.

Chapter Four

Corporate Governance from the Islamic Perspective

4.1 Introduction

Over the past decade a dramatically heightened interest in corporate governance from the Islamic perspective has been observed, particularly in Saudi Arabia. Scholars have studied corporate governance from the Islamic perspective in order to examine the religious efficiency for tackling malpractice and corruption. These wrongdoings are seen as the main reasons behind national and international corporations' and market related scandals.[1] Consequently, Muslim thinkers have chosen Islam as a basis for delimiting corporate governance practices,[2] so that any new legislation complies with the needs of Saudi Arabia's contemporary Islamic society. It is hoped by Abdul Rahman that Islam would benefit Islamic financial institutions or even global corporations if Islamic principles and values were incorporated into habitual business practices.[3]

It is affirmed that corporate governance, either from the Islamic perspective or the western standpoint, covers essential tasks, thus assigning both the corporations' and the market contributors' goals. It is understood that the Islamic perspective would include additional values to those of corporate governance practices, as it relies on Islamic objectives for which there is no substitute in western corporate governance.[4] Having said this, the aims of corporate governance from the Islamic perspective are to amend those corporate legal regimes that were founded in the Muslim world, to impose Islamic objectives and values on day-to-day business and corporate dealings, to challenge the concept of Islamic social justice and most importantly to encourage Muslims, whether it be individuals or corporations, to

1 Mohammad Al Gamal, '*Islamic Bank Corporate Governance and Regulations: A Call for Metallization'*, Unpublished, 2005, p. 9.
2 Lilian Miles and Simon Goulding, 'Corporate Governance in Western (Anglo-American) and Islamic Communities: Prospects for Convergence', *Journal of Business Law*, 2010, 2, p. 126.
3 Abdul Rahim Abdul Rahman, 'Issues in Corporate Accountability and Governance: An Islamic Perspective', *The American Journal of Islamic Social Sciences*, 15 (1), p. 60.
4 Zulkifli Hasan, 'Corporate Governance from Western and the Islamic Perspective', *A Paper Presented at the Annual London Conference on Money, Economy and Management*, Imperial College, 2008, p. 4.

perform their worldly activities in accordance with Islamic legislation, thus attaining God's blessings.[5]

Therefore, this chapter will investigate corporate governance from an Islamic perspective. The primary target of the chapter is to examine whether or not the principles of corporate governance, as supplemented in Islamic law have attained the purpose of corporate governance. If they have, then to what extent would the Saudi regulator take advantage of this theory if it was approved, considering that Saudi Arabia is one of the biggest and most important Islamic countries with respect to its religious rule, legal approach, commerce and economic position. The Saudi legislator mentioned that Islamic legislation is the national and first law in Saudi Arabia.[6]

To achieve these objectives, this chapter has been divided into six sections. In the first section, there is a discussion and definition of Islam as a religion and its legal sources. Here, in the context of Saudi Arabia, it will examine the *Qur'an* and the *Sunna* as primary Islamic legislative sources, as well as the *Ijma* and the *Qiyas* as secondary Islamic law sources. The second section analyses Islamic objectives. The third section emphasises the Islamic vision for human values. Section Four studies whether or not principles of corporate governance supplemented in Islamic law attain their purpose. Section Five evaluates evidence from Saudi Arabia. Finally, a summary is provided.

4.2 Definitions of Islamic Legal Sources

It has been suggested that a specific aspect that characterises the nature of corporate governance from the Islamic perspective is Islamic law (*Shari'a*). This is because *Shari'a* has dominance over all aspects of life, ethical and social. *Shari'a* literally means in Arabic, the way to the source of life. However, *Shari'a* is now used to denote a legal structure in line with the behaviour called for by *Qur'an* and *Sunna*. Therefore, each deed enacted by Muslims should imitate Islamic law and perceive ethical standards that express what is true

5 Maria Bhatti and Ishaq Bhatti, 'Toward Understanding Islamic Corporate Governance Issues in Islamic Finance', *Asian Politics and Policy*, n.d., 2 (1), p. 26. Also, Rifaat Abdel Karim, 'The Nature and Rationale of a Conceptual Framework for Financial Reporting by Islamic Banks', *Accounting and Business Research*, 1995, 25 (100), p. 285.
6 Basic Law of Governance 1992, Art. 1. It states that 'The religion in Saudi Arabia is Islam and the constitution is the Book of God and the *Sunna* (traditions) of His Messenger'.

and fair.[7] In Islamic jurisprudence, the religion Islam (*Shari'a*), is defined as displaying the conditions and direct commands of God as prescribed for worship through the Prophet Mohammad.[8] It also identifies the legislation and values system which guide Muslims' throughout their worldly life, including their personal, social, political and intellectual lives.[9] Furthermore, Kamali states:

> *Shari'a* refers to commands, prohibitions, guidelines and principles that God has addressed to mankind pertaining to their conduct in this world and salvation in the next.[10]

Every Muslim must practice five obligations, specifically, believing in one God (*shahada*), praying five times a day at a certain time (*salat*), fasting for one month (*sawm*), performing pilgrimage (*hajj*) at least once in a lifetime if possible and paying alms (*zakat*).[11]As the Prophet Mohammad observed:

> Islam is based on the following five principles: to testify that none has the right to be worshipped but Allah and Mohammad is Allah's apostle; to offer the [compulsory congregational] prayers dutifully and perfectly; to pay *zakat* [obligatory charity]; to perform *hajj* [pilgrimage to *Makka*]; to observe fast during the month of *Ramadan*.[12]

It should also be mentioned that *Shari'a* is a body of Islamic law, which is traditionally viewed by Muslims in Islamic societies as essential. There are various sources of Islamic law used in Saudi jurisprudence. The most original, and the primary sources, accepted universally by all Muslims, are the *Qur'an* and the *Sunna*. There are also secondary sources of Islamic

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7 Mervyn Lewis, 'Islamic Corporate Governance', International Association for Islamic Economics, *Review of Islamic Economics*, 2005, 9 (1), p. 14.
8 Mohammad Abu Zahra, *The Origins of Islamic Jurisprudence*, Arabic edition, Dar Al Nahda, Cairo,1970, p. 12.
9 Asyraf Dusuki and Nurdianwati Abdullah, '*Maqasid* Al *Shari'a*, *Maslahah* and Corporate Social Responsibility', *The American Journal of Islamic Social Sciences*, 24 (1), p. 30.
10 Mohammad Kamali, *Shari'a Law: An Introduction*, One World Book Ltd, 2008, p. 14.
11 Timur Kuran, 'The Economic System in Contemporary Islamic Thought: Interpretation and Assessment', *International Journal of Middle East Studies*, 1986, 18 (2), p. 135.
12 Mohammad Al Bukhari, *Sahih Bukhari*, Hadith Number: 7, Darussalaam for Publication and Distribution, Saudi Arabia, 1999, p. 13.

law, but only two of them, namely the *Ijma* and the *Qiyas*, are applied in Saudi Arabia as a basis for juristic principles.[13]

In addition, Islamic legal sources, as mentioned above, are seen to be the cornerstone of proof and the support of corporate governance from the Islamic perspective.[14] It is also understood that Islamic law sources provide the necessary material by which to study corporate governance from the Islamic perspective. In other words, Islamic law sources are fundamental to the sustainability of corporate governance from the Islamic perspective, and to further developing it into a corporate governance ideal. Islamic law sources are, additionally, the reference point of Saudi regulators when encompassing such laws or regulations.[15] Accordingly, Islamic law sources will be discussed briefly when considering their association to corporate governance from the Islamic perspective.

4.2.1 The *Qur'an* (Muslims' Book of God)

First and foremost, the *Qur'an* is the primary Islamic law source; it specifies the moral, philosophical, social, political and economic basis on which society should be constructed. It is defined as God's speech and comprises words that were collected by the Prophet Mohammad for over twenty-three years until his death. The *Qur'an* comes to current Muslims via trustworthy narratives, starting with an *Al Fatihah sura* and finishing with an *Annas sura*. Furthermore, the number of *Qur'an suras* (verses) is 114, and the number of *Qur'an ayahs* (paragraphs) is 6236.[16]Allah says that:

> We have sent down to you (O Mohammad) the Book (the *Qur'an*) as an exposition of everything, guidance, a mercy, and glad tidings for those who have submitted themselves (to Allah as Muslims).[17]

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13 Abd Rahman Al Shalhoub, *Constitutional Order in Saudi Arabia between the Law and Comparative Law*, Arabic edition, 1999, p. 38.
14 Hij Abd Jabbar, 'The *Shari'a* Supervisory Board: A Potential Problem in Islamic Finance?', *Company Lawyer*, 2008, 29 (1), p. 29.
15 Article 7 of the Basic Law of Governance suggests that 'Government in Saudi Arabia derives its authority from the Book of God and the *Sunna* of the Prophet, which are the ultimate sources of reference for this Law and the other laws of the State'.
16 *Supra* note 8 at 24.
17 Holy Qur'an, *Sura* 16, *Ayah* 89, King Fahd Complex for the Printing of the Holy Qur'an.

Examples of the subjects of the *Qur'an* are, in order, unity with God, modes of worship, judicial proceedings, political and government issues, crimes, punishments, marriage, divorce and financial transactions (*Fiqh Al Mu'amalat*).[18] It can be said that *Qur'anic* scriptures detailing financial transactions, mainly trade, mortgages, trust, contracts, economy, writing and deeds of sale may be challenged in support of the corporate governance from the Islamic perspective, as well as of those indications that are mentioned in corporate governance by researchers with an Islamic perspective.[19]

4.2.2 The *Sunna* (Prophet Mohammad's Traditions and Customs)

The *Sunna* is the second primary Islamic law source, known as the compilation of the Prophet Mohammad's sayings, deeds and reports. The *Sunna*, significantly, comes from the *hadith* and explains in full detail the elements that come from the *Qur'an*.[20] There is, nevertheless, a diversity of *Qur'an suras* that have advised Muslims to accept the Prophet's *Sunna*, especially when attained from reliable narrators. Allah articulates that 'And whatsoever the messenger [Mohammad] gives you, take it; and whatsoever he forbids you, abstain [from it]'.[21]

In fact, the *Sunna's* crucial task in relation to corporate governance from the Islamic perspective is to support an Islamic vision for values, for example, Islamic accountability, Islamic transparency, Islamic justice and additional Islamic values. These Islamic values have been discussed according to the Prophet's traditions as will be clarified later in this chapter.

4.2.3 The *Ijma* (Consensus of Opinion)

The *Ijma* is the secondary Islamic legal source, which denotes Muslim clerics' agreement as to a warrant after the Prophet Mohammad's death.[22] Moreover, the Prophet encourages *Ijma*

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18 Abdulwahab Kalhaf, *Islamic Jurisprudence*, Arabic edition, Dar Al Kalam, Kuwait, 1986, p. 54.
19 Volker Nienhans, 'Corporate Governance in Islamic Banks, Islamic Financial Architecture: Risk Management and Financial Stability', *Islamic Research and Training Institute*, Islamic Development Bank (IDB), Jeddah, 2003, p. 301.
20 *Supra* note 8 at 28.
21 Holy Qur'an, *Sura* 59, *Ayah* 7, King Fahd Complex for the Printing of the Holy Qur'an. Allah also says that 'He, who obeys the messenger [Mohammad], has indeed obeyed Allah, but he who turns away, and then we have not sent you [O Mohammad] as a watcher over them', Holy Qur'an, *Sura* 4, *Ayah* 80, King Fahd Complex for the Printing of the Holy Qur'an.
22 *Supra* note 8 at 34.

when he notifies that ‘My community shall never agree on an error’.[23] It is clear that *Ijma* has a significant place; increasingly so nowadays, since Muslim clerics are expected to deal with a large number of sophisticated laws, thus satisfying Muslim societies’ needs, in terms of developing their corporate legal regimes. It would therefore be proposed that *Ijma* might assist corporate governance from the Islamic perspective. This proposal can be accomplished by Muslim clerics when they announce their opinions in accordance with their expert field of study. They can then review their opinions in comparison with each other’s, thus, founding satisfactory corporate governance general issues.[24]

4.2.4 The Qiyas (Analogical Deduction)

The *Qiyas* is another secondary Islamic law source, and it acknowledges the assessment of two cases: the former case has Islamic evidence and the latter case does not, or lacks evidence, in addition to formulating a decision towards aspects of Islamic jurisprudence.[25] The *Qiyas* is, thus, a preparatory point for decision making, but it should not be instigated if there is obvious relevant evidence from the above-mentioned Islamic law sources, namely the *Qur’an*, the *Sunna* and the *Ijma*, that covers the defined topic.[26] As Khadduri suggests, Islamic decision making was advanced by *Caliph Omar* when he laid down to the judge of *Basra* the four Islamic law sources to be consumed in terms of reaching decisions in the particular order of the *Qur’an*, the *Sunna*, the *Ijma* and then the *Qiyas*.[27]

It has been observed that the *Qiyas* has become the greatest ideology, in addition to altering Muslim social interaction.[28] This phenomenon can prove the necessity of applying the *Qiyas* in Islamic countries in terms of promulgating successful international laws. For instance, the International Islamic *Fiqh* Academy’s last meeting discussed concerns relating to re-ruling on

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23 Muslim ibn al-Hajjaj Nisaboori, *Sihih Muslim*, Hadith Number: 5107, Darussalaam for Publication and Distribution, Saudi Arabia, 1999, p. 975. Allah reports that ‘And whoever contradicts and opposes the messenger [Mohammad] after the right path has been shown clearly to him, and follows other than the believers’ way, we shall keep him in the path he has chosen, and burn him in hell – what an evil destination’, Holy Qur’an, *Sura* 4, *Ayah* 115, King Fahd Complex for the Printing of the Holy Qur’an.
24 *Supra* note 19 at 302.
25 Abdur Rahman Doi, *Shari’a: The Islamic Law*, Ta Ha Publishers, UK, 1984, p. 70.
26 Maren Hanson, ‘The Influence of French Law on the Legal Development of Saudi Arabia’, *Arab Law Quarterly*, 1987, 2, p. 274.
27 Majid Khadduri, ‘Nature and Sources of Islamic Law’, *The George Washington Journal of International Law and Economics*,1953, 3, p. 7.
28 Bryan Turner, ‘Revisiting Weber and Islam’, *The British Journal of Sociology*, Blackwell Publishing, 2010, p. 161.

man-made positive international financial and market regulations so as to fit Islamic legislation.[29]

4.3 Islamic Objectives (*Maqasid Al Shari'a*)

Primarily, Islamic objectives are the targets that Muslims aim to achieve in life. These targets, are known as the Islamic five necessities: wealth (*mal*), unity with God (*tawheed*), the human self (*nafs*), the intellect (*aql*) and posterity (*nasl*).[30] Indeed, the major Islamic objectives connected to corporate governance practices are the Islamic objectives of wealth (*mal*) and unity with God (*tawheed*). These objectives, therefore, will be analysed in the forthcoming subsections.

4.3.1 Islamic Objective of Wealth (*Mal*)

Recent developments in corporate governance from the Islamic perspective have amplified the need for an understanding of the Islamic objective of wealth (*mal*), due to the features that distinguish it from other wealth systems founded in western countries.[31] The Islamic objective of wealth also depends on the above-stated Islamic legal sources, specifically those in the *Qur'an* and the *Sunna*, which prohibit usury or interest (*riba*), gambling (*qimar*) and uncertainty (*gharar*). Notably, the Islamic objective of wealth encourages the undertaking of contracts and the paying of alms (*zakat*).[32]

4.3.1.1 Undertaking of Contracts

Arguably, almost all global corporate governance principles concentrate on sustaining stakeholder groups' benefits, since they have entered into contracts with the corporations. This principle has been mentioned in corporate governance from the Islamic perspective, as the undertaking of contracts.[33] The Islamic objective of wealth concerns the undertaking of contracts, according to which Muslims shall record the details of their business' contracts and

29 For more information, see the link, available at: http://www.fiqhacademy.org.sa/, [Accessed 1 November 2012].
30 *Supra* note 9 at 31.
31 Mervyn Lewis, 'Islam and Accounting', *Accounting Forum*, Blackwell Publishers, 2001, 25 (2), p. 117.
32 *Supra* note 14 at 29.
33 Zamir Iqbal and Abbas Mirakhor, 'Stakeholders Model of Governance in Islamic Economic System', *Islamic Economic Studies*, 2004, 11 (2), p. 22.

transactions in order to use them when and where there is a need.[34] Islamic law has an obvious perspective regarding how financial reporting and accounting practices should be commenced in terms of the Islamic objective of wealth.[35] Allah reveals that:

> O you, who have believed, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice. Let no scribe refuse to write as Allah has taught him. So, let him write and let the one who has the obligation dictate. And let him fear Allah, his Lord, and not leave anything out of it.[36]

The undertaking of contracts, in addition, focuses on transactions being fair to all contracting parties, so the contracts should not be drawn up if the contracting parties are not in agreement.[37] Allah declares that:

> O you, who believe, eat not up your property among yourselves unjustly except it is a trade amongst you, by mutual consent. And do not kill yourselves [nor kill one another]. Surely, Allah is most merciful to you.[38]

Corporate governance practice needs to be based on a contract to be undertaken with company managers. In this regard, it is suggested that from the Islamic viewpoint, a corporation must complete a contract with Muslim managers specifically according to the Islamic principles of conducting business. Altogether, Islamic corporations should not dominate their debtors, and they should respect contracts. The contracts, nevertheless, should clearly identify the nature of the products to be sold, and then the contracts should clearly equally specify the rights and duties of the buyer and the seller in order to avoid any clashes.[39]

4.3.1.2 Paying of Alms (*Zakat*)

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34 Mohammad Qattan, '*Shari'a* Supervision: The Unique Building Block of Islamic Financial Architecture', Islamic Financial Architecture: Risk Management and Financial Stability, *Islamic Research and Training Institute*, Islamic Development Bank (IDB), Jeddah, 2003, p. 275.
35 *Supra* note 31 at 118.
36 Holy Qur'an, *Sura* 2, *Ayah* 282, King Fahd Complex for the Printing of the Holy Qur'an.
37 Omar Chapra, *Islam and the Economic Challenge*, Leicester, Islamic Foundation and the International Institute of Islamic Thought, Publishing and Distributing Islamic Books, Riyadh, 1992, p. 15.
38 Holy Qur'an, *Sura* 4, *Ayah* 29, King Fahd Complex for the Printing of the Holy Qur'an.
39 *Supra* note 2 at 129.

Zakat is the third aspect of Islamic religion, and is a distinctive feature of the Islamic objective of wealth.[40] It is undisputable that *zakat* is only offered to definite persons, for instance, the poor, the handicapped, those in debt, orphans, the unemployed and prisoners.[41] Allah expresses that:

> As *sadaqat* [here it means *zakat*] are only for the *fuqara* and *Al Masakin* [poor], and those employed to collect [the funds], and to attract the hearts of those who have been inclined [towards Islam], and to free the captives, and for those in debt, and for Allah's cause and for the wayfarer [a traveller who is cut off from everything]; a duty imposed by Allah. And Allah is all knower, all wise.[42]

Kuran opines that *zakat* appears to be a basic replacement scheme for wealth; a means of taking from wealthy Muslims and giving to the poorest Muslims.[43] This idea has been supported by Rice, who noted that the richest Muslims are not valid rulers of their wealth. Rather, they are trustees who should pay out their wealth in accordance with the rationing of trust.[44]

Besides, the process of *zakat* collection is that assertion that alms have to be rewarded on all capital that has not been used for a complete lunar year. The percentage of *zakat* is, moreover, two and a half per cent of personal income capital and ten per cent of all investors' and corporations' capital.[45] It is remarkable that such *zakat* governmental bodies, which are in charge of gathering and distributing *zakat*, have been formed in many Islamic countries including Saudi Arabia, Bahrain and Pakistan. In particular, the purpose of the Saudi Department of *Zakat* and Income Tax is to control and accumulate *zakat* on commercial

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40 *Supra* note 31 at 29.
41 *Supra* note 11 at 136.
42 Holy Qur'an, *Sura* 9, *Ayah* 60, King Fahd Complex for the Printing of the Holy Qur'an. Allah further reports that 'And that which you give in gift to others, in order that it may increase your wealth by expecting to get a better one in return from other people's property, has no increase with Allah; but that which you give in zakat [charity or tax] seeking Allah's countenance, then those, they shall have manifold increase', Holy Qur'an, *Sura* 30, *Ayah* 39, King Fahd Complex for the Printing of the Holy Qur'an.
43 Timur Kuran, 'Islamic Economics and the Islamic Sub Economy', *The Journal of Economics Perspectives*, 1995, 9 (4), p. 159.
44 Gillian Rice, 'Islamic Ethics and the Implications for Business', *Journal of Business Ethics*, 1999, 18, p. 348.
45 Gambling and Karim, 'Islam and Social Accounting', *Journal of Business Finance and Accounting*, 1986, 13 (1), p. 40.

goods from Saudi individuals and Saudi institutions as well as to direct and gather taxes from non-Saudi individuals and foreign corporations that do business there.[46]

It is said that due to the sacred obligation of *zakat*, Muslims who recompense *zakat* are not only accomplishing their obligations to the state, but are also purifying their wealth and obeying Allah.[47] In other words, because of *zakat* religious inevitability, it would be remunerated more willingly by Muslims than the income tax applied in modern countries.[48]

Again, Kochuyt interprets the meaning in a Quranic sense 'for Allah's cause' from the above-mentioned Ayah as linked to the concept of CSR advantages in the Islamic world, such as building and maintaining mosques, religious practicalities, schools, charitable trusts, hospitals, social projects and relief programs inside the Islamic realm and worldwide.[49]

There is a coalition point between *zakat* and the social responsibility of corporations. This is owing to the fact that individuals are believed to have a sense of social responsibility. In particular, the purpose of Islamic *zakat* is to tolerate individuals to receive their living costs in a just way, without mistreatment of others in order that the whole community can benefit. The best practice of corporate governance requires corporations to make donations, which can be equalised with *zakat* from the Islamic perspective. Thus, it is assumed that corporate governance from the Islamic perspective should direct corporations towards making donations, sponsoring, engaging in patronage, allocating funds for humanitarian aid, supporting youths and the needs of low-income groups, child welfare and medical institutions and for the development of sport, science and culture. These voluntary actions will eventually raise their CSR as a key element of corporate governance, as encouraged by the government (for example, by preferential taxes) causing them to be highly valued by society.

More precisely, the link between the concept of CSR and the Saudi Islamic society as individuals can be seen through the Islamic encouragement to pay zakat as an Islamic obligation. In other words, there is a religious issue for Muslim individuals and corporations in reference to the concept of CSR, which is the paying of the *zakat*. For instance, the Saudi

46 For more information, see the Official Website of the Saudi Department of *Zakat* and Income Tax, available at: http://www.dzit.gov.sa/en/, [Accessed 1 November 2012].
47 *Supra* note 31 at 118.
48 *Supra* note 43 at 159.
49 Thierry Kochuyt, 'God, Gifts and Poor People: on Charity in Islam', *Social Compass*, 2009, 56 (1), p. 98.

zakat department collect the percentage of *zakat* that the Saudi Muslim individual should pay in accordance with their assets and wealth. Another matter, that can be understood as an implementation of the principle of CSR in Saudi Arabia, is the Saudisation activities towards increasing the percentage of national employment; a policy that can be supported done by individuals and corporations.[50]

However, public knowledge about corporations' environmental and social effectiveness depends on those corporations' voluntary disclosure of the implementation of the CSR. For instance, the SABIC Company announced its donations to relief work following the 2004 Asian Tsunami and the 2008 earthquake in Pakistan.[51]

4.3.1.3 Prohibition of Usury or Interest (*Riba*)

It is understood that the prohibition of *riba* is in accordance with the achievement of God's blessings and social justice,[52] and that it has been examined by several Islamic economists, since it is renowned for its potential for unfair gain.[53] As Kuran presents *riba* to emphasise that the pre-*Arabian* exercise of demanding the balance from a borrower who is not able to accomplish repayment according to a timetable containing both the rule and amassed interest. As a result, the prevention of *riba* is simply a means of preventing actions that may be socially harmful.[54] In other words, the greatest disadvantage of *riba* is the unjust deliverance of wealth from the poorest to the richest. In contrast, wealth accretion may be delimited in the richest hands;[55] as the saying goes, the rich get richer, while the poor get poorer. Allah reiterates that:

> Those who eat *riba* [usury or interest] will not stand [on the day of resurrection] except like the standing of a person beaten by Satan leading him to insanity. That is because they say: trading is only like *riba*, whereas Allah has permitted trading and forbidden *riba*. So, whosoever receives an admonition from his lord and stops

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50 *Saudi Companies& Social Responsibility: Challenges and Ways Forward*, a Study by Tamkeen Development and Management Consulting, King Fahd National Library, Riyadh, 2007, pp. 20-23.
51 Cameron Thibos and Kate Gillespie, *Islam and Corporate Social Responsibility in the Arab World: Reporting and Discourse*, Hand Book of Islamic Marketing, 2011, p. 305.
52 *Supra* note 31 at 117.
53 Mohammad Ayub, *Understanding Islamic Finance*, John Wiley & Sons, UK, 2007, p. 44.
54 *Supra* note 43 at 156.
55 Hans Visser, *Islamic Finance: Principles and Practice*, Edward Elgar Publishing Ltd, UK, 2009, p. 38.

> eating *riba* shall not be punished for the past; his case is for Allah [to judge]; but whoever returns *riba*, such are the dwellers of the fire – they will abide therein.[56]

On the other hand, the Prophet Mohammad pronounces that:

> Avoid the seven great destructive sins, then the people asked: O Allah's apostle, what are they? Then, he informed the destructive sins including eating up the *riba* [usury or interest].[57]

However, there are several kinds of *riba*. The two most well-known types of *riba* as defined under Islamic jurisprudence are as follows: Firstly, *riba an-Nasia*, which is a kind of usury that is usually encompassed by loan transactions, since the exchange is concluded with or without surplus from one of the counter-values. In other words, *riba an-Nasia* is known to be the increase in the total amount of the debt owing to an adjournment in payback of the debt during a determined time frame. *Riba an-Nasia* consists of interest-based lending; remuneration for lending or renting money. For example, *riba an-Nasia* occurs whenever a creditor offers money to a debtor for a set time as a determined proportion of interest to be compensated monthly. This interest often ensues as credit in conventional financial dealings.[58] Secondly, *riba al-Fadl* arises with the expense of a calculation by the debtor to the creditor in exchange for supplies of the same type or the exchange of low superiority for better superiority supplies, such as money for money, dates for dates, wheat for wheat, rice for rice, gold for gold and silver for silver. *Riba al-Fadl* was barred since it could be used as a manoeuvre for *riba an-Nasia* and be as such the cause of jeopardy and doubt. In addition to avoiding this type of *riba*, the exchange of supplies from both margins should be equivalent and prompt.[59]

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56 Holy Qur'an, *Sura* 2, *Ayah* 275, King Fahd Complex for the Printing of the Holy Qur'an. Allah also says 'O you who believe, eat not *riba* [usury or interest] doubled and multiplied, but fear Allah that you may be successful', Holy Qur'an, *Sura* 3, *Ayah* 130. Allah tells us that 'O you who believe, be afraid of Allah and give up what remains [due to you] from *riba* [usury or interest] [from now onward], if you are [really] believers. And if you do not do it, then take a notice of war from Allah and his messenger but if you repent, you shall have your capital sums. Deal not unjustly [by asking more than your capital sums], and you shall not be dealt with unjustly [by receiving less than your capital sums]', Holy Qur'an, *Sura* 2, *Ayah* 278, King Fahd Complex for the Printing of the Holy Qur'an.

57 Mohammad Al Bukhari, *Sahih Bukhari*, Hadith Number: 28, Darussalaam for Publication and Distribution, Saudi Arabia,1999, p. 639.

58 Angelo Venardos, *Islamic Banking and Finance in South-East Asia: its Development and Future*, World Scientific Publishing Ltd, UK, 2006, p. 63.

59 *Supra* note 50 at 53.

Thus, it may be concluded that in corporate governance from the Islamic perspective, it is not recommended that corporations grant credits or any other form of loan that requires the debtor to pay interest, as then they will profit from this. From the Islamic perspective, loans should be granted on the basis of mutual financial aid, which is then a matched interest-free loan. Furthermore, to increase the profits from any financial activity, it is simply claimed that corporations buy other corporations' shares and then make profits in the form of dividends.[60]

4.3.1.4 Prohibition of Gambling (*Qimar*)

Gambling (*qimar*) is defined as the fluctuation of easily available wealth when playing games of chance.[61] The prevention of gambling under Islamic legislation is not, therefore, resistance to the self-determination aspect of the Islamic financial regime. This regime permits any financial submissions that are accredited by Islamic legislation.[62] In light of this, Allah informs that:

> They ask you (O Mohammad) concerning alcoholic drink and gambling, say: In them is a great sin and (some) benefit for men, but the sin of them is greater than their benefit.[63]

In terms of corporate governance, gambling may be akin to playing the stock market, whereby its players take excessive risks for wealth enhancement. Such gambling has become typical in countries where the Anglo-American corporate governance model prevails. Continuing the discussion on *qimar,* as relevant to corporate governance from the Islamic perspective, it should be stated that securities market players, especially corporation managers and market traders, should not take excessive risks on the stock exchange when selling and buying shares to accumulate wealth. In this regard, it is recommended that in addressing corporate governance from the Islamic perspective, legal regulations should be developed in such a way that trading on stock exchanges is not equivalent to *qimar*.[64]

4.3.1.5 Prohibition of Uncertainty (*Qharar*)

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60 *Supra* note 4 at 6.
61 Hij Abd Jabbar, 'Islamic Finance: Fundamental Principles and Key Financial Institutions', *Company Lawyer,* 2009, 30 (1), p. 25.
62 Ibid.
63 Holy Qur'an, *Sura* 2, *Ayah* 219, King Fahd Complex for the Printing of the Holy Qur'an.
64 *Supra* note 4 at 7.

The term uncertainty (*qharar*) means risk taking, being engaged in ambiguous financial activities such as trade in birds or fish prior to their capture.[65] In addition to ensuring financial justice, the Islamic objective of wealth is concerned with tackling uncertainty (*qharar*) and removing it from financial transactions and contracts. As a result, the Islamic objective of wealth requires that goods and services should be valuable, moveable, recognisable and non-harmful.[66] Otherwise, the goods and services would be invalidated under suspicion of uncertainty (*qharar*).[67]

To sum up, as indicated in the research scope and limitations in the introductory chapter the research is limited regarding its discussion of an Islamic perspective on corporate governance, since this subject is far reaching, and can be studied from a variety of perspectives including law, finance, management and economics. However, it seems that prohibition of gambling and uncertainty in corporate governance from the Islamic perspective would remind us of the prohibition against derivatives and risk taking. In this regard, the Islamic *Fiqh* Academy argued against derivatives and risk taking contracts including futures contracts. It then suggested that these kinds of contracts be prevented in *Shari'a* legislation, since it has three Islamic finance prohibition pillars including against gambling, usury and the uncertainty. Having said this, it would be an area recommended for future research into Islamic finance.[68]

4.3.2 Islamic Objective of Unity with God (*Tawheed*)

First, and most significantly, the term unity with God (*tawheed*) is generally understood to mean the awareness and continuance of the unity and oneness of Allah in everyone's activities.[69] The unity with God's foremost achievements is to free human beings from their

65 *Supra* note 50 at 56. Also, Allah notifies that 'O you who believe intoxicants [all kinds of alcoholic drinks], gambling and Al *Azlam* [arrows for seeking luck or decision] are an abomination of Satan's handiwork. So avoid (strictly all) that (abomination) in order that you may be successful', Holy Qur'an, *Sura* 5, *Ayah* 90, King Fahd Complex for the Printing of the Holy Qur'an.
66 *Supra* note 50 at 60.
67 *Supra* note 58 at 26.
68 Journal of Islamic *Fiqh* Academy, 1998, 16 (2), p. 653.
69 Mohammad Haneef, 'The Islamic Worldview, and Islamic Economics', *IIUM Journal of Economics and Management*, 1997, 5 (1), p. 39.

reliance on other human beings, and to inspire believers' recognition of all unity with God's distributions, whereby achieving the complete value of unity with God's principles.[70]

The Islamic unity with God, however, has three distributions as follows. Firstly, maintaining the unity of lordship (*tawheed rububiyah*), which means there is only one God who originates everything and is the only lord of the universe, as well as being merited all the honour and appreciation. Secondly, preserving the unity of God's names (*tawheed asmaa wa sifaat*) that indicates all believers undoubtedly consider all ninety-nine of God's names. Finally, sustaining the unity of worship (*tawheed ebadahat*) which ensures all believers direct all forms of worship to God since he alone justifies all forms of worship.[71]

It has been said that unity with God is the Islamic religion's soil, and that this creates the Islamic viewpoint representing a point of variance from western countries' approaches in terms of corporate and business submissions. It is understood that a separation between sacred and secular dealings exists in western countries, since religion is the individual's personal concern. This methodology does not make sense from the Islamic perspective because unity with God refuses a separation between sophisticated life objects and religion. In fact, the Islamic religion should direct all the believers' life objectives including politics, economy, commerce, ethic and social values.[72] As a result of this assertion, the religious lookout covering unity with God is the most distinguished feature of corporate governance from the Islamic perspective. In particular, Muslims are involved in God's will and their behaviour should be engaged to attain God's blessing. Muslims, hence, should consider their life on earth and in the hereafter in accordance with Islamic principles.[73]

In regards to satisfying God's requirements for sanctification while conducting business, Muslims (whether individuals or corporations) should seek to undertake their diverse obligations such as the best performance, community benefits and income maximisation,

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70 Abdel Bashir, 'Ethical Norms and Enforcement Mechanism in Profit-Sharing Arrangements', *The Mid-Atlantic Journal of Business*, 1998, 34 (3), p. 261. It is narrated that when the Prophet Mohammad (peace be upon him) sent his governor to Yemen, he said to him: 'You are going to a nation from the people of the scripture, so let the first thing to which you will invite them, be the *tawheed* of Allah', see Mohammad Al Bukhari, *Sahih Bukhari*, Hadith Number: 469, Darussalaam for Publication and Distribution, Saudi Arabia, 1999, p. 1649.
71 Saleh Al Fawzaan, *Explaining the Meaning is no God but Allah, and Derives from its Effects*, Arabic edition, Islamic University, Madinah, 2002, p. 23.
72 *Supra* note 4 at 6.
73 *Supra* note 66 at 261.

without prejudicing equities' submissions between shareholders.[74] Further, business dealings should be stimulated and directed by the concept of *tawheed*.[75] These bring us to the statement that corporate governance from an Islamic perspective should encourage corporations to conduct business with a sense of fairness which is, of course, one of the global corporate governance principles. More specifically, company managers should perform their responsibilities and obligations honestly. To this end, boards of directors should act exhibiting an outstanding sense of duty and corporations should treat all shareholders fairly.[76]

To conclude, unity with God is the very stimulus of *Shari'a* and values, since it demonstrates itself in habitual dedication and personal devotion to religion and law, in politics and economics, in both belief and actions.[77] Unity with God requires the embracing of Islamic values, namely accountability, justice, secretariat, truthfulness, brotherhood and sincerity. According to Chapra, unity with God is a human necessity that ensures awareness of moral values, basic equity, brotherhood, social justice and honesty.[78] Consequently, these Islamic values will be examined in the next section.

4.4 Islamic Values

It is argued that global corporate governance principles and codes of best practice established over the last decade not only focus on achieving profit maximisation or economic proficiency, but also ensure that corporations are guided in accordance with ethical standards appropriate to benefit of society in general.[79] Islamic values are controlled significantly, according to the above-mentioned *Shari'a* principles and objectives.[80] These *Shari'a* principles and objectives are, furthermore, directed towards the reliability of human behaviour in addition to certifying public welfare and perfection.[81] Islamic values, nonetheless, should be assumed by Muslims in their financial endeavours, so that their deeds

74 Nabil Baydoun and Roger Willett, 'Islamic Corporate Reports', *ABACUS*, 2000, 36 (1), p. 80.
75 *Supra* note 7 at 20.
76 Fuad Al Omar, 'The Role of Values and Ethics in Enhancing the Confidence of Shareholders, Customers and Investors: International Experiences, Methods and Models', Arabic edition, *Seminar of the Organisation for Economic Institutions*, 2008, p. 5.
77 *Supra* note 10 at 17.
78 *Supra* note 37 at 13.
79 Gooden, S, 'Participation of Stakeholders in the Corporate Governance of Islamic Financial Institutions', *New Horizon*, 2001, 114, pp.12-15.
80 *Supra* note 44 at 347.
81 *Supra* note 44 at 348.

will not harm others and will continue to respect their individuality.[82] Islamic values, moreover, can attack human negative values, such as greed, selfishness and scarcity that might otherwise lead to financial and business irregularities and corruption. For instance, outlaw revenue boosts by board members and top executives would force corporations in their transactions and compliances to waive their values.[83]As Hassan and Salleh witnessed:

> It is man who is involved in the process of managing the business of the company towards achieving its mainstream goal of maximising the wealth of its owners. The codes of upholding trust, maintaining integrity, exercising transparency and accountability would remain as mere noble codes if the issues of man, his values, ethics and moral conduct are not tackled in the first instance.[84]

The Islamic vision of values, nonetheless, consists of a variety of ethics that are underlined in corporate governance from the Islamic perspective as the following: Firstly, Islamic accountability (*hesab*) is seen as a significant value when supporting corporate governance from the Islamic perspective. However, the Arabic term '*hesab'* displays God's full accountability towards human beings, those who have liabilities to God in all things. In addition, this term is repeated eight times in various *Qur'an ayahs*.[85] Allah enunciates that:

> Did you think that I had created you in play [without any purpose], and that you would not be brought back to me?[86]

Furthermore, the Prophet Mohammad points out several Islamic accountabilities such as religious accountability, political accountability, social and family accountability.[87] The Prophet advocates that:

82 *Supra* note 31 at 108.
83 *Supra* note 72 at 1.
84 Nik Hassan and Mohammed Salleh, *Corporate Governance from the Islamic Perspectives*, Kuala Lumpur, IKIM, 2002, p. 100.
85 *Supra* note 31 at 113.
86 Holy Qur'an, *Sura* 23, *Ayah* 115, King Fahd Complex for the Printing of the Holy Qur'an. Allah says 'Does man think that he will be left neglected [without being punished or rewarded for the obligatory duties enjoined by his Lord Allah on him]?', Holy Qur'an, *Sura* 75, *Ayah* 36, King Fahd Complex for the Printing of the Holy Qur'an. Allah additionally reports that 'The hearing, and the sight, and the heart, of each of those one will be questioned [by Allah]', Holy Qur'an, *Sura* 17, *Ayah* 36, King Fahd Complex for the Printing of the Holy Qur'an.
87 Mohammad El Shafie, *Liability and Penalty in the Holy Qu'ran*, Arabic edition, 1982, p. 41.

> Every one of you is a guardian, and accountable for what is in his custody. The ruler is a guardian of his subjects and accountable for them; a husband is a guardian of his family and is accountable for it; a lady is a guardian of her husband's house and is accountable for it. So, all of you are guardians and accountable for your wards and things under your care.[88]

When looking back to the Islamic heritage as a rehearsal of Islamic accountability, it cannot be overlooked that the ancient Muslims at the outset of the Islamic empire did initially exercise something resembling a modern meaning of the accountability. The second Islamic empire's *Caliph*, *Omar Ibn Al Khattab,* ensured the time of major pilgrimage was also the time of accountability for local governors and employees, those who used to come to *Makka* in order to be prosecuted by the *Caliph* himself and other members of the public in terms of Islamic country affairs at the time.[89]

It would thus be proposed that Islamic accountability can be anticipated in terms of corporate governance from an Islamic perspective. Islamic accountability can be achieved when Muslims are aware of their financial and other conducts are being accounted by God until the day of judgement. This includes company executives being accountable to both boards of directors and shareholders; the board of directors being accountable to shareholders, auditors being independently accountable to all shareholders, the majority shareholders being accountable to minority ones, and the company itself being accountable for its actions before the government and society as a whole.[90] Thus, Islamic accountability would naturally encompass the accountability principle as specified under the OECD principles of corporate governance. It reports that:

> The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.[91]

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88 Mohammad Al Bukhari, *Sahih Bukhari*, Hadith Number: 592, Darussalaam for Publication and Distribution, Saudi Arabia,1999, p. 546.
89 Abbas Al Akkad, *Omar Genius*, Arabic edition, Modern Library, Beirut, 2008, p. 46.
90 *Supra* note 72 at 18.
91 Organisation for Economic Co-Operation and Development, *OECD Principles of Corporate Governance*, 2004, p. 58.

Secondly, Islamic justice (*adalah*) is an essential Islamic value, since it excludes segregation and monopoly as well as promising equitable circulation of wealth.[92] Islamic justice has been pronounced by the *Qur'an sura* as coming:

> O you who believe, stand out firmly for justice, as witnesses to Allah, even though it be against yourselves, or your parents, or your kin, be he rich or poor, Allah is a better protector to both [than you]. So, follow not the lusts [of your hearts], lest you avoid justice; and if you distort your witness or refuse to give it, verily, Allah is ever well-acquainted with what you do.[93]

It would thus be argued that Islamic justice, in terms of corporate governance from an Islamic perspective, might be prepared by corporations when they meditate on their shareholders' desires and avoid unfair business transactions. Justice should be maintained among all parties to corporate governance, as well as ensuring those corporations maintain a fair business with its competitors.[94] In addition, all shareholders should be treated fairly by management and shareholders should stand away from injustice and prevent treasonable actions among them.[95] Allah says that:

> [*Dawud* (David) said immediately without listening to the opponent] he has wronged you in demanding your ewe in addition to his ewes. And, verily, many partners oppress one another, except those who believe and do righteous good deeds, and they are few.[96]

Thirdly, Islamic consultation (*Ash-Shura*) is a worthy factor for the achievement of corporate governance from an Islamic perspective. The implications of Islamic consultation are to guarantee that decisions are made in line with Islamic legislation. According to Abdul Rahman, Islamic consultation would involve an enforced division of corporate governance

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92 *Supra* note 34 at 277.
93 Holy Qur'an, *Sura* 4, *Ayah* 135, King Fahd Complex for the Printing of the Holy Qur'an. Allah utters 'Indeed we have sent our messengers with clear proofs, and revealed with them the scripture and the balance (justice) that mankind may keep up justice', Holy Qur'an, *Sura* 57, *Ayah* 25, King Fahd Complex for the Printing of the Holy Qur'an. Allah further says, 'O you who believe, stand out firmly for Allah as just witnesses; and let not the enmity and hatred of others make you avoid justice. Be just: that is nearer to piety; and fear Allah. Verily, Allah is well-acquainted with what you do', Holy Qur'an, *Sura* 5, *Ayah* 8, King Fahd Complex for the Printing of the Holy Qur'an.
94 *Supra* note 34 at 279.
95 Saleh Al Fawzaan, *Doctrinal Summary*, Arabic edition, Islamic University, Madinah, 2002, p. 95.
96 Holy Qur'an, *Sura* 38, *Ayah* 24, King Fahd Complex for the Printing of the Holy Qur'an.

from an Islamic perspective when board members and top executives take into account the corporation's beneficiaries' suggestions before formulating any decision.[97] The evidence which supports an Islamic consultation is proclaimed by a *Qur'an sura*, thus:

> And by the mercy of Allah, you dealt with them gently. And had you been severe and harsh-hearted, they would have broken away from about you; so pass over (their faults), and ask (Allah's) forgiveness for them; and consult them in the affairs. Then when you have taken a decision, put your trust in Allah, certainly, Allah loves those who put their trust (in him).[98]

Fourthly, the Islamic secretariat (*amanah*) imposes a necessary value since it holds a variety of destructive conducts, explicitly cheating, deception, stealing and bribery.[99] Thus, every individual involved in the corporation is liable (*amanah*) to act in accordance to moral and ethical standards. Allah states:

> O you who believe, betray not Allah and his messenger, nor betray knowingly your *amanah* [things entrusted to you and all the duties that Allah has ordained for you.[100]

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97 *Supra* note 3 at 61.

98 Holy Qur'an, *Sura* 3, *Ayah* 159, King Fahd Complex for the Printing of the Holy Qur'an. Allah also articulates 'And those who answer the call of their lord and perform *As-Salat*, and who conduct their affairs by mutual consultation, and who spend of what we have bestowed on them.' Holy Qur'an, *Sura* 42, *Ayah* 38, King Fahd Complex for the Printing of the Holy Qur'an.

99 *Supra* note 34 at 280.

100 Holy Qur'an, *Sura* 8, *Ayah* 27, King Fahd Complex for the Printing of the Holy Qur'an. Allah also speaks that 'And eat up not one another's property unjustly [in any illegal way e.g. stealing, robbing, deceiving, etc.], nor give bribery to the rulers [judges before presenting your cases] that you may knowingly eat up a part of the property of others sinfully', Holy Qur'an, *Sura* 2, *Ayah* 188, King Fahd Complex for the Printing of the Holy Qur'an. Allah states that 'Verily, Allah commands that you should render back the trusts to those to whom they are due; and that when you judge between men, you judge with justice. Verily, how excellent is the teaching which he [Allah] gives you! Truly, Allah is ever all-hearer, all-seers', Holy Qur'an, *Sura* 4, *Ayah* 58, King Fahd Complex for the Printing of the Holy Qur'an. In addition, the Prophet Mohammad' tradition approves that 'The *Quraish* [Prophet Mohammad's tribe] had been anxious about the *Quraish* woman who had committed theft, and said: Who will speak to Allah's Messenger about her? They said: Who dare it, but *Usama*, the loved one of Allah's Messenger? So *Usama* spoke to him. Thereupon Allah's Messenger said: Do you intercede regarding one of the punishments prescribed by Allah? He then stood up and addressed [the people] saying: O people, those who have gone before you were destroyed, because if any one of high rank committed theft amongst them, they spared him; and if anyone of low rank committed theft, they inflicted the prescribed punishment upon him. By Allah, if Fatima, daughter of Mohammad, were to steal, I would have her hand cut off', see Muslim ibn al-Hajjaj Nisaboori, *Sihih Muslim*, Hadith Number: 4187, Darussalaam for Publication and Distribution, Saudi Arabia, 1999, p. 953.

Fifthly, Islamic truthfulness (*siddiq*) is an additional chief value. Truthful people are, in particular, those who do not lie in their speech and faith, as well as those who are rated second equal after all Prophets (peace be upon them) at the day of resurrection.[101] Allah narrates that:

> And who so obeys Allah and the messenger [Mohammad], and then they will be in the company of those on whom Allah has bestowed his grace, of the prophets, the *siddiqun* [those followers of the prophets who were first and foremost to believe in them, the martyrs, and the righteous]. And how excellent these companions are![102]

In regard to the Islamic framework of corporate governance, corporations' board members and top executives should attend to the value of truthfulness in all their corporations' activities, containing information, policies, transactions and most importantly board annual financial statements, whereby enabling all corporate stakeholders' groups to take reasonable decisions.[103]

Sixthly, Islamic sincerity and intention (*ikhlas and niyyah*) is a crucial value since the difference in an individual's manners is considered herein in terms of intentional and non-intentional acts.[104] The necessity of sincerity is labelled by the Prophet Mohammad's tradition so that:

> The [reward of] deeds, depends upon the intentions and every person will get the reward according to what he has intended. So, whoever emigrated for the sake of Allah and his apostle, then his emigration will be considered to be for Allah and his apostle, and whoever emigrated for the sake of worldly gain or for a woman to marry, then his emigration will be considered to be for what he emigrated for.[105]

It is hoped that in reference to corporate governance from an Islamic perspective under a structure guaranteeing Islamic sincerity, that corporations' board members and top executives

101 *Supra* note 19 at 291.
102 Holy Qur'an, *Sura* 4, *Ayah* 69, King Fahd Complex for the Printing of the Holy Qur'an.
103 *Supra* note 19 at 295.
104 *Supra* note 19 at 298.
105 Mohammad Al Bukhari, *Sahih Bukhari*, Hadith Number: 680, Darussalaam for Publication and Distribution, Saudi Arabia, 1999, p. 1493.

should estimate that their intentions' and actions are sincere. They should undertake obligations to control corporations in the performance of a successful strategy that profits shareholders' specifically and other stakeholders' groups.[106]

Finally, the Islamic brotherhood (*ukhuwwah*) offers an alternative critical value, illustrating that all human beings are equal, not paying attention to colour, language or race. Humans should not discriminate between each other, but should instead admire each other.[107] Allah states that:

> O mankind! We have created you from a male and a female, and made you into nations and tribes, that you may know one another. Verily, the most honourable of you with Allah is that [believer] who has *at-taqwa*. Verily, Allah is all-knowing, all-aware.[108]

The Islamic brotherhood provides a variety of opportunities for different forms of co-operation. This phenomenon can be empowered by the corporations' participants so its performance would be effortless and friendly. In addition, managers are indulged under Islamic legislation so that they can look after their workers and act on their behalf. Therefore, those managers are likely to treat their employees as they would brothers and sisters, and in doing so, the meaning of brotherhood will be achieved.[109]

4.5 Do the Principles of Corporate Governance Supplemented in Islamic Law Attain their Purpose?

Recent developments in the field of corporate governance have led to a renewed interest in it from an Islamic perspective. This interest has stressed the effectiveness of a religious theory that would or would not progress corporate governance practices. In other words, due to the connection between corporate governance from the Islamic perspective and the various sacred indications, namely the Islamic objective of wealth (*mal*) and the Islamic vision for values, researchers into corporate governance have debated whether corporate governance from the Islamic perspective competes with the eminent corporate governance models in the

106 *Supra* note 34 at 280.
107 *Supra* note 34 at 280.
108 Holy Qur'an, *Sura* 49, *Ayah* 13, King Fahd Complex for the Printing of the Holy Qur'an.
109 *Supra* note 2 at 130.

west. For example, the Anglo-American shareholders' corporate governance model and the Continental European stakeholders' corporate governance model.[110]

There are a variety of ideologies that highlight the differences between the model of Islamic corporate governance and theories that are common elsewhere. Firstly, the ethical basics of western business morals stem chiefly from socially derived secular values and not religious moral values. Secondly, the fundamental beliefs and values of western corporate governance theories persist in emphasising self-interest, although there is a trend to amend some principles to suit the interests of society. Finally, the greatest corporate governance theoretical framework is based on the agency theory.[111]

It might be worth noting that the Anglo-American shareholders' corporate governance model has incorporated a significant variety of corporate governance issues including strong legal protection of shareholders', the persistent of disclosure and transparency requirements and strong bankruptcy and insolvency legislation.[112] Nevertheless, a critical approach is most often focused on why corporations, which are functioning in the Islamic world, are so attractive under the Anglo-American shareholders' corporate governance model when it comes to implementing corporate governance practices and corporations' undertakings. This phenomenon has been proposed by adequate corporate governance academics. As Hasan assumed, a large number of Islamic corporations has approved and put into practice the Anglo-American shareholders' corporate governance model.[113] In addition, Al Gamal perceived that there are more than one global corporate governance models. Nonetheless, the Anglo-American shareholders' corporate governance model can be employed alongside a corporate governance model formulated from an Islamic perspective.[114]

Hence, there is plenty of evidence with which to evaluate this trend. It is assumed that a variety of countries, including Islamic countries, have adopted Anglo-American shareholders corporate governance model to enhance affordability and attract investment.[115] According to

110 It is not planned to write again about the Anglo-American shareholders' corporate governance model since it was written about it in the second chapter. Hence, this section is focused on corporate governance from the Islamic perspective with an evaluation of the above stated model when necessary.
111 *Supra* note 7 at 14.
112 Alvaro Cuervo, 'Corporate Governance Mechanisms: A Plea for Less Code of Good Governance and More Market Control', *Corporate Governance*, Blackwell Publishing, 2002, 10, p. 86.
113 *Supra* note 4 at 8.
114 *Supra* note 1 at 9.
115 *Supra* note 2 at 126.

Miles and Goulding, a momentous motivational force behind the adaption of the Anglo-American shareholders' corporate governance model by the Islamic world's capital markets and corporations is the goal to contribute to global command and occupations. Meanwhile, almost all Islamic countries' undertake corporate governance preparations that are found to be below expectations when compared with global corporate governance principles.[116] This dates back to a variety of factors. It is submitted that the Islamic world is suffering from a huge number of political, legal, social and economic conflicts. For instance, the Islamic world is coping with high levels of illiteracy, fraudulent authorised regimes, religious radicalisation processes, shortcomings in women's rights' and repression of human rights' reports. These issues, undoubtedly, have decreased the Islamic countries' charisma in terms of their functionality as open market areas that support the conduct of business in general and implement the best practices of corporate governance in particular.[117] It is also argued that although corporate governance from the Islamic perspective provides an ethical and value led framework, it cannot be overlooked, as there is a poor record among the Islamic countries in regard of corruptions. This is due to the many commentators who support corporate governance from an Islamic perspective having suggested the significance of Islamic values that would challenge corporate governance principles, since previous international collapses happened as a result of the absence of morality in auditing and accounting firms' deeds.[118]

Once again, it is proposed from the Islamic viewpoint that stakeholders are the emotional and unemotional entities whose property is at risk from deliberating corporate' capitulations. Accordingly, there are particular connotations affecting Continental European stakeholders' corporate governance model and corporate governance from the Islamic perspective.[119] While it is thought that the objectives of the Continental European's stakeholders corporate governance model are intended to enhance all the stakeholders' groups' profits, as well enabling them to make decisions concerning their corporations' activities, it is apparent that corporate governance from the Islamic perspective has the same aforementioned targets.[120] However, it has gone further than the Continental European stakeholders' corporate governance model in terms of increasing income to fall in line with abiding Islamic

116 *Supra* note 2 at 130.
117 *Supra* note 2 at 130.
118 Rodney Wilson, 'Islam and Business Ethics', *New Horizon*, 2003, 132, pp.15-16.
119 *Supra* note 33 at 18.
120 *Supra* note 5 at 31.

legislation and values.[121] Another reason why corporate governance from the Islamic perspective is considered to have diverged from the Continental European stakeholders' corporate governance model is that Islamic corporations more fully empower stakeholders' privileges because of the strong belief in accountability to God.[122] In Particular, Slahudin compared corporate governance from the Islamic perspective with the OECD principles of corporate governance. He summarised that the OECD covers six different aspects and rights as connected to corporate governance, while corporate governance from the Islamic perspective had a broader prospect, and incorporates commitments beyond those to shareholders, financiers, suppliers, customers and employees.[123]

On the other hand, the development of corporate governance principles from an Islamic perspective has been criticised by some corporate governance observers. Miles and Goulding assert that corporate governance from an Islamic perspective does not provide a topical model, since it is a combination theory of recommendations and prescriptions that are prearranged in an ambiguous fashion. Scholars additionally note that corporate governance from an Islamic perspective is not legally enforceable, because it goes beyond acknowledged global corporate governance principles.[124] Another criticism is that the Islamic law does not encompass any definitions or interpretations of the term 'corporate governance'. As a result, we might ask: how is it possible to identify a link between current worldwide corporate governance principles and corporate governance in the Islamic context?[125]

Nevertheless, we agree with the opinions stated above, and it can also be pointed out that even if corporate governance from the Islamic perspective were valid for Islamic corporations, it would not be effective for global corporations, since it is reliant on assumptions which are contradicted by their secular approach. It would therefore be argued that these studies lack explanations with which to link Islamic legislation to empowered corporate governance issues, within either Islamic institutions or global corporations. In particular, it is not apparent thus far how these Islamic sources, objectives and values might be fulfilled in light of corporations' and capital markets' submissions.

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121 *Supra* note 4 at 8.
122 *Supra* note 2 at 130.
123 Slahudin, C. 'OECD Principles and the Islamic Perspective on Corporate Governance', *Review of Islamic Economics*, 12 (1), pp. 29-39.
124 *Supra* note 70 at 81.
125 Mohammad Sourial, *Corporate Governance in the Middle East and North Africa: An Overview*, Arabic edition, Cairo, Egypt, Ministry of Foreign Trade, 2004, p. 20.

4.6 Evidence from Saudi Arabia

Having examined the main ideals of corporate governance from an Islamic perspective, this section will examine the extent to which the Saudi regulator has commended the main ideals of corporate governance from an Islamic perspective within its corporate governance framework. In other words, does the Saudi corporate governance framework sensibly sustain the main ideals of corporate governance from an Islamic perspective? Hence, it is reliable now to investigate significant CGC objects, so as to observe whether or not these support the main ideals of corporate governance from an Islamic perspective.

It is said that the CGC necessitates a variety of best practices. Therefore, it requires the board of directors' to take responsibility for fulfilling the needs of sub-committees such as the audit committee and the nomination and remuneration committee, the need for adequate disclosure and transparency requirements, the desire for shareholders' rights. In particular, the majority of the CGC fundamentals are promulgated by the UK corporate governance committees' recommendations and the OECD principles of corporate governance.[126] Accordingly, this expresses how the Saudi regulator (Capital Market Authority Board) would determine an Islamic viewpoint in response to its corporate governance framework.

It is significant to note that from the outset of the CGC, there does not appear to be an aspect informing Islamic principles of corporate governance. The Capital Market Authority Board comments on the CGC, pronouncing that:

> These regulations include the rules and standards that regulate the management of joint stock companies listed in the stock exchange to ensure their compliance with the best governance practices that would ensure the protection of shareholders' rights as well as the rights of stakeholders.[127]

Accordingly, the Capital Market Authority Board in introducing the CGC does not consider the first-instance Basic Law of Governance in terms of passing new laws to operate alongside *Shari'a* legislation. The Basic Law of Governance is the constitutional law of Saudi Arabia,

126 Riyadh Chamber of Commerce and Industry, *Corporate Governance: The Definition, the Principles, and the Saudi Experience*, Arabic edition, 2007, p. 10.
127 Corporate Governance Code 2006, Art. 1 (A).

and all economic, finance and administrative regulations should operate in accordance with the mandate for the Basic Law of Governance. It is however frequently debated that the Capital Market Law and implementing regulations, including those of the CGC are separated by powerful regulations that are enacted by the Capital Market Authority Board in order to resolve capital market and corporations' transactions and dealings without any consideration of other Saudi laws, including the Basic Law of Governance. This is in fact clear, since the majority of capital market implementing regulations have been promulgated by worldwide experiences and ideals in addition to satisfying the needs of the Capital Market Authority. Therefore, the Capital Market Authority Board cannot abandon a supportive capital market that is implementing regulations, even if those regulations have no Islamic centre. What is important then, is that those regulations should not contradict basic Islamic legislation. In approving this, the Basic Law of Governance insists that:

> The religion in Saudi Arabia is Islam and the constitution is the Book of God and the *Sunna* (traditions) of His Messenger.[128]

It is obvious that the CGC has inherited some features from the Anglo-American shareholders' corporate governance model. For example, the CGC indicates that a member of the board of directors can represent all shareholders.[129] This declaration confines accountability to shareholders only. As a result, it can be said that the accountability of the board of directors, as mentioned under the CGC can work in line with the meaning of accountability from an Islamic perspective, which inspires board members to be accountable to God in all worldly actions as well in those related to other aspects of the corporation.

Another significant example of the effectiveness of the Anglo-American shareholders' corporate governance model on the CGC is article 11-C. It insists that the board of directors must carry out its duties in a responsible manner, in good faith and with due diligence.[130] This statement resembles the UK Companies Act, but does not involve the attendant considerable discussion regarding the significance of this point.

128 Basic Law of Governance 1992, Art. 1.
129 Corporate Governance Code 2006, Art. 11 (D).
130 Corporate Governance Code 2006, Art. 11 (C).

The Capital Market Authority Board, advisably, should improve the CGC a line with the following idea where possible. In a Muslim community such as Saudi society, the progress of a corporate governance framework should function in accordance with Islamic legislation as well as alongside with other significant man-made positive regulations that are not in conflict with the Islamic legislation. Consequently, corporate governance scholars have mentioned two methods as follows:[131]

I. Create a corporate governance framework based on the soul of Islamic legislation and after that review that corporate governance framework in reference to modern corporate governance models; or
II. Begin with corporate governance created by consulting modern corporate governance models, and examine them against Islamic legislation, and then accept those modern corporate governance principles that are consistent with Islamic legislation and refuse those that are not.

The development of a Saudi corporate governance framework, based on an Islamic perspective, should be taken seriously by the Capital Market Authority Board. Islamic values have led to considerable explanations about the meaning of Islamic justice, trustworthiness and brotherhood. Personally speaking, I am of the view that corporate governance from the Islamic perspective should be encompassed in the official documentation of the CGC issued by the Capital Market Authority Board. In other words, I am in the support of encouraging Islamic applications within a Saudi corporate governance structure. It can however be observed that corporate governance from an Islamic perspective is not yet empowered as an indispensable instrument for supporting a Saudi corporate governance framework. This is because corporate governance from the Islamic perspective is a relatively recent assumption in literature. Certainly, the CML, the CL and the implementing regulations, which are the pieces of law directly referenced for the implementation of Saudi corporate governance provisions, have a secular approach, since these provisions are promulgated pursuant to on-going international corporate governance principles. This simply indicates that the Saudi regulator is not very familiar with corporate governance from an Islamic standpoint, even though Islamic legislation and values are understood as being national Saudi law. It seems that the Saudi regulator is, however, attractive in terms of corporate governance from the

131 *Supra* note 70 at 80. Also, Rifaat Abdel Karim, ‘The Nature and Rationale of a Conceptual Framework for Financial Reporting by Islamic Banks’, *Accounting and Business Research*, 1995, 25 (100), p. 285.

Islamic perspective, but operates without actual practices and implementations of the Islamic viewpoint due to the uncertainty surrounding it.

4.7 Summary

This chapter has investigated corporate governance from an Islamic perspective. It has offered a definition of Islam and the law sources that underpin it; including the *Qur'an*, the *Sunna*, the *Ijma* and the *Qiyas*. Islamic objectives were highlighted by focusing on the Islamic objectives of wealth and unity with God. The Islamic vision of values was appraised by illustrating values such as Islamic accountability, justice, consultation, secretariat, truthfulness, sincerity and brotherhood. However, there is a great point of view of corporate governance mentioned by the Islamic law as implemented under the Anglo-American corporate governance model. It has been argued that corporate governance from the Islamic perspective would not be considered a modern corporate governance model. The analysis of corporate governance from the Islamic perspective, and how can it advantage Saudi corporate governance arrangements was presented in this chapter. The development of a Saudi corporate governance framework will be described in the coming chapter.

Chapter Five

Development of the Saudi Corporate Governance Framework

5.1 Introduction

This chapter aims to underscore the development of the Saudi corporate governance framework. The research question seeks to resolve the extent to which the corporate governance framework has been developed in the Saudi legal setting. Accordingly, this chapter has been divided into a number of sections. Firstly, the evolution of the Saudi corporate governance framework will be debated; the chapter will then deal with the hypothesis associated with the Corporate Governance Code as it relates to the pilot and assessment. Thirdly, the duplication of applications between Company Law and the Corporate Governance Code will be examined. Fourthly, the role of the listed corporations' self-regulatory corporate governance policies for developing a Saudi corporate governance framework will be analysed. A summary will then be provided to conclude.

5.2 Evolution of the Saudi Corporate Governance Framework

A significant reason for the evolution of the Saudi corporate governance framework has been the serious need to modernise and develop the statute of the Saudi economy and capital market; as well as improving accountability of Saudi listed corporation board members and executives. Since 2000, Saudi policy-makers have enacted many essential legal economic and capital market presentations, which were expected to enhance Saudi Arabia's economic reputation so that the country would be able to maintain its economic position and characteristics throughout the world. In addition, the following issues are the most current instances of the new economic and capital market strategy, which have been taken because of the widespread evaluation of commercial and economic regulations linked to economic and capital market dealings.

First, the establishment of the Supreme Economic Council in 1999 was the first step as a result of an urgent notification by the Saudi executive authority.[1] This meant that economic

1 The Supreme Economic Council Law, Royal Order, No. A-111, dated 30 August 1999.

improvement would be a major affair in all new developments within the country. The Supreme Economic Council cabinet is comprised of the King as the Head as well as a number of ministers and deputy ministers and the chairman of the Capital Market Authority Board.[2] Nonetheless, the Supreme Economic Council has a variety of responsibilities in accordance with its position as supervisor of the country's economic and financial policies. By way of illustration, the Supreme Economic Council Law assists that:

> The economic policy of Saudi Arabia is based on the principles of comprehensive social welfare and a free-market economy which is open to all goods and capital. This is in order to achieve the strengthening of the economy's ability to react effectively and flexibly to changes in the international economic environment.[3]

Secondly, the creation of the Saudi *Arabian* General Investment Authority was aimed at improving investments in Saudi Arabia.[4] The main objectives of establishing this organisation were to form a pro-business environment, to supply complete services and to sponsor and explore a greater number of investment opportunities within the energy, transportation and knowledge based industries. A crucial objective of the General Investment Authority was to eliminate the plights that had been conveyed to domestic and foreign investors in terms of creating or running a business.[5]

Thirdly, the passing of the Foreign Investment Law which was issued in 2000 regulates the requirements for investing in Saudi Arabia.[6] The Foreign Investment Law consists of eighteen articles and defines the prohibited business activities for foreign investments as well as the percentage of tax that foreign investors have to pay. The Foreign Investment Law resolves the foreign investment dispute settlements. Article 13 of the Foreign Investment Law insists that:

> Without prejudice to agreements to which Saudi Arabia is party: Disputes arising between the government or the Saudi partners and the foreign investor in relation

2 Supreme Economic Council Law 1999, Art. 4.
3 Supreme Economic Council Law 1999, Art. 1.
4 Saudi Arabian General Investment Authority Law, Royal Decree, No. 20, dated 10 April 2000.
5 Saudi Arabian General Investment Authority Law 2000, Art. 3.
6 Foreign Investment Law, Royal Decree, No. M/1, dated 10 April 2000.

> to its investments licensed in accordance with this Law shall, as far as possible, be settled amicably.[7]

Indeed, the Foreign Investment Law was enacted because there was a government plan to place Saudi Arabia as one of the most attractive countries in the region and internationally for investment targets. In order to achieve this position, a strong law was required to be conceded in order to protect foreign investments. Correspondingly, according to a recent international report, Saudi Arabia has been ranked first amongst the Middle East and North African countries; and twelfth among international countries in terms of its ease in facilitating business.[8]

Finally, ratification of the Capital Market Law which was issued in 2003 consists of sixty-seven articles.[9] In accordance with this law, the existence of the Capital Market Authority has power over listed corporations and the stock exchange. A further explanation about the role of the Capital Market Authority as an outer corporate governance institution will be provided in the next chapter.

The second momentous reason for the evolution of the Saudi corporate governance framework was that there was an extreme Saudi exchange failure at the beginning of 2006, which thrust the Saudi legislator (the Capital Market Authority Board) to protect the securities market and share investors who were face with another unexpected future failure. The Capital Market Authority Board issued a project for corporate governance on 1st July 2006 and subsequently issued the final form of corporate governance on 12th November 2006 concerning resolution No. 1-212-2006. In addition, the Capital Market Authority Board during the issuing of the CGC was concerned about the most important mechanisms associated with raising efficiency in order to increase the attractiveness of the traded Saudi securities.

Therefore, the Capital Market Authority Board took into account the principles of corporate governance, which had been approved by the international organisations. For instance, the

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7 Foreign Investment Law 2000, Art. 13.

8 See the World Bank Group, available at: http://www.doingbusiness.org/rankings,[Accessed 1 November 2012].

9 The Capital Market Law, Royal Decree, No. M-30, dated 1 August 2003.

value of the OECD principles of corporate governance and the UK corporate governance code could be seen in the reports by Cadbury and Greenbury in terms of enacting the CGC.[10]

In particular, the CGC contains 18 articles, which deal with a variety of corporate governance aspects. Article 1 introduces the code, and Article 2 provides definitions for the technical expressions associated with the code. For instance, the definitions of the accumulative voting process; of independent, executive and non-executive members; of stakeholders and of minority shareholders. Articles 3, 4, 5, 6 and 7 provide general rights of shareholders; facilitation of shareholders' exercising of rights and access to information; shareholders rights related to the general meeting; voting rights and dividend rights of shareholders. Articles 8 and 9 afford policies and procedures related to disclosure and transparency as well as disclosure in the Board of Directors' report. Consequently, Articles 10, 11, 12, 13, 14, 15, 16, 17 and 18 provide the main functions, responsibilities, formation, meetings and committees of the board, the audit committee, the nomination and remuneration committee, remuneration and indemnification of board members and conflict of interest within the board.[11] In this respect, a variety of explanations and analytical and comparative methods of these articles will be examined through Chapters 7, 8 and 9 of this study.

Another noteworthy reason for the evolution of the Saudi corporate governance framework has been related to the academic efforts, which have been carried out by many Saudi public and private institutions. These academic attempts can be traced back as follows: Firstly, the tenth symposium for developing account and audit practices in Saudi Arabia, which took place at King Saud University in 2003, recommended the adoption of corporate governance principles and their subsequent implementation, especially those related to transparency and disclosure. Secondly, in 2007 many conferences and symposiums discussed the importance of corporate governance in Saudi Arabia. These included the conference, which took place on corporate governance regarding financial and exchange companies; and the symposium regarding the role of banks as investors in encouraging corporate governance principles to their customers, both held by the Institute of Saudi Banking and the International Finance Corporation (IFC). Finally, during the period 2008 - 2009 there were many conferences and seminars, which took place, which could be viewed as being more effective in terms of the

10 Riyadh Chamber of Commerce and Industry, *Corporate Governance: The Definition, the Principles, and the Saudi Experience*, Arabic edition, 2007, p. 40.
11 Corporate Governance Code 2006, Art. 1 to 18.

subjects of corporate governance and the claim for the need to apply this. The first workshop was supported by the Capital Market Authority and the US Securities and Exchange Commission. The second was a workshop on corporate governance held at King Saud University in the King Abdullah Centre for Research and Studies. The final was an international conference on corporate governance which took place at King Khalid University in the Centre of Corporate Governance.[12]

5.3 Corporate Governance Code between the Pilot and Assessment

Recently, there has been a perspective proposed by Saudi corporate governance observers. This argument questions why the CGC was introduced by the Capital Market Authority Board as voluntary guidelines instead of binding provisions from the CGC announcement. Observers have pointed out that a variety of the implementing regulations, such as the market conduct regulations and the merger and acquisition regulations,[13] have been pronounced mandatory from their announcement so why not the CGC? Observers have specifically concluded that the majority of listed corporations rely on what has been formulated by the CGC with regards to a diversity of complications on the listed corporations' operations and owner-shareholders profit maximisation.[14]

This argument was predicted and considered carefully by the Capital Market Authority Board when the CGC was launched. The Capital Market Authority Board declared that the role of the CGC was to provide guidelines. Thus, this code contains the standards which regulate the administration of the listed corporations to confirm their obedience to good corporate governance practices which could potentially and fairly make certain the rights protection of stakeholders and shareholders.[15] Even so, the Capital Market Authority Board is able to demand one or more of the CGC articles to be required as long as the Capital Market Authority Board sees this as being suitable for the Saudi market.[16] This approach is lawful

12 Saudi Organisation for Certified Public Accountants, *Evaluating and Improving Governance in Organisations*, Arabic edition, 2011, p. 5.
13 Market Conduct Regulations, Capital Market Authority Board's Resolution, No. 1-11-2004, dated 4 October 2004. Also, Merger and Acquisitions Regulations, Capital Market Authority Board's Resolution, No. 1-50-2007, dated 3 October 2007.
14 *Supra* note 10 at 44.
15 Corporate Governance Code 2006, Art. 1 (A).
16 Corporate Governance Code 2006, Art. 1 (B).

since the Capital Market Authority Board has the power as a legislative and regulatory body to encompass any regulation by law, which would benefit the Saudi market.[17]

In addition, the Capital Market Authority Board indicated that the CGC should be operative from its publication date.[18] This tendency does not mean that the CGC is compulsory from its declaration. Rather, it provides the Capital Market Authority Board with a practical aspect in introducing the CGC and allowing listed corporations to familiarise themselves with it. In doing so, the Capital Market Authority Board considers the significance of the period of time for the CGC before delivering all the CGC articles into force.[19]

Notwithstanding this, the Capital Market Authority Board requires the listed corporations to provide evidence of the implemented and unimplemented CGC articles with such explanations in their board annual financial reports.[20] A great number of listed corporations, including *Al Baha* Investment and Development Company, *Mouwasat* Medical Services Company, Filling and Packing Materials Manufacturing Company and Petro *Rabigh* Company, are examples of corporations in breach of this requirement. Subsequently, the Capital Market Authority Board finalised these corporations in accordance with their ignorance of this requirement.

The verdict of the Capital Market Authority Board against the Food Products Company, which violated their condition of enveloping the implemented and unimplemented regulations of the CGC in the board's annual report, is deemed to be a significant case. The Capital Market Authority Board ordered a fine of $13,333 to be imposed on the above-stated company because it did not declare anything in its 2010 annual report regarding instigated and non-instigated CGC provisions.[21] However, the sanction was in accordance with Article 1-C of the CGC:

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17 Article 7-D of the Capital Market Law includes that 'The Capital Market Authority Board shall exercise all authorities entrusted to the authority in accordance with the provisions of the Capital Market Law'.
18 Corporate Governance Code 2006, Art. 19.
19 *Supra* note 10 at 40.
20 Corporate Governance Code 2006, Art. 1 (C).
21 Issued Decision, No. 2-32-2011, dated 23 October 2011 by the Capital Market Authority Board.

> A company should disclose in the Board of Directors' report, the provisions that have been implemented and the provisions that have not been implemented as well as the reasons for not implementing them.[22]

From the above-stated violated company case, it can be seen that the Capital Market Authority Board policy is to continue to transform CGC articles from those, which are non-binding to those which are binding in the near future. It is apparent that the Capital Market Authority Board, by adopting this approach, observes the Cadbury report principle 'comply or explain'. This is not surprising since the Capital Market Authority Board pays extensive attention to the UK corporate governance reports, including the Cadbury report, the Greenbury report, for developing its CGC.[23]

Nevertheless, the above-stated company did breach a binding article of the CGC, so the fine which was imposed by the Capital Market Authority Board was legitimate. By doing so, the Capital Market Authority Board does not give the listed corporations the right to ignore this binding article in their Boards of Directors' annual financial reports. Specifically, the listed corporations are entitled to waiver the implementation of non-binding articles of the CGC, but they should clearly state the reason behind non-implementation of these non-binding articles in their annual reports. Thus, when it comes to binding articles of the CGC, the listed corporations should definitely comply; otherwise, the Capital Market Authority Board will be able to either fine the listed corporations that are in breach or bring these corporations before the Committee for the Resolution of Securities Disputes. This is in line with Article 59-B of the CML which declares that:

> 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.[24]

22 Corporate Governance Code 2006, Art. 1 (C).
23 *Supra* note 10 at 13.
24 Capital Market Law 2003, Art. 59 (B).

Conversely, the 2009 statistics of the Capital Market Authority Board stated that listed corporations had abided with the CGC provisions by a percentage of 96%.[25] On the contrary, the findings of the World Bank did not concur with the statistics of the Capital Market Authority Board. The findings nominated that the CGC was at a premature stage and subsequently replicated international good corporate governance practices.[26] The findings of the World Bank could be seen as being greater appreciated and the nearest to the rational. However, the percentage which was declared by the Capital Market Authority Board has been doubted as well-developed markets would not be able to achieve such a high percentage; and the Saudi market which remains a developing and emerging market would not be able to achieve this either.

5.4 Duplication of Applications between the Company Law and the Corporate Governance Code

This section will examine the current version of the CL and how it is associated with the CGC. This is because the CL is being activated by the Ministry of Commerce and Industry whereas the CGC is an implemented regulation which is under the supervision of the Capital Market Authority. In addition, the CL is an obvious example of on-going man-made French laws which have been worked into the Saudi corporate legal structure.[27] Significantly, the CL has thirteen chapters which consist of 226 compulsory articles.[28]

The CL adjusts the formations of all companies including joint liability companies, limited partnerships, limited liability companies, professional companies and joint stock companies.[29] It can be anticipated that the impact of the CL on the future of the corporate legal structure

25 See *Aleqt* Newspaper, February 1, 2011, Issue 6322.
26 The Report on the Observance of Standards and Codes on Corporate Governance in Saudi Arabia, available at: http://estandardsforum.org/saudi-arabia/standards/principles-of-corporate-governance, [Accessed 1 November 2012].
27 Thabet Koraytem, 'The Islamic Nature of the Saudi Regulations for Companies', *Arab Law Quarterly*, 2000, p. 65.
28 Royal Decree, No. M-6, dated 22 July 1965.
29 Company Law 1965, Art. 2 and 5 to 10. In particular, the Company Law has established a variety of company arrangements. Firstly, the partnership is the optimal model for those companies where each partner charges joint responsibility. Secondly, the limited partnership is made up of two groups of partners. The joint venture partners are subject to the same legal regime governing the partners in the venture, they shall be liable in solidarity. Thirdly, the joint venture is a company that does not have the hidden moral personality that exists in relation to others and their limited partners only. Finally and most significantly, joint stock companies are companies that divide their capital into shares of equal value and which can be traded commercially, and into so-called partners in these companies' shareholders. These partners are liable only for debts to the extent the value of shares they own in the company.

will be to clarify and distinguish the ambiguity between the Ministry of Commerce and Industry jurisdictions. This is the home of this piece of legislation in terms of the Saudi listed companies, with the Capital Market Authority responsibilities to the stock exchange and the listed companies' submissions. Specifically, this ambiguity has been pointed out as being the major negative aspect challenging the promotion of a corporate governance framework and it has been the greatest factor behind Saudi market failure.[30]

Having discussed that the Capital Market Authority is a semi-governmental body, which is in charge of corporate governance regulations and implantations, it also seems that there is a dual system regarding corporate governance provisions for listed corporations and the stock exchange between the Capital Market Authority and the Ministry of Commerce and Industry (the body responsible for the implementations of the CL). However, the Saudi policy maker opines that the Capital Market Authority is the advanced body for encouraging the implementations of the corporate governance provisions, since the CL is being reviewed by the Consultative Council (the Saudi legislative body). In contrast, the Capital Market Authority is seen by the Saudi policy maker as the body that promulgates the corporate governance's regulations as implemented for listed corporations and stock exchange submissions. Notwithstanding this, the CL, which is the reference point for the Ministry of Commerce and Industry has acknowledged particular corporate governance provisions, even though these provisions have been located in scattered parts of the CL. In other words, the CL does not nominate a singular chapter to denote corporate governance system or provisions. Accordingly, the dual corporate governance system between the Capital Market Authority and the Ministry of Commerce and Industry is insufficient. Yet the Capital Market Authority usually depends on its Capital Market Law and its implementing regulations when there is need, regardless of whether this is for enacting or promulgating new rules, or to take reasonable actions regarding the stock exchange and the listed corporations' dealings. It is therefore proposed that the Saudi legislative body (the Consultative Council) should consider this dual corporate governance system (overseen by the Capital Market Authority and the Ministry of Commerce and Industry) fully. This legislative body is working to reform the Saudi CL in accordance with new developments and sustainability for the Saudi economy and corporate legal structure.

30 *Supra* note 10 at 9.

It is becoming increasingly difficult to ignore the debate about the duplication of the application of the legal clauses between the CGC and the CL.[31] There are, however, numerous similarities and some differences between the provisions of the CGC and the CL in terms of encouraging good corporate governance practices. These similarities and differences can be accounted for as outlined below:

It is clear that the subject of disclosure and transparency in the corporation board annual report as well as subject of challenging the board sub-committees, namely the nomination, remuneration and audit committees, have been strongly emphasised by the CGC instead of the CL.[32] In particular, the CL has more or less grasped an understanding of the features of the corporation board's annual report, the encouragement to form the board audit committee and the external auditors' obligations, although several significant areas that are connected to these subjects remain unclear.

Most importantly, a diversity of corporate governance legal aspects is defined under both laws. For example, both laws deliver shareholders' general rights such as those relating to voting, general meeting attendance, dividends and the right to litigate against any board member. Further examples are those pertaining to board actions including the board meeting, board members' indemnifications and conflict of interest within the board.[33] For example, the conflict of interest lawful articles under the CGC are similar to those found under the CL. Three articles regulating the conflict of interest situations are exactly the same. A classic example which can be quoted here is Article 18-B of the CGC, which is similar to Article 69 of the CL concerning conflict of interest. It asserts that:

> A board member shall not, without prior authorisation of the general meeting, to be renewed annually, participate in any activity which may likely compete with the activities of the company, or trade in any branch of the activities carried out by the company.[34]

31 *Supra* note 10 at 43.
32 Corporate Governance Code 2006, Art. 8 to 15.
33 Articles 3, 5-7, 12, and 16-18 of the Corporate Governance Code correspond to Articles 66, 69-71, 73-80, 82-84, 87-88, 93-95, 107 and 108 of the Company Law.
34 Corporate Governance Code 2006, Art. 18 (B).

Altogether, these corporate governance provisions have been stated equally by the CGC and the CL with a little bit of identification. It can be suggested that the differences between both articles in these laws cannot be denied under any circumstances. Therefore, the differences should be addressed under re-legalisation. Leaving these articles without a process of reconsideration would be an open door for being misused. Nevertheless, the disapproval can be placed herein according to the following points:

Firstly, Article 5-F of the CGC gives shareholders who have at least 5% of the corporation shares the approval to lay down any aspect to the general meeting agenda.[35] Regardless, this is a creative right by the CGC since there is no equivalent associated with this right under the CL. In addition, it would appear that this clause is not in support of the minority shareholders and those who should be protected by law, and therefore amending this clause, or removing it from the CGC, is required.[36]

Secondly, Article 67 of the CL condenses that the board member should own a total amount of the corporation shares that are worth at least $2,666 as a guarantee certificate; whilst there is no similar article under the CGC.[37] It would appear that the clause associated with the CL is legitimate since the shares must be deposited in one of the banks chosen by the Ministry of Commerce and Industry within 30 days of the board member nomination. The shares are non-transferable until the interval of the time arranged for the hearing of any liability case against the board member, or until a decision is passed in a liability case.[38] Therefore, this CL clause should be re-enacted to the CGC because it preserves the shareholders’ rights against any misconduct facilitated by board members.

Thirdly, Article 12-D of the CGC advises that it is prohibited to combine the position of the board Chairman and those of other board executives whilst endorsed under Article 78 of the CL.[39] The separation of the board’s Chairman and other executive positions is one of the advanced corporate governance provisions that has been enacted in accordance with the

35 Corporate Governance Code 2006, Art. 5 (F).
36 More clarifications will be discussed in Chapter Nine.
37 Company Law 1965, Art. 67.
38 Company Law 1965, Art. 67.
39 Corporate Governance Code 2006, Art. 12 (D), and Company Law 1965, Art. 78.

suggestions of the Cadbury report. Therefore, the CL clause should be amended in accordance with this reasonable clause.[40]

Finally, Article 12-A of the CGC maintains that the minimum number of board members should be three and the maximum number eleven. With regards to Article 64 of the CL, the minimum number is three but there is no maximum number.[41] It would seem that good practice has been followed by the CGC rather than the CL and therefore, the CL should be modified in line with this standard.

5.5 The Role of the Listed Corporations' Self-Regulatory Corporate Governance Policies for Developing the Saudi Corporate Governance Framework

To begin with, the Saudi corporate governance framework can be improved by the role of the listed corporations' self-regulatory corporate governance policies. It is however encouraged by the Capital Market Authority Board that the company board should form its own self-regulatory corporate governance policy. This policy should not conflict with that of the CGC.[42] Nevertheless, if the company board abandons the formation or the implementation of its self-regulatory corporate governance policy, then the shareholders can be seen as being an influential mechanism for the self-regulatory corporate governance policy with regard to their rights during the company general meeting. In particular, the shareholders would appeal to the undertakings of the self-regulatory corporate governance policy in order to be implemented.[43] This is also supported in the corporate governance literature. According to Charkham:

> Soft law, as in the codes of corporate governance, are similar to a sword with two edges. At best, this way of proceeding secures flexibility and avoids the need for primary legislation at every turn; at worst, such sanctions as there are, seem inadequate to secure compliance. Therefore, it rests on the shareholders to enforce them and if they are unable to do so, codes will be ineffective.[44]

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40 More explanations will be provided in Chapter Seven.
41 Corporate Governance Code 2006, Art. 12 (A), and Company Law 1965, Art. 64.
42 Corporate Governance Code 2006, Art. 10 (C).
43 Ibrahim Al Muneef, *Corporate Governance Functions and Duties and Responsibilities of the Board of Directors*, Arabic edition, Dar Al Mouder, Riyadh, 2006, p. 111.
44 Jonathan Charkham, *Keeping Better Company: Corporate Governance Ten Years on*, Oxford University Press, Oxford, 2005, p. 301.

It is proposed that the use of soft-law methods, including those of developed corporate governance policies, are chiefly utilised to cope with the failures of corporations.[45] It could be argued that self-regulation is flexible and can react swiftly in order to modify. Significantly, self-regulation would be more suitable than statutes for cultural differences since self-regulation draws from public debate and subsequently can be accepted within the organisation to be regulated to a greater extent than statutes, which are enforced by external legislators.[46]

The endorsement of the company board to formulate a self-regulatory corporate governance policy is probably the greatest challenge that has been made by the Capital Market Authority Board in its official document (CGC). As a result of this improvement, the formation policy would positively mirror the corporation position among other listed corporations that have not yet produced self-regulatory corporate governance policy. Thus, those listed corporations that apply their self-regulatory corporate governance policies would attract more investment from market contributors. Specifically, those officials and employees of listed corporations would see the self-regulatory corporate governance policy as a practical solution to inspire corporate governance standards inside their corporations.[47]

A recent empirical study showed that 57% of Saudi listed corporations had recognised self-regulatory corporate governance policies. This study further proposed that a greater number of the share investors in the Saudi exchange were more willing to invest in the shares of the listed corporations that had put into practice both the CGC and their self-regulatory corporate governance policies.[48]

Many Saudi corporate governance observers have argued about the aforesaid percentage, and believe that the study has not correctly displayed the number of listed corporations with self-regulatory corporate governance policies.[49] In reality, the total numbers of listed corporations

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45 David Walker, *A Review of Corporate Governance in UK Banks and other Financial Industry Entities- Final Recommendations*, 2009, p. 70.
46 Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law and Capital Markets Law*, Pearson Education Ltd, 3ed, 2009, p. 194.
47 Saleh Al Shaalan, *Corporate Governance in Saudi Joint Stock Companies*, Arabic edition, Unpublished Master Dissertation, King Saud University, 2007, p. 114.
48 Ibid, p. 115.
49 *Supra* note 10 at 52.

that have recognised self-regulatory corporate governance policies are no more than twenty-five out of 150, which would mean a current percentage of 17%.

In the framework of this research, the focus is on Saudi listed corporations, which number 150. Moreover, it is worth noting that the number of the Saudi family non-listed companies is more or less 11,000 companies outside the stock exchange. These non-listed companies do not have corporate governance self-regulatory policies even if the Capital Market Authority is trying to inspire the applications and the implementation of corporate governance for these non-listed companies. The Capital Market Authority is also encouraging non-listed companies to become listed companies, hence achieving a diversity of advantages. For instance, when the family non-listed companies join the stock exchange and become listed companies this contributes to the development of the Saudi economy, while sustaining the principle of CSR. In particular, family non-listed companies obtain a variety of advantages when joining the stock exchange and becoming listed companies; such as increasing company capital, improving their company’s professional reputation, and tackling the dilemma of loss of shares for family members on the death of the founder.[50]

In addition to analysing the existence and effectiveness of corporate governance self-regulations inside listed corporations, ten listed corporations have been selected with self-regulatory corporate governance policies. In fact, the significant criterion behind the selection of the ten listed corporations is that they either used to be family non-listed companies or closed listed companies. In addition, these ten listed corporations are thought to be mid-level corporations in terms of profitability and sustainability. In particular, there are another 15 of the 25 listed corporations that pursue corporate governance policies. The major shareholders of these 15 listed corporations are normally the government, so these 15 listed corporations have self-regulatory corporate governance policies. However, the outcome is similar to the sample of the previous selected ten listed corporations regarding the applications and the implementations of corporate governance. The ten corporations selected are outlined as follows:

1. The *SAVOLA* Group.
2. The *Arabian* Pipes Company.

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50 Ahmed Al Othaim, Family Corporate Governance, King Fahd National Library, Riyadh, 2008, p. 89.

3. *Nama* Chemicals Company.
4. Saudi Paper Company.
5. Saudi Automotive Services Company.
6. *Taiba* Holding.
7. *Aseer* Company.
8. *Al Dress* Petroleum and Transport Services Company.
9. *Dar Alarkan* Company.
10. *Zamil* Group Holding.

In general, it would seem that the self-regulatory corporate governance policies of the above-stated listed corporations have covered the following aspects: Firstly, the shareholders' common rights covering the general meeting attendance, the voting process and the financial dividends rule. For example, the self-regulatory corporate governance policy of the *Arabian* Pipes Company indicates that:

> A shareholder shall be entitled to all rights attached to the share. In particular, the right to attend the general meeting and participate in deliberations and vote on relevant decisions; the right of disposition with respect to shares; the right to a share of the corporation's assets upon liquidation; the right to a share of the distributable profits; the right to supervise the activities of the Board of Directors and file responsibility claims against board members and the right to inquire and have access to information without prejudice to the interests of the corporation.[51]

Secondly, it is also specified that the board's responsibilities are vested on them even when they have delegated some of their responsibilities. For instance, the self-regulatory corporate governance policy of *Taiba* Holding affirms that:

> Without prejudice to the competences of the general meeting, the corporation's board shall assume all the necessary powers for the corporation management. The ultimate responsibility for the corporation rests with the board even if it sets up committees or delegates some of its powers to a third party.[52]

51 *Arabian* Pipes Company, Corporate Governance Policy 2008, Art. 3.
52 *Taiba* Holding, Corporate Governance Policy 2008, Art. 7.

Thirdly, there is apprehension concerning disclosure and transparency requests. To illustrate this, the self-regulatory corporate governance policy of *Nama* Chemicals Company stipulates that:

> The corporation shall lay down in writing the procedures and supervisory policies connected to disclosure and transparency.[53]

It would be assumed that all the aforesaid self-regulatory corporate governance policies for listed corporations are copied and pasted from the CGC without any extra information. This is considered obvious since these listed corporations depend only on the CGC to form their self-regulatory corporate governance policies. Thus, these listed corporations do not attempt to transmit worldwide corporate governance ideologies such as the OECD principles of corporate governance and the last UK Combined Code to their self-regulatory corporate governance policies, especially when provisions have been missed out or debilitated in the CGC. It is apparent that some of these corporate governance self-regulations have been created to keep the Capital Market Authority Board contented since they are not explained sufficiently. Moreover, they are not actually put into practice and therefore this is a typical example of company window-dressing. Market contributors always note such infringements associated with either the CGC or self-regulatory corporate governance policies if found. Thus, it is difficult to predict whether the listed corporations are actually knowledgeable and familiar with the actuality of the corporate governance self-regulatory policies. It is additionally difficult to ascertain whether the corporate governance self-regulatory policies are playing an essential role for the development of the Saudi corporate governance framework now.

However, the *SAVOLA* Group has taken an advanced step of implementing either the CGC or its own self-regulatory corporate governance policy. This corporation has willingly practiced disclosure and transparency requirements. This corporation has been recently rewarded a variety of prizes by the Capital Market Authority Board in terms of the optimal practice of corporate governance. The *SAVOLA* Group has been ranked number one in Saudi Arabia in terms of its corporate governance and transparency and second in the Arab world according

53 *Nama* Chemicals Company, Corporate Governance Policy 2008, Art. 5.

to the results of the study conducted by Standard and Poor's and the *Hawkama* Institute, which was published in early 2011.[54]

Another possible reason why the self-regulatory corporate governance policies of some of the listed corporations' are considered non-existent in practice is related to the absence of Saudi corporate governance experts. In particular, the legal advisors of such listed corporations' are not well-trained. Yet, their corporations have not well-structured self-regulatory corporate governance policies. This methodology has been broadly presented in well-developed markets. According to Turnbull reliance on self-regulation has come about over the last few years. Consequently, the social experts have a lack of experience and technical training and as such they do not appreciate the possibilities.[55]

5.6 Summary

This chapter has analysed the development of the Saudi corporate governance framework. The research question of this chapter has discussed how the Saudi corporate governance framework has been advanced. This chapter has looked further into the evolution of the Saudi corporate governance framework, and has also focused on a variety of factors that have enhanced the corporate governance framework including the necessity to improve the position of economic and capital market as well as the necessity to enact modern pieces of legislation, which would support the corporate sector. Section Four has examined the duplication of applications between the CL and the CGC. This section of the paper has provided some recommendations for reforming both CL and CGC articles as well as referring to the other subsequent chapters which will investigate some duplicated applications of both the CL and the CGC. Subsequently, the role of the self-regulatory corporate governance policies in supplementing the Saudi corporate governance framework was debated in Section Five. By doing so, the approaching chapter will consider the Saudi external institutional framework for corporate governance.

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54 See the Official Website of SAVOLA Group, available at: http://www.savola.com/savolae/Savola_Awards.php, [Accessed 1 November 2012].
55 Shann Turnbull, 'Stockholder Governance: A Cybernetic and Property Rights Analysis', *Scholarly Research and Theory Papers, Blackwell Publishing*, Oxford, 1997, 5 (1), p. 12.

Chapter Six

The Saudi External Institutional Framework for Corporate Governance

6.1 Introduction

It would seem apparent that the strong need to differentiate the Saudi institutions for activating corporate governance provision took place after the creation of the Capital Market Authority.[1] This authority was faced with this superior challenge shortly after its establishment following the market catastrophe, which occurred in 2006. This market failure resembled other international market and corporation disasters, and specifically reminds us of the US stock exchange failure at the beginning of the last century.

The Saudi external institutional framework for corporate governance concurs with the following idea whereby the outer institutions can be found in the regulatory setting in which the corporation operates. In addition, it embraces the presence of government assistance for the detection of fraud as well as market devices. Specifically, these external institutes have a significant impact on a corporation's corporate governance. Yet, they principally do this via regulations, codes of conduct, certification of financial reports and legal enforcement.[2]

However, this chapter has been specifically outlined to gain a proper understanding of how the corporate governance framework works in Saudi Arabia. Thus, this chapter will clarify the external rings of the institutional charters. This chapter also attempts to answer a significant research question regarding the role which the supervisory bodies play in the activation of the corporate governance system in Saudi Arabia. Accordingly, this chapter is divided into a number of sections.

Section 1 will analyse the Capital Market Authority with keen attention being paid to the role of the General Department of Corporate Governance. Section 2 will investigate the Committees for the Resolution of Securities Disputes. Section 3 will focus on the Saudi Stock Exchange. Section 4 will revise the Ministry of Commerce and Industry. Section 5 will study

1 Royal Decree, No. M-30, dated 1 August 2003.
2 Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law and Capital Markets Law*, Pearson Education Ltd, 3ed, 2009, p. 137.

the accounting and auditing professions and the Saudi Organisation for Certified Public Accountants. Section Six will assess the Saudi National Anti-Corruption Commission and a summary will be provided at the end of the paper.

6.2 Capital Market Authority

It was previously explained that the CML was enacted in 2003 to regulate the Capital Market Authority in order for its responsibilities towards the stock exchange and share investors to be employed. According to Article 4 of the CML releases the Capital Market Authority, which is created within the Kingdom of Saudi Arabia and has the requirement of reporting directly to the King. In addition, the Capital Market Authority has legal personality, administrative and financial sovereignty. Therefore, the Capital Market Authority has executive and legislative powers to pass and adopt regulations in addition to sustaining the reliability of the market value.[3] Specifically, the Capital Market Authority has the ability to obtain the entire activities that are essential for accomplishing its prearranged responsibilities and functions.[4]

It is important to note that the Capital Market Authority does not have the right to have a hold in any commercial dealings in order to obtain a particular interest in any scheme which has been proposed for profit, to borrow or lend any funds, or to acquire or to own or issue any securities.[5] As the Capital Market Authority is the regulator of the capital market, its members, whether Board of Directors or employees, should distance themselves from what they actually direct. This can be found in Article 8 of the CML, which 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.[6]

3 Capital Market Law 2003, Art. 4 (A), 6 and 7.
4 Capital Market Law 2003, Art. 4 (A).
5 Capital Market Law 2003, Art. 4 (B).
6 Capital Market Law 2003, Art. 8.

Article 9 of the CML also 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.[7]

It has been suggested that the most recent crucial Saudi corporate governance institution is the Capital Market Authority, which is a semi-governmental body with an appointed governmental board. Moreover, this board contains five permanent members who are required to be highly qualified and their membership duration is for the period of five years subject to a single renewal. These members are appointed, and the Chairman and the Deputy Chairman are nominated, and their salary is predetermined, by royal order.[8]

It has been argued that with the Capital Market Authority Board's capability the enactment of statutory regulations has become quicker and easier as long as the proposed regulations have been controlled by the CML articles. However, this has given the Capital Market Authority Board the right to progress any article which has comes under the CML without it first being reviewed by the Council of Ministers and the Consultative Council as first-instance legislative bodies.[9] The Capital Market Authority Board has taken justifiable statutory pieces of legislation, known as the implementing regulations, in addition to accomplishing its obligations. To demonstrate this, the Capital Market Authority Board has enacted merger and acquisition regulations, investment fund regulations, security business regulations, authorised persons' regulations, market conduct regulations, listing rules and a corporate governance code.[10]

Furthermore, the main objectives of the Capital Market Authority is to develop the Saudi market; to regulate the issuance and trading in securities, to achieve transparency and fairness in securities' transactions; to monitor the disclosure of information connected to securities and the listed companies and to adjust the actions of the stock exchange and listed

7 Capital Market Law 2003, Art. 9.
8 Capital Market Law 2003, Art. 7 (A) and 7 (B).
9 Capital Market Law 2003, Art. 5 (B).
10 Capital Market Law 2003, Art. 66.

companies.[11] Instead, the Capital Market Authority Board has a diversity of roles covering the stock exchange and the listed companies' submissions that are subject to the following:[12]

1) Laying down policies, work plans, and the promulgation of needed regulations to satisfy the above-stated objectives of the Capital Market Authority.
2) Altering the application regulations which would be necessary to put these regulations into effect.
3) Granting the flotation of securities.
4) Adjourning the stock exchange actions for a period of time.
5) Banning any security traded on the stock exchange.
6) Formatting vital principles for external auditors who review the reports of the stock exchange, brokerage companies, investment funds and listed companies.

The Capital Market Authority Board is influential in taking a variety of different application activities, reliant on its duty of the level and scope of either a corporation's or an individual's infringement. Thus, the Capital Market Authority Board would issue a caution, seize stock, remove income, which has been expanded unlawfully, impose a fine or delist a corporation found in contravention of the CML and the implementing regulations.[13] This can be traced back when reviewing the fines and issued decisions that have been taken by the Capital Market Authority Board against individuals and listed corporations which have been in breach. In particular, the Capital Market Authority Board has the same rights as the Committees for the Resolution of Securities Disputes when punishing breached individuals or corporations. These punishments will be covered in detail, when discussing the Committees for the Resolution of Securities Disputes, later on in this chapter.

Thus, in general, it would seem that the Capital Market Authority Board is the bureau in charge of enacting regulations that are produced to adjust the Saudi stock market and for implementing these regulations at the same time. In particular, it can be seen that the Capital Market Authority Board is a starting point for rule-making and for controlling the affairs of the listed companies which were subject matter until recently under the supervision of the

11 Capital Market Law 2003, Art. 5 (A).
12 As this thesis is restricted, it is not assume to cite such further explanations and legal articles here. Accordingly, these points have been summarised from the original version of the Capital Market Law from article 6.
13 Capital Market Law 2003, Art. 59 (A).

Ministry of Commerce and Industry and other distributed Saudi bodies and laws. This is due to the ability of the Capital Market Authority Board to issue and amend any piece of market regulation in accordance with the best practice found in other international jurisprudence. However, the major role of the Capital Market Authority regarding the implementation of corporate governance provisions is prepared mainly by the General Department of Corporate Governance. Hence, more explanations will be provided concerning this significant department.

6.2.1 The General Department of Corporate Governance

The Capital Market Authority Board as a body has several departments in charge of enacting the CML and implementing regulations. One of these departments is the General Department of Corporate Governance. This department has held a number of responsibilities for improving and implementing the corporate governance system as outlined: [14]

1) The department develops communication with specialised international and local institutes correlated to corporate governance with the intention of launching and extending corporate governance practices in the listed companies.
2) It encourages the perceptions of transparency, disclosure, liability and equality.
3) It enhances the knowledge of the listed companies and investors with CGC provisions.
4) It promotes and oversees the implementation of the self-regulation of the corporations' corporate governance polices.
5) It trains the representative of the listed companies about the corporate governance practices.[15]

With the thought of the magnitude of the academic research functions to advance good corporate governance practices, the general department of corporate governance has recently conducted a questionnaire regarding the opinions and suggestions of the officials of the listed companies and share investors. Notably, this questionnaire relates to the reality of corporate governance practices and the adherence to the legislative frameworks of the listed companies,

14 See, the Capital Market Authority Board Annual Report, 2011, p. 25.
15 Recently, the General Department of Corporate Governance has held workshops in many Saudi districts that are concern about the preparation of the report of the board of directors and to complete forms related to the rules of corporate governance. See, Al-Riyadh Newspaper, January 9, 2012, Issue 15904.

in order to allow the laying down of enforcement plans to improve the regulatory and supervisory tasks of corporate governance by the Capital Market Authority.[16]

Significantly, the General Department of Corporate Governance plays a noteworthy role regarding the issuing of financial decisions and suiting the abusing corporations in front of the Committees for the Resolution of Securities Disputes by referencing the Capital Market Authority Board to do so. The researcher visited the General Department of Corporate Governance and observed its strategy for referencing the Capital Market Authority Board to punish the breached listed companies.[17] In fact, the punishment process involves the General Department of Corporate Governance analysing the articles of associations, website announcements, stock exchange website pronouncements and annual financial reports of the board of such listed companies. When the General Department of Corporate Governance finds such violations of CGC provisions and the interconnected articles from the implementing regulations, especially the listing rules, it passes a decision via the Capital Market Authority Board. Decisions observe recorded suggestions, and outline recommendations and the lawful articles, which have been sustained to discover violations that have been committed by the breached companies, and its opinion regarding the fines.

This delegation of responsibility from the Capital Market Authority Board to the General Department of Corporate Governance is in accordance with Article 7-D of the CML, which holds that:

> The Capital Market Authority Board may delegate, by a published resolution, any of its functions. The Capital Market Authority Board shall, however, at its discretion, retain the power to review the actions and decisions made by those who have been delegated with such powers.[18]

6.3 Committees for the Resolution of Securities Disputes

Once again, the Saudi judicial authority is divided into three forms, namely the *Shari'a* courts system, the board of grievances and the quasi-judicial committees. Specifically, these quasi-

16 See, *Al-Jazirah* Newspaper, November 29, 2010, Issue 13941.
17 The researcher visited the General Department of Corporate Governance from 29 July until 10 October 2011.
18 Capital Market Law 2003, Art. 7 (D).

judicial committees do not have agreeable and containable structures since their jurisdictions are extended within a range of instructions and under a great number of governmental and semi-governmental bodies.[19] Nevertheless, the Committees for the Resolution of Securities Disputes can be seen as quasi-judicial financial commissions. The fundamental mission of these committees is to protect shareholding investors and market equity and to resolve disputes arising out of CML and the implementing regulations function.[20]

There have been no studies concerning the Committees for the Resolution of Securities Disputes and their roles for challenging the corporate governance framework. Conducting research and obtaining law cases from the Committees for the Resolution of Securities Disputes can be expected to be much more difficult, as the law cases are interconnected to some prominent corporations and powerful individuals. Even though the researcher visited the Capital Market Authority and the Committees for the Resolution of Securities Disputes, assistance from these bodies was minimal.[21]

Nevertheless, the role of the Committees for the Resolution of Securities Disputes regarding the corporate governance framework is obvious since a variety of corporate sector law cases are considered by these committees. For instance, the conflict of interest within the board cases, the insider trading cases and the shareholders pleas are arbitrated by these committees. In particular, the Committees for the Resolution of Securities Disputes have advanced and promoted good corporate governance practices since these practices cannot occur without support from the enforcing judicial system. The Committees for the Resolution of Securities Disputes can be seen as successful quasi-judicial committees, which are placed outside of the ill-suited *Shari'a* courts system.

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19 See Chapter Two, p. 20.

20 It is announced that the number of legal cases that were seen by the committees for the resolution of securities disputes was approximately 977 at the beginning of 2011 and the total amount of compensation is around $16 Million US. See, *Al-Jazirah* Newspaper, June 8, 2011, Issue 14132.

21 In contrast, the debate about publishing the Committees for the Resolution of Securities Disputes law cases has arisen. While some believe that publishing the Committees for the Resolution of Securities Disputes law cases is not needed since these committees cannot be accepted as independence judicial foundations, others think that publishing the Committees for the Resolution of Securities Disputes law cases is a critical necessity. See, *Okaz* Newspaper, April 16, 2011, Issue 3590. This is definitely correct because all quasi-judicial committees, including the Committees for the Resolution of Securities Disputes, used to be prevented from publishing cases until recently when the Council of Ministers royal decree encouraged the quasi-judicial committees to publicly announce a summary of terminated law cases as it happens with the Committees for the Resolution of Securities Disputes law cases. See, Royal Decree, No. 215, dated 22 June 2009.

Accordingly, this subsection will investigate the Committees for the Resolution of Securities Disputes by considering two committees: the Committee for the Resolution of Securities Disputes and the Appeal Committee for the Resolution of Securities Conflicts. It is predicted that analysing the Committees for the Resolution of Securities Disputes law cases will be addressed in Chapters 7, 8 and 9. Before doing so, it is deemed plausible to assume that writing about the Committees for the Resolution of Securities Disputes and their law cases is an original contribution to the research.

6.3.1 Committee for the Resolution of Securities Disputes (CRSD)

The Capital Market Authority Board launched a quasi-judicial committee, acknowledged as the Committee for the Resolution of Securities Disputes (hereinafter CRSD). The CRSD consists of a number of legal advisors who are experts in Islamic financial and legal transactions, financial contracts and capital market laws. Furthermore, these legal advisors are appointed by the Capital Market Authority Board, and their membership term is three years subject to repeat. More specifically, these legal advisors should not have any direct commercial interests or any family affiliation, up to the fourth instance, with the parties involved in the grievances or the suits passed before the committee.[22]

In particular, the CRSD is intended as an independent quasi-judicial commission from the executive power of the Capital Market Authority Board. However, it has been argued that the CRSD is not a fully independent committee for two reasons. The first is being that CRSD members are chosen and compensated for by the Capital Market Authority Board. This means that CRSD members look like employees who have been recruited by the Capital Market Authority Board. Therefore, the appointment of these legal advisors should be completed by the Council of Ministers, like the Appeal Committee for the Resolution of Securities Conflicts members, in order to ensure the independence of this committee.

The second noteworthy reason is that the Capital Market Authority made it conditional that grievances and suits should be filed first awaiting a decision for ninety days unless the Capital Market Authority provided permission to submit the case to the CRSD prior to the end of this determined time.[23] In accordance with this condition, the defendant is unable to

22 Capital Market Law 2003, Art. 25 (A).
23 Capital Market Law 2003, Art. 25 (E).

present their case to the CRSD before they file their case with the Capital Market Authority. As a result of this condition, the Capital Market Authority interference on the committee independence is obvious.

However, the CRSD has all of the powers to consider suits and grievances. These are outlined as follows:[24]

1) Public cases – cases being sued against the individual who is refusing to comply with the provisions of the CML and the implementing regulations.
2) Private cases – cases being sued by investors against authorised groups.
3) Grievance cases – cases being claimed by an individual against complex regulations and proceedings issued by the Capital Market Authority Board and the stock exchange.
4) Temporary cases – cases being presented to the CRSD in order to decide temporary determinations.

In addition, the CRSD should start deciding suits and grievances within a period not longer than fourteen days from the filing date of the suits and grievances being filed with the committee.[25] In addition, the CRSD has the right to concern itself with issued decisions, awarding damages or requesting a reversion to the original position which would act as assurance of the aggrieved rights.[26] By law, the CRSD does not accept suits one year after the action has taken place in terms of the statute of limitation.[27]

As an exception in the Saudi evidence system, the CRSD can accept electronic communication processes such as computer data, email, telephone recordings and facsimile messages as approved evidence in financial transactions and security cases.[28] The Saudi legislator is not in agreement with the idea of accepting the electronic communication process as evidence in other legitimate substances.

24 Capital Market Law 2003, Art. 25 (D).
25 Capital Market Law 2003, Art. 25 (B).
26 Capital Market Law 2003, Art. 25 (C).
27 Resolution of Securities Disputes Proceedings Regulations 2011, Art. 27.
28 Capital Market Law 2003, Art. 25 (I).

Additionally, the CRSD has a variety of punishments that can be imposed as long as the defendant has breached, is breaching or is about to breach the practices against the CML, implementing regulations and stock exchange policies. These punishments would be considered as public actions against anyone who has violated the law. These punishments are, accordingly, subject to the following:[29]

1. Noticing and forcing the defendant to give up or be banned from performance of the breach.
2. Empowering the defendant to deem the essential actions to avoid the breaching, or to deem such essential actions to treat the consequences of the breach.
3. Indemnifying people who have suffered damages as a result of the breach undertaken by the defendant.
4. Compelling the defendant to pay back to the Capital Market Authority the interest realised as a result of such breaching.
5. Adjourning the trading in the security.
6. Seizing and executing property.
7. Banning travel and imprisoning.
8. Forbidding the defendant working with listed companies.

Specifically, the CRSD by the Capital Market Authority Board endorsement is able to enforce fines on abused parties, either corporations or individuals, those who are responsible for a planned breach of the provisions of the CML, implementing regulations and stock exchange policies. However, these fines should be no less than $2,666 and no more than $26,666 for each breach that has been committed by the defendant whether it by an individual or a corporation.[30]

6.3.2 The Appeal Committee for the Resolution of Securities Conflicts

First and most importantly, the Appeal Committee for the Resolution of Securities Conflicts has three members who are usually nominated by the Council of Ministers royal decree. In addition, their membership duration is for three years, is subject to renewal, and members

29 Capital Market Law 2003, Art. 59 (A).
30 Capital Market Law 2003, Art. 59 (B).

often represent the Ministry of Commerce and Industry, the Ministry of Finance and the Bureau of Experts at the Council of Ministers.[31]

In addition to illuminating the procedures for the Appeal Committee for the Resolution of Securities Conflicts regarding the grievances and suits, the defendants, whether they are breaching corporations or individuals, can ask for permission to appeal before the Appeal Committee for the Resolution of Securities Conflicts - as long as the CRSD has terminated the legal case and it is within thirty days of the final decision being announced. The Appeal Committee for the Resolution of Securities Conflicts decision is, significantly, the final verdict since the Appeal Committee for the Resolution of Securities Conflicts has the judicial power to refuse or accept the CRSD judgement.[32]

In a recent legal case, the appeal by the Chairman of the Saudi Diary and Foodstuff Company was accepted by the Appeal Committee for the Resolution of Securities Conflicts.[33] Moreover, the Appeal Committee for the Resolution of Securities Conflicts invalidated the fine of $13,333, which was imposed by the CRSD against the defendant.[34] The CRSD punished the defendant in line with article 5-A of the Market Conduct Regulations, which states that:

> An insider is prohibited from disclosing any inside information to any other person when he knows or should have known that it is possible that such another person may trade in the security related to the inside information.[35]

The verdict of the CRSD was that the defendant was being found suspicious of disclosing inside information about the corporation to a third party. The defendant subsequently appealed before the Appeal Committee for the Resolution of Securities Conflicts within the

31 Capital Market Law 2003, Art. 25 (G). The Council of Ministers has recently re-appointed the Appeal Committee for the Resolution of Securities Conflicts members for three years since October 2011. See the link available at: http://crsd.org.sa/En/Conflict/Pages/Member.aspx, [Accessed 1 November 2012].
32 Resolution of Securities Disputes Proceedings Regulations 2011, Art. 39.
33 Issued Decision, No. 888-L-D1-2011 dated 18 June 2011 by the Appeal Committee for the Resolution of Securities Conflicts.
34 Issued Decision, No. 1-5-2010 dated 24 January 2011 by the Committee for the Resolution of Securities Disputes.
35 Market Conduct Regulations 2004, Art. 5 (A).

determined time of thirty days after the CRSD decision and was regarded as being not guilty by the Appeal Committee for the Resolution of Securities Conflicts.[36]

6.4 The Saudi Stock Exchange

There are number of reasons associated with the establishment of the Saudi stock exchange including the launch of stock exchanges in neighbouring countries, namely Kuwait and Jordan, the increase in public knowledge about stocks, and the privatisation plans of the Saudi corporations. As a result of these factors, the Saudi stock exchange was created in its first incarnation took place in 1984 under the supervision of both the Ministry of Commerce and Industry and the Saudi *Arabian* Monetary Agency.[37] Statistically, in 1996, shareholdings of seventy listed corporations were energetically traded. In the same year, the total market capitalisation was estimated at $45.9 billion with a market P/E ratio of 13.1. In accordance with this market capitalisation, the Saudi stock exchange was graded as the thirteenth largest developed market and the most superior of the markets within the Arab Gulf countries.[38]

However, the current Saudi stock exchange was introduced in 2003. The CML observes that a market shall be established in the Kingdom for the trading in securities which shall be known as the "Saudi stock exchange".[39] In addition, the stock exchange is directed by a board comprised of nine members who are chosen and nominated by the Council of Ministers royal decree upon nomination of the Capital Market Authority Board. Three members of this board should represent a variety of governmental bodies including the Ministry of Finance, the Ministry of Commerce and Industry and the Saudi *Arabian* Monetary Agency, and the remainder of members represent four licensed brokerage corporations and two listed corporations.[40]

There is a significant amount of evidence to suggest that the stock exchange has advanced since the number of listed companies at the beginning of this exchange transformation was seventy and now consists of around 150 corporations. The greatest responsibility of the stock

36 Issued Decision, No. 888-L-D1-2011 dated 18 June 2011 by the Appeal Committee for the Resolution of Securities Conflicts.
37 Asam Al Ghamdi, *Commercial Law: Business, Dealer, Commercial Companies,* Arabic edition, Shaqri Library, Riyadh, 2007, p. 38.
38 International Finance Corporation, Emerging Stock Markets Fact book, p. 328.
39 Capital Market Law 2003, Art. 20 (A).
40 Capital Market Law 2003, Art. 21.

exchange with regards to the corporate governance framework is contributing towards the general meetings of corporations in order to ensure the voting process is carried out fairly; and to satisfy that the minority shareholders will be given their rights during these general meetings. Principally, the stock exchange is accountable for several challengeable targets that are connected to good corporate governance practices which:[41]

1) Guarantee equity of listing requirements.
2) Ensure impartiality of transactions.
3) Undertake transparency requirements.
4) Certify technical mechanisms and information for securities listed in the stock exchange.
5) Resolve any disputes and approval of regulations.

6.5 The Ministry of Commerce and Industry

It is thought that the Ministry of Commerce and Industry has a variety of responsibilities in terms of being a strong premise as a Saudi external corporate governance institution. In addition, the Ministry of Commerce and Industry has a vital department, known as the Department of General Companies, which is accountable for studying and amending the articles of association of such newly established corporations.[42]

The role of the Ministry of Commerce and Industry which is connected to corporate governance is to certify that the transformation of companies to be listed corporations has been fulfilled in accordance with the application of Company Law alongside the principles of good corporate governance regarding shareholders' rights; as well as having the right to attend the corporation's general meeting.[43]

6.6 The Accounting and Auditing Professions and the Saudi Organisation for Certified Public Accountants

41 Capital Market Law 2003, Art. 20 (C).
42 Company Law 1965, Art. 49.
43 Company Law 1965, Art. 83.

There is no doubt that the accounting and auditing professions at their external level have a wide range of liabilities – being in charge of assisting good corporate governance practices equally with other apparatuses responsible for implementing good corporate governance practices. Nonetheless, the accounting and auditing professions have been seen as a major negative factor in the international financial collapse in many international capital markets.[44] Similarly, the circumstance does not differ in the case of the Saudi accounting and auditing professions. It is supposed that the Saudi accounting and auditing professions were one of the causative factors responsible for the Saudi market catastrophe in 2006 when they did not perform their duties fairly and were evidently lacking in professionalism.[45]

Historically, the first Saudi accounting and auditing company was founded in 1957 by the Ministry of Finance, which subsequently permitted seven licensed accounting and auditing companies, six of which were foreign and only one was a Saudi accounting and auditing company.[46] According to Al Angari, the Saudi accounting and auditing professions previously lacked suitable specialised education and training and as a consequence there were a lack of highly qualified accountants and auditors.[47]

It is thought that the CL is a great factor behind the weaknesses of the Saudi accounting and auditing professions. Nevertheless, the CL situates the requirements for licensed accounting and auditing companies such as their nationality, reputation, residence and their members' certificates and experiences. In addition, the CL requests the administration of different corporations to plan a financial report and submit this to a chartered public accountant and audit company. Specifically this chartered company should have the right to access the corporation's records, to demand information and descriptions and to attain the corporation's assets and liabilities.[48]

Unfortunately, the CL, as a reference for the accounting and auditing professions as seen, does not involve a sufficient number of accounting and auditing standards. It does not satisfy

44 Istemi Demirag and Jill Solomon, 'Guest Editorial: Developments in International Corporate Governance and the Impact of Recent Events', *Blackwell Publishing*, Oxford, 2003, 11, p. 1.
45 Ibrahim Al Muneef, *Corporate Governance Functions and Duties and Responsibilities of the Board of Directors,* Arabic edition, Dar Al Mouder, Riyadh, 2006, p. 92.
46 Awad Al Rahele, 'Audit Committees as one of the Pillars of Corporate Governance', Arabic edition, *Journal of King Abd al-Aziz University of Economics and Management*, 2008, 22, p. 179.
47 Hussam Al Angari, *Auditing in the Kingdom of Saudi Arabia*, Arabic edition, Sarawat Library, Jeddah, 2004, p. 10.
48 Company Law 1965, Art. 130.

the Saudi home needs for supportive legal clauses regarding the functions of the accounting and auditing professions.[49]

This has encouraged the Saudi regulator to assign the task of advancing the accounting and auditing professions to the special entity, namely the Saudi Organisation for Certified Public Accountants. Particularly, the Saudi Organisation for Certified Public Accountants is in charge of promoting the Saudi accounting and auditing companies and their principles. It has a substantial number of targets as outlined:[50]

1) Improving and supporting accounting and auditing standards;
2) Arranging contemporary education programmes and training workshops;
3) Contributing towards regional and international seminars and symposiums linked to the accounting and auditing occupations; and
4) Conducting and publishing specific research related to accounting and auditing standards.

Furthermore, the Saudi Organisation for Certified Public Accountants has made urgent recommendations to the boards of different Saudi corporations regarding the lack of transparency regarding audit committee functions as well as the shortage of satisfactory control rules. Significantly, the Saudi Organisation for Certified Public Accountants has stimulated that current developed committees, explicitly the nomination, the remuneration, the risk and audit committees be implemented on the boards of different corporations since these committees were not previously present a couple of years ago.

In addition, the Saudi Organisation for Certified Public Accountants found and highlighted in its report that a huge number of the members of such audit committees did not hold specific certifications in accounting and auditing, and therefore the lack of professionalism would have a destructive effect on the interests of shareholders and other beneficial groups.[51]

To sum up, the accounting and auditing companies are outer institutional bodies for activating corporate governance when they fulfil their responsibility for computability.

49 Mohammad Al Amari, *The Development of Accounting Standards and Practices in the Kingdom of Saudi Arabia*, Unpublished PhD Thesis, University of Glasgow, 1989, p. 71.
50 Certified Public Accountants' Regulations 1992, Art. 25.
51 The Annual Report of the Saudi Organisation for Certified Public Accountants, 2007, p. 10.

Nonetheless, the accounting and auditing companies have the extreme role of corporate governance applications as external overseers of the records and submissions of different corporations especially concerning adequate accounting and auditing standards. In particular, the accounting and auditing companies provide the solutions to the application of corporate governance principles regarding disclosure and transparency; as well as being the keys to a resilient legal framework within the corporate division. In this regard, the audit committee of the Board of Directors as an assistive device in the implementation of good corporate governance practices and as an internal corporate governance mechanism will be examined when debating the sub-committees of the Board of Directors in Chapter 7.

6.7 The National Anti-Corruption Commission

Corruption has been defined as the mistreatment of delegated supremacy for personal achievement. Examples of corruption can include fraud, bribery and favouritism.[52] Recently, corruption has gained the attention of Saudi regulators after a variety of irresponsible corrupted actions have been committed by corporations or individuals. It is understood that corruption happens elsewhere, in both the developed or less developed countries, but it should be less so in Saudi Arabia. In this respect, a recent empirical international report graded Saudi Arabia as one of the six-three least corrupt countries in the world.[53]

In addition, corruption inside the Saudi market can be seen when some listed corporations and individuals have not been seemed about applying the CML and the implementing regulations, including the CGC, or at least not amplifying why they have not conformed with this. These corporations and individuals have been unconcerned when the Capital Market Authority Board has issued them with a fine. It is important to note that the conflict of interest within the board and insider trading would be pointed out as an example of corruption, which would be accomplished, by the board members or top executives when they have traded in their corporations' submissions or competed in the actions of their corporation.[54]

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52 Mohammad Al Bushra, *Corruption and Organised Crime,* Arabic edition, *Naif* Arab University for Security Sciences, 2007, p. 10.

53 See, the Recent Report: Transparency International: The Global Coalition against Corruption, available at: http://www.transparency.org/content/download/53922/860361/Annual+Report+2009_web.pdf,[Accessed 1 November 2012].

54 More explanations will be encompassed when discussing the conflict of interest within the board later on in Chapter Seven.

Therefore, it is hoped that the National Anti-Corruption Commission will be an assisting semi-governmental organisation for encouraging good corporate governance practices. The National Anti-Corruption Commission, which is directly associated to the King, is a newly renowned body, but it is expected that the corruption dealings and wrong-doings should be under the scope of this commission.[55] According to Article 1 of the National Anti-Corruption Commission Law, companies in which the state owns a minimum percentage of 25% of their capital should be included within the commission's specialisation.[56]

6.8 Summary

This chapter has evaluated the Saudi external institutional structure for corporate governance. The aim of this chapter has been to determine the external supervisory organisations responsible for enhancing and promoting the Saudi corporate governance framework. Consequently, several external institutions have been emphasised including the Capital Market Authority, the General Department of Corporate Governance, the Committees for the Resolution of Securities Disputes, the Saudi Stock Exchange, the Ministry of Commerce and Industry, accounting and auditing companies, the Organisation for Certified Public Accountants, and the National Anti-Corruption Commission.

55 Royal Decree, No. 165, dated 7 May 2011.
56 National Anti-Corruption Commission Law 2011, Art. 1.

Chapter Seven

Current Board of Directors' Practices in Saudi Corporate Governance

7.1 Introduction

The previous chapter provided an account of the external Saudi institutional framework for corporate governance. However, the corporate board is believed to be a significant entity of the internal institutional framework for corporate governance.[1] Therefore, the board should act appropriately, either toward stakeholder groups (including the shareholder group) or to the corporation. This chapter will debate the main research question, which relates to the current practices of the Saudi corporate governance regarding the board of directors. This chapter is therefore divided into a number of sections. The first section addresses the board members' duties, and the second considers the board's responsibilities. The creation of the board is examined in Section Three. The separation of the board members' powers is emphasised in Section Four, and board membership categories are discoursed in Section Five. The board meeting is appraised in Section Six. Next, Section Seven analyses the board sub-committees by focusing on two substantive committees: the audit committee and the nomination and remuneration committee. The board members' compensations are reconnoitred in Section Eight. Finally, a summary is given.

7.2 Board Members' Duties

7.2.1 General Overview

It is thought that due to the extensive power conferred on the corporation directors in addition to managing the corporation, there is an opportunity for directors to depart from the corporation's purposes and mismanage the corporation. Therefore, international corporate governance principles have identified a variety of board members' duties in order to ensure that these board members are directing the corporation properly and accurately as regards the corporation policies, and are satisfying the corporation targets. In particular, there are

1 Tarek Abdel Aal, *Corporate Governance: Concepts, Principles, Experiences,* Arabic edition, University House, Alexandria, 2005, p. 57.

company law jurisprudences in which the law clearly states that the association between the corporation and its board members is a principal-agent association which encourages board members to owe the corporation, the well-known expression being 'fiduciary duty'.[2] Board members are fiduciary agents; hence, their powers should be implemented not only as required by law, but also for the benefit of the corporation as a whole.[3]

This association between the corporation and the board members, based on the principle-agent association, is not referred to under either the CL or CGC provisions. Moreover, the fiduciary duty is not recognised by these pieces of legislation. This is supported by evidence that the idea of the fiduciary duty is immature in the Middle East.[4] In the US, for example, the use of the term 'fiduciary' is evaded regarding board members of corporations. This is because board members have commitments that are related to the duty of loyalty; a duty to act responsibly with regards to the power they hold and to carry out their duty of care. Accordingly, use of the term 'fiduciary' to define numerous entirely different obligations simply complicates the issue.[5]

However, in literature, the fiduciary duty is divided into three major duties, comprising the duty of care, the duty of loyalty and the duty to act within one's power. This is sustained by the OECD principles of corporate governance, which declare that there are two important origins of the fiduciary duty of board members: the duty of care and the duty of loyalty, providing that:

> Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.[6]

This section will attempt to investigate whether the board members' duties provided for in the CGC and the CL are appropriate for guaranteeing that board members will not disobey the

2 Mustafa Kamal, *The Joint Stock Company*, Arabic edition, Undergraduate House, Alexandria, 2001, p. 68.
3 David Malcolm, '*Directors' Duties: The Governing Principles'*, Chapter Five in Ian Ramsay, Corporate Governance and the Duties of Company Director, Centre for Corporate Law and Securities Regulation, Faculty of Law, University of Melbourne, 1997, p. 61.
4 Lu'ayy Al Rimawi, 'Emerging Markets of the Middle East: A Critique of Selected Issues in Arab Securities Regulation', *Journal of Financial Regulation and Compliance*, 1999, 7 (2), p. 160.
5 Norwood Beveridge, 'The Corporate Directors' Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transition', *DePaul Law Review*, 1991, 41, p. 656.
6 Organisation for Economic Co-Operation and Development, *OECD Principles of Corporate Governance*, 2004, p. 59.

rules, or whether reform is required to enhance the current board of directors' practices in Saudi corporate governance. Accordingly, these duties will be covered by focusing on the duty of care, the duty of loyalty and the duty to act within one's power.

7.2.2 Duty of Care

The duty of care is one of board members' greatest duties in accordance with the power that they have to direct their corporation and to fulfil their responsibilities in the best interests of the shareholders and the corporation, equally. In so doing, board members should carry out their responsibilities with sensible care and skill in terms of making contractual decisions. Accordingly, their duty of care takes place within several international jurisprudences. For example, the UK Companies Act states that it is necessary for people to act with a degree of skill and care that may be reasonably expected from people of their knowledge and experience.[7] The UK Companies Act, therefore, uses a subjective measure to decide whether board members are in violation of the duty of care that they owe to their corporation.[8]

In the Saudi case, the board members' duty of care has not been clearly specified in either the CL or the CGC. This simply means that the Saudi regulator finds both pieces of legislation futile when it comes to stipulating the measure of care for the corporation's board members. To put it differently, it is difficult to hold board members responsible for violations of their duty of care under Saudi legislation, even though the CL has identified two primary board member responsibilities; namely civil and criminal liabilities against breaches such as management malpractice and cheating.[9]

Additionally, Article 75 of the CL stipulates that the corporation should be bound by all the acts performed by the board of directors within the limits of its competence. The corporation should also be responsible for damages arising from unlawful acts committed by directors in the administration of the corporation.[10] It seems that under this article, board members are immune when they make mistaken decisions, even if these decisions are made deliberately. Therefore, the Saudi regulator should clarify the board members' liabilities regarding duty of

7 Andrew Hicks and S.H. Goo, *Cases and Materials on Company Law*, Blackstone Press Ltd, 1994, p. 310.
8 Stephen Griffin, *Company Law Fundamental Principles*, England, Pearson Education Ltd, 2006, p. 297.
9 Asam Al Ghamdi, *Commercial Law: Business, Dealer, Commercial Companies*, Shaqri Library, Riyadh, Arabic edition, 2007, p. 108.
10 Company Law 1965, Art. 75.

care under the CL, and add this to the CGC. Actually, the Saudi regulator can adapt the duty of care concept and definition from other international jurisprudences, such as the UK Companies Act, which points out the duty of care clearly and sensibly:

> A director of a company must exercise reasonable care, skill and diligence. This means the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and the general knowledge, skill and experience that the director has.[11]

7.2.3 Duty of Loyalty

The term 'duty of loyalty' is the principle of the fiduciary that the board member has a duty of loyalty, which is defined as the prevention of conflicts of interest and insider trading.[12] It is affirmed that board members are expected to exercise a duty of loyalty toward the corporation and its shareholders. In addition, board members should not indulge in any conduct that would be unfavourable to the interests of the corporation. Consequently, the duty of loyalty is challenged by the well-known conflict of interest within board situations and insider trading.[13]

7.2.3.1 Conflict of Interest within the Board

Conflict of interest within the board is generally understood to mean any situation that may affect the neutrality of a member's decisions due to personal interests (both material and moral) or those of his or her relatives.[14] In other words, a conflict of interest arises when the board member comes across circumstances where there is the possibility of formal exploitation or stimulus affecting private interest.[15]

11 UK Companies Act 2006, s. 174 (1 and 2).
12 *Supra* note 5 at 688.
13 Salah Al Ghazali, *Conflict of Interest Law: The Necessity*, Arabic edition, Kuwait, 2008, p. 15.
14 Ibid.
15 Joel Demski, 'Corporate Conflict of Interest', *Journal of Economic Perspectives*, 2003, 17 (2), p. 51.

The concept of conflicts of interest within the board came into legal existence in the eighteenth century, when the US court of law assumed the prohibition statute in a conflict of interest case, notwithstanding the operation's objectivity or wrongness.[16] Soon afterwards, the UK House of Lords followed the US' attitude towards the board member's conflict of interest case.[17] After this, the conflict of interest situation was not taken to be obstructive, as the case was deemed effective as long as a majority of disinterested board members agreed.[18] Current international practice is in support of certifying some conflict of interest cases. However, this support is dependent on particular restraints that should be implemented. Otherwise, board members found to be in breach of a conflict of interest will be considered guilty and punished, either by having a fine imposed upon them or by being given another sentence for their breach.[19]

Endorsements of conflicts of interest within the board (i.e. the duty of loyalty) by board members differ across various international legal structures. In some European legal structures, the preparation against breaches of conflicts of interest involves precise recompense for the corporation for the damage that occurs as a consequence of the conflict of interest within the board by the board member. Moreover, breaches of conflicts of interest within the board in the US and the UK are stricter than the compensation in some of the European legal structures, as stated above, because the US and the UK instruct a particular disclosure and transparency measure when there is a submission involving a conflict of interest within the board situation.[20]

Conflicts of interest between board members and their corporations can occur in several ways, such as when there is a submission between corporations and their directors, or when there is a submission between the corporations and third parties, while at the same time a board member has a personal interest in the matter.[21] It is argued that decisions taken in support of the corporation should be made exclusively for the profit of the corporation. Sensibly, these decisions taken should not be made with a view to obtaining particular

16 Harold Marsh, 'Are Directors Trustees? Conflict of Interest and Corporate Morality', *Business Law*, 1996, 22, p. 36.
17 Robert Pennington, *Directors' Personal Liability*, BSP Professional Books, Oxford, 1989, p. 41.
18 Dennis Block, Michael Maimone and Steven Ross, 'The Duty of Loyalty and the Evolution of the Scope of Judicial Review', *Brooklyn Law Review*, 1993, 59, p. 77.
19 *Supra* note 16 at 37.
20 Luca Enriques, 'The Law on Company Directors' Self-Dealing: A Comparative Analysis', International and Comparative Corporate Law Journal, Kluwer Law International, 2000, 2 (3), p. 303.
21 Ibid, p. 299.

personal subsidy for the board members and top executives. For example, the conflict of interest situation may occur when board members are selling their own property to their corporation, or because they are discussing a contract under which their corporation will fund them.[22]

There is a debatable viewpoint regarding conflicts of interest. This argument considers that those on the board who are likely to have a conflict of interest are notably the non-executive members, since they are not wholly independent. For instance, non-executive members often possess shareholdings and options in the corporation.[23] Moreover, non-executive members may encounter a conflict of interest when taking a director's post in two competing corporations, as their responsibilities for one may conflict with those for another. It appears that non-executive members, who participate either commercially or for private gain by being non-executive members of a competing corporation, would be in danger of being found to be in abuse of their duty of loyalty. Therefore, they should cease any conduct that purposely harms the corporation.[24]

It is estimated that non-executive members are those who are encouraged to occupy the board and the board sub-committees' seats, either by the Saudi legislator or other international corporate governance legislators.[25] Therefore, being a non-executive member does not prevent the occurrence of conflict of interest cases, which cannot be tackled in the absence of strong regulations governing these cases. Conflicts of interest within the board in the Saudi case, however, do not contest the argument that non-executive members are the most vulnerable to conflicts of interest within the board. This is obvious, as the board members, either executive or non-executive, in the law cases that will be analysed in this section were in breach of conflict of interest within the board.

In particular, Saudi legislation has established the meaning of conflict of interest from the enacting of the CL of 1965. Consequently, the clauses regulating conflicts of interest within the board found under the CGC are derived from this law without modification.[26] As a new

22 Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law and Capital Markets Law*, Pearson Education Ltd, 3rd ed, 2009, p. 170.
23 *Supra* note 15 at 59.
24 *Supra* note 22 at 167.
25 Article 12-C of the Corporate Governance Code confirms that 'The majority of the members of the board of directors shall be non-executive members'.
26 Company Law 1965, Art. 68 and 69.

restraint by the CGC, the corporation board should create a written rule that concerns any corporation assets and the illogical disposal of them stemming from dealing with related groups, and this should resolve conflicts of interest within the board and treat any probable submissions of the conflicts of interest of the board members.[27]

Furthermore, Article 18-A of the CGC affirms that a board member may not have any interest, whether directly or indirectly, in the transactions or contracts made for the account of the company, except with authorisation from the ordinary general meeting, which is to be renewed annually. Transactions made by way of public bidding are, however, excluded from this restriction if the board member has submitted the best offer. In particular, the board member should declare to the board any personal interest he or she may have in the transactions or contracts made for the account of the company. Such declarations should be recorded in the minutes of both the corporation general meeting and the board meeting. The interested board member may not participate in voting on the resolution to be adopted in this respect. More to the point, the board chairman must inform the ordinary general meeting, when it convenes, of the transactions and contracts in which any board member has a personal interest. Such communication must be accompanied by a special report for the company's external auditor.[28] However, the UK Companies Act outlines conflicts of interest as follows:

> A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).[29]

A well-known legal case of conflict of interest concerned a decision by the board chairman and the board members of the Saudi Chemical Company to purchase 15% of the shares of one of the company's subsidiary groups without informing the company's general meeting, despite the chairman having an interest in the transaction. In addition, the Saudi Chemical

27 Corporate Governance Code 2006, Art. 10 (B). The Capital Market Authority Board issued a resolution, No. 1-33-2011, dated 30 October 2011, making Article 10-B of the Corporate Governance Code obligatory on all the listed corporations from 1st January 2012.
28 Corporate Governance Code 2006, Art. 18 (A).
29 UK Companies Act 2006, s. 175 (1 and 2).

Company failed to announce that the transaction was associated with a related group, either on its website or on the stock exchange website. As a result, the Capital Market Authority Board imposed a fine of $13,333 on the board chairman and each board member.[30] The verdict was in connection with Article 28 of the Listing Rules, which indicates that:

> The directors of a company should exercise their powers and carry out their duties in such a way as to serve the interest of the company.[31]

It is suggested that the fines enforced by the Capital Market Authority Board on each board member should have been higher. The board chairman, particularly, should have been fined $26,666, because he had an aggregate interest in the transaction and is supposed to be responsible for safeguarding the shareholders' interests. The sentence also seems strange in light of the fact that the board chairman was prevented from participating in the listed corporation's board meetings for a period of time, as this punishment is stipulated in the CML.[32]

In this case, the Capital Market Authority Board punished the board chairman and the board members for being in breach regarding the conflict of interest situation. The board chairman and all the board members were not actually conducting insider trading, which is regulated by Article 50-A of the CML. Rather, they were simply trying to hide the transaction, because they did not first obtain authorisation at the ordinary general meeting to complete the transaction. In addition, the board chairman was served by the board members to conduct this transaction because he had a personal interest, as stated above.[33]

Nevertheless, Article 18-B of the CGC confirms that board members may not, without annually renewed authorisation from the ordinary general meeting, participate in any business or enterprise that is in competition with the company, or engage in any commercial activities

30 Issued Decision by the Capital Market Authority Board, dated 2009.
31 Listing Rules 2004, Art. 28. This condemnation was, advisably, in accordance with Article 18-A of the Corporate Governance Code which states that 'A board member shall not, without a prior authorisation from the general meeting, to be renewed each year, have any interest whether directly or indirectly in the company's business and contracts.'
32 Article 59-A- of the Capital Market Law assures that 'Barring the violating person from acting as a broker, portfolio manager or investment adviser for such period of time as is necessary for the safety of the market and the protection of investors.'
33 For more information, see http://www.argaam.com/article/articledetail/127502/ [Accessed 1 November 2012].

conducted by the company. Otherwise, the company has the right either to claim damages from them or to consider the operations they have conducted for their own account as having been conducted for the account of the company.[34]

A classic law case concerned the *Methanol* Chemicals Company general meeting, which dismissed a board member suspected of a conflict of interest. In fact, the removal was enforced after the suspended board member was given a period of three months in which to finish his private competing application that was completed against the company's works, but failed to do so.[35] The removal of the board member by other board members was consistent with Article 18-B of the CGC. It is astonishing that the board members of the *Methanol* Chemicals Company dismissed the board member on the grounds of conflict of interest due to having prior permission to act, as he had indeed obtained this from the company's ordinary general meeting. This notwithstanding, the decision was made without any interference from the Capital Market Authority Board. However, it appears that the Capital Market Authority Board should have imposed a fine on the removed board member.[36]

Altogether, with regard to Articles 18-A and 18-B of the CGC, it can be supposed that the CGC has made some exceptions that are not counted as a conflict of interest within the board, as follows:[37]

I. When the board member has received prior permission from the corporation's ordinary general meeting to act, which should be renewed on a yearly basis.
II. When the board member informs the board and the shareholders about any private undertakings and commercial agreements that he or she has accomplished for the corporation.
III. When the board member is the primary bidder through the general bidding.

It can be noted that the issue of informing the other board members and shareholders regarding conflicts of interest has been discussed internationally. For example, the declaration of a board members' interest has been conditioned under the UK Companies Act.

34 Corporate Governance Code 2006, Art. 18 (B).
35 Issued Decision by the Capital Market Authority Board, dated 2008.
36 For more information, see http://www.argaam.com/article/articledetail/188919/ [Accessed 1 November 2012].
37 Corporate Governance Code 2006, Art. 18 (A and B). These articles correspond to Company Law 1965, Art. 68 and 69.

It upholds that if a company's board member is in any way, either directly or indirectly, interested in a planned submission with the company, he or she must announce the nature and the extent of his or her interest to the other board members.[38]

In particular, the CGC exclusions are strongly disputed, as they reflect good corporate governance practices. As Prairie maintained, the general bidding exception to be completed by board members when they are the optimal bidders is an unnecessary exception by the Saudi legislator. Prairie further stated that board members' offers in general bidding are undoubtedly likely to be the most successful offers to win the general bidding, because the board members are expected to be familiar with the corporation's information and affairs.[39]

It is consequently observed that these exceptional terms are not needed at all, as they damage equality and accountability, thereby permitting a monopoly by the board members. Additionally, the CGC has meaninglessly opened a door to board members to trade in their corporations' contracts. For this reason, it is considered that these exceptional terms should be removed from the CGC in order to avoid misrepresentation by the board members and top executives.[40] This is in accordance with the idea that the avoidance of conflicts of interest within the board (i.e. the duty of loyalty) would be accomplished by the board members being prevented from either going into a conflict of interest with the corporation or competing with the corporation.[41]

Once again, the conflict of interest permits unlawful monopoly by board members. The following instance is an example of conflicts of interest within the board. The *Herfy* Company announced its ordinary general meeting agenda, with the meeting due to be held on 29th March 2012.[42] The general meeting agenda consisted of several issues, the most important of which was the approval of the transactions and contracts to be made with related groups during 2011, and licensing for the following year, including the approval of land leases and the rental of residential buildings worth an annual $208,000 from the chief executive, who was also a board member. The chief executive owned 20% of the

38 UK Companies Act 2006, s. 177 (1).
39 Mohammad Prairie, *The Saudi Law of Commercial Transactions*, Institute of Public Administration, Arabic edition, Riyadh, 2007, p. 224.
40 Ibid.
41 Erich Schanze, 'Directors? Duties in Germany', *Company, Financial and Insolvency Law Review*, 1999, 3 (2), p. 294.
42 See, Al-Riyadh Newspaper, March 11, 2012, Issue 15966.

corporation's share capital and was therefore one of the corporation's major shareholders. Form this example, the conflict of interest within the board is very obvious; the chief executive stood to make private interest on his own behalf with the approval of the corporation's ordinary general meeting. In reality, there was no excuse for him to trade and take advantage of the company where he was the chief executive and held a significant number of shares.[43]

7.2.3.2 Insider Trading

It is known that when board members trade in the securities of a company of which they have inside knowledge, their actions are subject to numerous rules and diverse legislation. Board members have a fiduciary duty to their corporation, so if they deliver information to achieve personal returns, they are obliged to disclose this.[44] In particular, Franks suggested that insider trading takes place when board members do not gain direct benefit from some other party to a contract. Instead, the board members use their knowledge and experiences to buy or sell shareholdings in the company or to deal on the stock exchange.[45] Both Saudi legislation and the CML have identified and defined insider trading as:

> Information obtained by the insider and which is not available to the general public, has not been disclosed, and such information is of the type that a normal person would realise that in view of the nature and content of this information, its release and availability would have a material effect on the price or value of a security related to such information, and the insider knows that such information is not generally available and that, if it were available, it would have a material effect on the price or value of such security.[46]

The UK Companies Act, however, makes no mention of insider trading, except for as presented in the terms of the Criminal Justice Act of 1993. This act defined this situation as follows:

43 For more information, see http://www.argaam.com/article/articledetail/259724/ [Accessed 1 November 2012].
44 Aaron Yoran, *Insider Trading in Israel and England*, Alpha Press, Jerusalem, 1972, pp. 15-16.
45 John Franks, *The Company Director and the Law*, Oyez Publishing Limited, London, 1981, p. 26.
46 Capital Market Law 2003, Art. 50 (A).

> An individual who has information as an insider is guilty of insider dealing if, in the circumstances including when [the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary] he deals in securities that are price-affected securities in relation to the information, and if he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned above or he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession to another person.[47]

The UK Criminal Justice Act further stipulates that the Secretary of State or the Director of Public Prosecutions has the right to consent to the handover of the insider dealing to the prosecution. It states that:

> An individual guilty of insider dealing shall be liable - on summary conviction, to a fine not exceeding the statutory maximum or imprisonment for a term not exceeding six months or to both; or on conviction on indictment, to a fine or imprisonment for a term not exceeding seven years or to both.[48]

It is vital, when analysing Saudi law cases, to understand how the Capital Market Authority Board and the CRSD are able to detect insider dealing. The first legal case of insider trading was issued by the CRSD, involving punishment of a board member from the Saudi Hotels and Resorts Company with a combined punishment that prohibited the defendant from working with listed corporations for three years and imposed a fine of $26,666.[49] The punishment was in accordance with Article 59-A of the CML, which stipulates that:

> If it appears to the Capital Market Authority that any corporation or person has engaged, is engaging or is about to engage in acts or practices constituting a violation of any provisions of the Capital Market Law, or the regulations or rules

47 UK Criminal Justice Act 1993, s. 52.
48 UK Criminal Justice Act 1993, s. 61.
49 Issued Decision, No. 289-L-D1-2008, by the Committee for the Resolution of Securities Disputes, dated 8th July 2008.

> issued by the Capital Market Authority, or the regulations of the stock exchange, the Capital Market Authority Board shall have the right to bring a legal action before the Committee for the Resolution of Securities Disputes to seek an order for the appropriate sanction that includes barring from working with companies whose securities are traded on the stock exchange.[50]

This case, furthermore, corresponds to 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 any corporation or person responsible for the violation of the Capital Market Law, its Implementing Regulations and the regulations of the stock exchange. The fine that the Committee for the Resolution of Securities Disputes can impose shall not be less than $2.666 and shall not exceed $ 26.666 for each violation committed by the defendant.[51]

In fact, while chairman of the Saudi Hotels and Resorts Company board, the defendant purchased a large number of shares from another corporation that was going to be taken over by the Saudi Hotels and Resorts board. Hence, he bought these shares in accordance with knowledge he had due to his position. Furthermore, he was the main official undertaking the negotiations, and signed on behalf of the aforementioned company. As a result, the punishment was in line with Article 50-A of the CML, which advocates that:

> Any person who obtains, through family, business or contractual relationship, inside information is prohibited from directly or indirectly trading in the security related to such information, or to disclose such information to another person with the expectation that such person will trade in such security.[52]

It is thought that the sentence and the fine were lawful as they punished the chairman of a listed corporation; a harsh punishment that was appropriate to his malpractice, imposed in a way that reflected his position regarding obvious insider trading. Nevertheless, the CRSD

50 Capital Market Law 2003, Art. 59 (A).
51 Capital Market Law 2003, Art. 59 (B).
52 Capital Market Law 2003, Art. 50 (A).

should have forced the company's chairman to repay the interest he gained from the transaction, but it did not do so.

The second legal case of insider trading was issued by the CRSD, demanding that a board member of the *Gassim* Agricultural Company repay the interest he accrued, comprising approximately $899,299, to the Capital Market Authority. The defendant was also prohibited from working in a listed corporation for three years and fined $26,666.[53] The board member was sentenced in accordance with Articles 59-A and 59-B of the CML.[54] Article 3-M of the Merger and Acquisitions Regulations provides further definition:

> Such an insider trading would arise if the director had, directly or indirectly, an interest (including his shareholding in the offeree company, if the director is a director of the offeror company, or his shareholding in the offeror company, if the director is a director of the offeree company) or duty (including where the director of the offeror company holds a position of a director or a manager of the offeree company, and where the director of the offeree company holds a position as a director or a manager of the offeror company) which is material and which conflicts or may conflict with the interests of the company.[55]

Thus, the defendant was a board member of the *Gassim* Agricultural Company. He purchased a large number of shares in another corporation when it was being taken over by *Gassim* Agricultural Company. He obtained these shares for six family members (his sons and daughters) in accordance with this submission. Consequently, the punishment was in pursuant to Article 50-A of the CML,[56] and the sentence and fine are surely lawful. This case

53 Issued Decision, No. 323-L-D1-2008 by the Committee for the Resolution of Securities Disputes, dated 11 November 2008.
54 Article 59-A of the Capital Market Law claims that 'If it appears to the Capital Market Authority that any corporation or person has engaged, is engaging or is about to engage in acts or practices constituting a violation of any provisions of the Capital Market Law, or the regulations or rules issued by the Capital Market Authority, or the regulations of the stock exchange, the Capital Market Authority shall have the right to bring a legal action before the Committee for the Resolution of Securities Disputes to seek an order for the appropriate sanction that includes barring from working with companies whose securities are traded on the stock exchange'. Article 59-B of the Capital Market Law considers that 'The Capital Market Authority Board may request the Committee for the Resolution of Securities Disputes to impose a fine upon any corporation or person responsible for the violation of the Capital Market Law, its Implementing Regulations and the regulations of the stock exchange. The fine that the Committee for the Resolution of Securities Disputes can impose shall not be less than $2,666 and shall not exceed $26,666 for each violation committed by the defendant'.
55 Merger and Acquisitions Regulations 2006, Art. 3 (M).
56 Article 50-A of the Capital Market Law argues that 'Any person who obtains, through family, business or contractual relationship, inside information is prohibited from directly or indirectly trading in the security

also confirms that insider trading can extend to board members' relatives even if the board members have nothing to do with the dealing themselves, because they are committing fraud and not considering the company's and the shareholders' interests at all in favour of their relatives' interests.

The most significant case of insider trading was the final verdict of the CRSD, which pronounced a combined punishment against a board chairman of the *Bishah* Agriculture Development Company. The punishment comprised a combination of imprisoning him for a period of three months, forcing him to repay to the Capital Market Authority a total amount of money equal to $14,050, fining him $26,666 and preventing him from working with listed corporations for three years.[57] The board member in question was guilty of insider trading in this company by selling and purchasing shares while being the board chairman of this company. The verdict of the CRSD was in accordance with Article 50-A of the CML.[58] Significantly, this was the first time that the punishment of imprisonment had been applied by the CRSD. There was strong rejection regarding this punishment by corporate governance observers in Saudi Arabia, who considered that the CRSD should not apply the punishment of imprisonment. That is to say, they believed that as the CRSD is a quasi-judicial committee, it should not be allowed to impose harsh punishments such as imprisonment.[59]

By law, the CRSD has the right to sentence individuals who have caused a lot of damage to the stock exchange, and who have committed insider trading, to imprisonment for a certain determined time of not more than five years, as is usually mentioned in the final verdict of the case.[60] However, Article 59-B of the CML offers the CRSD the right to impose a criminal sanction like imprisonment in order to resolve any violation of the CML and the Implementing Regulations. In fact, the final verdict of the CRSD was given after allowing the accused person a period of thirty days to appeal in front of the Appeal Committee for the Resolution of Securities Conflicts, which he failed to do. In fact, the defendant submitted the case before a general *Shari'a* court to be sued, but the court refused to accept and file the

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related to such information, or to disclose such information to another person with the expectation that such person will trade in such security'.

57 Issued Decision by the Committee for the Resolution of Securities Disputes, dated 17 August 2009.

58 Article 50-A of the Capital Market Law argues that 'Any person who obtains, through family, business or contractual relationship, inside information is prohibited from directly or indirectly trading in the security related to such information, or to disclose such information to another person with the expectation that such person will trade in such security'.

59 See *Aleqt* Newspaper, 19th August 2009, Issue 5791.

60 Capital Market Law 2003, Art. 57 (C).

case. The case was rejected because the general *Shari'a* court is not responsible for these kinds of capital market cases, and because the Saudi regulator has assigned these kinds of cases to be heard by the CRSD. In addition, the defendant did not accept the idea that his case would be seen by the CRSD, which is a quasi-judicial tribunal.[61] The defendant also refused to repay three times the sum he obtained from the transaction to the Capital Market Authority. In contrast, Article 64 of the CML provides the individual who has committed insider trading with a way to avoid imprisonment. It concludes that:

> A person charged with violation of insider trading may avoid proceedings before the Committee for the Resolution of Securities Disputes by reaching an agreement with the Capital Market Authority pursuant to which he agrees to pay the Capital Market Authority a sum not exceeding three times the profits he has realised, or three times the losses he has averted by committing the violation. Such arrangement shall be without prejudice to any compensation awardable as a result of the violation.[62]

The CML article regarding the criminalisation of insider trading, and the seeking of a financial penalty arbitrated by the CRSD and applied by the Capital Market Authority on behalf of itself and market contributors against the insider trader, reflects the capacity of the American Securities and Exchange Commission in terms of arbitrating and criminalising insider trading. In this respect, Nagy submits that the American Securities and Exchange Commission's capability to seek out financial fines for breeches of of the Federal Securities Laws is without doubt a considerable and advanced weapon to fight and tackle insider trading.[63]

The previous case however reveals the seriousness with which the CRSD treats any detected malpractice carried out by the board members or top executives of listed corporations. It holds that the violated board chairman deserved the combined punishment, as he breached lawful clauses of the CML. It seems that imprisonment can sometimes be a significant punishment used to tackle any irresponsible conduct that harms capital market equity, but it

61 Article 25-F of the Capital Market Law states that 'The Committee for the Resolution of Securities Disputes decision may be appealed before the Appeal Committee for the Resolution of Securities Conflicts within thirty days from their notification date.' See also *Aleqt* Newspaper, 19th August 2009, Issue 5791.
62 Capital Market Law 2003, Art. 64.
63 Donna Nagy, 'Criminalisation of Corporate Law: The Impact of Criminal Sanctions on Corporate Misconduct', *Journal of Business & Technology Law*, 2007, 2 (1), pp. 111-114. p. 111.

should be accomplished and imposed by the Saudi Criminal Prosecution rather than the CRSD.[64] Significantly, the punishment of imprisonment, as stated above, is evident in other international jurisprudence against insider trading, such as UK jurisprudence.

It is concluded that a conservative perspective of the law differs between criminal and civil liability. The difference exists in the availability of typical sanctions under criminal law. More precisely, corporate criminal liability scholars are divided into two groups. The former group hold the view that corporate criminal sentences focus on punishing expressions on the basis of an anxious equivalence between companies and company members. The latter group is of the view that corporate criminal sentencing means encouraging cost-internalisation by the company's participates, specifically shareholders and board members with top managers. Therefore, Lee introduces his theory of a corporate criminal sentence, which conceives of the corporation as a team. He announces that:

> A relationship among individuals each of whom treats doing her part towards shared goals as a principle of action alongside the pursuit of her individual goals. Moral agency in team settings is based on the notion that in doing one's part towards the team's goals, one becomes entitled to share in the credit for collective achievements of the team, and one shares in the discredit for its collective failures. In particular, when another member commits a wrong under the influence of the team's norms, the wrong is a negative achievement of the team, in which the members share.[65]

7.2.4 Duty to Act within the Powers

The board members' duties are essential corporate governance aspects because the board members in several jurisprudences hold extensive power. In addition, the board members' legal responsibilities are subject to being increased because of these duties in the company presentation.[66] However, the board members' extensive powers are in accordance with significant restrictions, such as those enforced by law, those enforced by the corporation

64 See, *Aleqt* Newspaper, August 19, 2009, Issue 5791.
65 Ian Lee, 'Corporate Criminal Responsibility as Team Member Responsibility', *Oxford Journal of Legal Studies*, 2011, 31 (4), p. 781
66 Wei Yuwa, 'Directors' Duties Under Chinese Law: A Comparative Review', *UNELJ*, 2006, 3, p. 31.

constitution and those enacted by the general meeting determinations.[67] In this regard, it can be seen that the board members' powers in the UK have been clearly limited under the UK Companies Act, which emphasises the duty of directors to act within their powers. It provides that the board members' powers should be in line with the corporation management subject to the UK Companies Act provisions, the corporation articles of association and any resolution generated by the corporation's general meeting.[68] The UK Companies Act insists that:

> A director of a company must: act in accordance with the company's constitution, and only exercise powers for the purposes for which they are conferred.[69]

Comparably, the CL has recognised the board members' delegation and limitation of powers. It confines the board members' powers to the CL provisions, to the corporation's articles of association and to a resolution enacted by the corporation's general meeting. It also limits the board members' powers with regard to financial matters. It reads that with due regard to the prerogatives vested in the general meeting, the board of directors enjoys full powers in the administration of the company. The board should be entitled, within the scope of its capability, to delegate one or more of its board members to perform an act or certain acts. Nonetheless, the board of directors may not sell or mortgage property or the place of corporation, or relieve the debtors of the corporation from their obligations, unless so authorised in the corporation's articles of association and the provisions of the CL.[70]

In particular, Article 13-B of the CGC gives the board of directors the right to delegate one or more of its responsibilities to other groups to fulfil. For instance, the board of directors can delegate some of its work to its sub-committees, such as the audit, nomination and remuneration committees. Nevertheless, permitting the board to delegate some of its responsibilities in accordance with Article 13-B does not mean that the supervision of these sub-committees and their works is decreased. It has been advised that the board must summarise the general procedures for founding such committees, demonstrating their responsibilities and supervision by the board. Specifically, the sub-committees must inform

67 Ross Grantham, 'The Content of the Director's Duty of Loyalty', *Journal of Business Law*, 1993, p. 150.
68 *Supra* note 22 at 195.
69 UK Companies Act 2006, s. 171 (A and B).
70 Company Law 1965, Art. 72.

the board about their submissions and results in order to ensure that the delegated culpabilities are perfectly in place.[71]

This means that the board has the right to delegate some of its jurisdictions to one or more of its sub-committees, thus fulfilling its role.[72] In general, therefore, it appears that board sub-committees are not able, under any circumstances, to restore the board, because the latter shoulders the critical responsibility for the corporation's submissions and contracts, even if the board sub-committees are significant and are seen to be performing well.[73] Nevertheless, notable aspects delimit this right of the board; the delegation of determined work should be within the board's jurisdiction and based on the duration and form of operations. Otherwise, the delegation is null and void.[74]

On the other hand, the CGC recommends that a company may not grant any cash loan whatsoever to any of its board members; nor may it guarantee any loan contracted by a member with a third party.[75] Arguably, the CGC clause is fair, as it safeguards the shareholders' capital and secures the corporation's financial position in terms of random and superfluous private mortgages to the board members. Specifically, it is said that a corporation's mortgage is open to abuse by a board member. The mortgage may be at an idealistically low rate of interest, and therefore mask compensation or a gift.[76]

The prohibition against rendering a cash mortgage is evident under the UK Companies Act, which asserts that a company must not offer a loan to a company's board member or one of its holding companies. The company may also not provide an agreement or security regarding a loan made by any person to such a board member, unless the submission has been ratified by a determination of the company's members.[77]

7.3 Board Responsibilities

71 Corporate Governance Code 2006, Art. 13 (B).
72 Corporate Governance Code 2006, Art. 11 (A). It also corresponds to Company Law 1965, Art. 72.
73 Corporate Governance Code 2006, Art. 11 (A).
74 Sadak Al Jubran, *The Joint Stock Company Board of Directors*, Arabic edition, Legal Publications, Beirut, 2006, p. 232.
75 Corporate Governance Code 2006, Art. 18 (C).
76 *Supra* note 22 at 176.
77 UK Companies Act 2006, s. 197 (1).

The Saudi regulator recognises the significance of the board of directors as a body whose fundamental mission is to drive the corporation in order to achieve its social and commercial targets.[78] This is obvious when reviewing the CGC and the CL provisions, which pay considerable attention to board responsibilities, and, in addition, guard the interests of the corporation, as well as those of the shareholders. It is also apparent that the Saudi regulator views the board as a good way of enhancing corporate governance practices among exchange and listed companies.[79] Thus, Saudi consideration agrees with international corporate governance principles, which regard the board as the first means of applying good practices. The OECD principles of corporate governance maintain that:

> The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.[80]

Moreover, the Cadbury report refers to the effectiveness of the board:

> Tests of board effectiveness include the way in which the members of the board as a whole work together under the chairman, whose role in corporate governance is fundamental, and their collective ability to provide both the leadership and the checks and balances which effective governance demands.[81]

The board, in particular, has the freedom to oversee executive management, and with that, it should also consider the significant corporation functions and enhance its value on behalf of the shareholders. Furthermore, the board should observe all tasks completed by executive management with the intention of replying to any submitted enquiries from the shareholders.[82] The board, by way of illustration, acts as a watchdog by either accepting or refusing the corporation's policies, such as incentive schemes and contracts that would

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78 Ibrahim Al Muneef, *Corporate Governance Functions and Duties and Responsibilities of the Board of Directors,* Arabic edition, Dar Al Mouder, Riyadh, 2006, p. 99.
79 Company Law 1965, Art. 64 to 82 and Corporate Governance Code 2006, Art. 10 to 18.
80 *Supra* note 6 at 24.
81 Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance*, 1992, p. 19.
82 Joseph Heath and Wayne Norman, 'Stakeholder Theory, Corporate Governance and Public Management: What Can the History of State-Run Enterprises Teach us in the Post-Enron Era?', *Journal of Business Ethics,* 2004, 53, p. 253.

provide support to the executive managers instead of acting on the shareholders' behalf.[83] The board quality is specifically a demanding element, side by side with the corporate governance framework, which achieves strategic business flexibility.[84]

Nonetheless, Articles 10 and 11 of the CGC both assign several responsibilities to the board of directors in terms of running the company as a going concern. These board responsibilities are as follows: Firstly, the board members' jurisdictions are clearly stated in the company's articles of association. Additionally, these jurisdictions must be completed in a way that is liable and in good standing. The board decisions should depend on satisfactory information from the company's executive administration or from any other trust sources.[85] This in fact is concurrent with the demand for a duty of good faith from the board member and has been stated under the UK Companies Act, which reveals that:

> A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.[86]

Secondly, all the board members should act on behalf of both the shareholders' and the company's interests, so they should avoid isolation from the shareholders, either individually or as a group.[87] It is therefore obvious that the Saudi regulator has a significant role in relation to the board and the board members' behaviour, as the board members should avoid any segregatory conduct towards shareholders, specifically when obtaining information and annual accounts, as well as when voting at the corporation's general meeting.

Thirdly, the new board members should be trained – by the board if necessary – to ensure adequate awareness of their jurisdictions.[88] The Saudi legislator pays great attention to the Cadbury report. It advises, in its suggestions for training new board members, that they should be entitled to attend various internal and external training programmes, and should be given an introduction to the corporation's interactions. It does not matter whether they are

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83 Jill Solomon and Aris Solomon, *Corporate Governance and Accountability*, John Wilev & Sons, Chichester, England, 2004, p. 5.
84 Saleh Hussain and Chris Mallin, 'The Dynamics of Corporate Governance in Bahrain: Structure, Responsibilities and Operation of Corporate Boards', *Blackwell Publishing*, 2003, 11 (3), p. 251.
85 Corporate Governance Code 2006, Art. 11 (B and C).
86 UK Companies Act 2006, s. 172 (1).
87 Corporate Governance Code 2006, Art. 11 (D).
88 Corporate Governance Code 2006, Art. 11 (F).

executive, independent or non-executive board members, as long as they do not have previous board experience.[89] Board members are expected to be highly skilled in order to accomplish their obligations reasonably and properly.[90] Certainly, a board which is comprised of highly skilled members such as lawyers, accountants and economists is able to gain several advantages on the corporation's and the shareholders' behalf.[91] In practice, the majority of listed companies announce on the exchange's website and on their own websites any vacant board member seats. Moreover, these listed companies have recently asked for highly qualified board members who are knowledgeable of the CL, the CML and the Implementing Regulations, including the CGC. This method is clearly supported by Article 29 of the Listing Rules, which advises that good-standing auditors, financers and accountants should occupy the board seats. For example, the *Nama* Chemicals Company lately advertised that due to the expiration date of the current board of directors, the company desires board members who are familiar with the above-mentioned regulations.[92]

Fourthly, the board must consent to and direct the company's technical policies. Therefore, the board:[93]

1) Arranges a complete policy for the company, the primary work plans and the rule of risk management, as well as evaluates these policies regularly.
2) Highlights the most suitable capital formation of the company, identifies the company's financial aims as well as ratifies its budgets.
3) Expresses the basis capital costs of the company and acquirement with disposal of assets.
4) Sets the targets to be achieved and monitors the operation of these targets as well as the overall performance of the company.
5) Examines the managerial and purposeful formation of the company on a periodic basis.
6) Annually reviews the usefulness of internal control by ensuring the reliability of financial and accounting proceedings, including the preparation of financial reports.[94]

89 *Supra* note 79 at 23.
90 Joseph Carcello, 'Government and the Common Good', *Journal of Business Ethics*, 2009, 89, p. 13.
91 Igor Filatotchev and Brain Boyd ,'Taking Stock of Corporate Governance Research While Looking to the Future', *Corporate Governance: An International Review*, 2009, 17 (3), p. 260.
92 See the Official Website of TADAWUL [Accessed 1 November 2012].
93 Corporate Governance Code 2006, Art. 10 (A).

Finally, the board creates a written policy that legalises the relationship with all the groups of stakeholders, in addition to securing their rights.[95] Clearly, this official objective of the CGC highlights the extent to which it has promulgated a diversity of worldwide corporate governance standards, as having a clear and positive relationship with all the stakeholder groups is one of the major OECD principles of corporate governance. The OECD states that:

> The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and sustainability of financially sound enterprises.[96]

In this respect, the UK Companies Act points out that:

> A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment, the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company.[97]

Furthermore, such an approach should be clearly written down by the corporation board in terms of creating a legalised relationship with all the stakeholder groups. This can inspire the board to respect its statutory and contractual obligations for the benefit of all stakeholders; namely the shareholders, lenders, suppliers, borrowers, employees and society as a whole. This written policy, importantly, includes the following:[98]

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94 Corporate Governance Code 2006, Art. 10 (B). The Capital Market Authority Board also issued a resolution, No. 1-33-2011, dated 30th October 2011, making Article 10-B of the Corporate Governance Code obligatory for all listed companies from 1st January 2012.
95 Corporate Governance Code 2006, Art. 10 (B-1).
96 *Supra* note 6 at 21.
97 UK Companies Act 2006, s. 172 (1).
98 Corporate Governance Code 2006, Art. 10 (E).

a) Mechanisms for compensating the stakeholders in respect of breaching their rights under contract law.
b) Tolls for resolving grievances or disagreements that occur between the company and its stakeholders.
c) Frameworks for sustaining a satisfactory association between consumers and suppliers and ensuring the confidentiality of related information.
d) A code of behaviour that should be agreed with accurate professional and ethical principles for the company's executives and employees.

7.4 Board Creation Standards

In corporations worldwide, there are two common board systems. First, the dual board is separate in civil law countries, such as France and Germany.[99] This board is divided into two bodies (two-tier). The former is the supervisory body, whose members are selected by shareholders in the corporation's general meeting, thus directing business decisions. The latter is the administrative body, which is charged by the supervisory body to carry out the business of the corporation.[100] The dual board has clear advantages; namely, the distinction between the executive and non-executive members and the differentiation between the position of the board chairman and that of the chief executive.[101] The dual board considerably assists all the stakeholders' groups by permitting them to have their representatives sit on the board, which empowers the stakeholder groups to look after their interests.[102]

Secondly, and most importantly, the unitary board (one-tier) is extensive in common law countries, such as the UK, US, Canada and New Zealand.[103] This board consists of executive, non-executive and independent members who should be appointed by the shareholders at the corporation's general meeting. Additionally, those board members' liabilities cover all the corporation's activities.[104] It is worth observing that independent enquiries and a

99 *Supra* note 81 at 9.
100 *Supra* note 23 at 122.
101 Gregory Maassen and Frans Bosch, 'On the Supposed Independence of Two-Tier Boards: Formal Structure and Reality in the Netherlands', *Corporate Governance: An International Review*, 1999, 7 (1), p. 31.
102 *Supra* note 81 at 6.
103 *Supra* note 81 at 6.
104 Lynch Fannon, *'From Workers to Global Politics: How the Way We Work Provides Answers to Corporate Governance Questions'*, 2005, p. 101.

disconnection between the supervision with the administrative purposes are found in this board.[105]

Regarding Saudi corporations' boards, most have adapted the unitary board, although the CGC and the CL give no preference as to board structure. Nevertheless, the CGC advocates that board structures should be tested by the board's nomination and remuneration committee, which can make alterations if necessary.[106] Subsequently, the board structures should be regulated by the CGC, thus lessening the possibility of any ambiguity and wrongdoing.

The CGC also acknowledges that the number of board members, which ought to be not more than eleven and not less than three, should be clearly stated in the corporation's articles of association.[107] This point is debatable, as the CL outlines just the minimum number, which is three board members, and leaves the maximum number open.[108] In contrast, the UK Companies Act stipulates that public corporations should have at least two directors.[109] As in the Saudi case, however, the maximum number is not defined. Arguably, insisting that the maximum number of board members should be no more than eleven is an innovative clause in the CGC, mimicking the international corporation board seats regulations, especially those found in the US.[110] In practice, the listed corporations are obstructed by this CGC clause, as the number of their board seats fluctuates between seven and eleven. For instance, *Al-Riyadh* Development Company's board has ten members.[111]

7.5 Separation of Board Members' Powers

It is becoming increasingly difficult to ignore the fact that spreading board members' powers across multiple members improves a corporation's targets, chiefly affecting its disclosure and transparency to all market contributors. It also makes the supervision undertaken by the board

105 *Supra* note 99 at 31.
106 Corporate Governance Code 2006, Art. 15 (C).
107 Corporate Governance Code 2006, Art. 12 (A and F).
108 Company Law 1965, Art. 64.
109 UK Companies Act 2006, s. 154 (2).
110 Jonathan Charkham, *Keeping Better Company: Corporate Governance Ten Years on*, Oxford University Press, Oxford, 2005, p. 197.
111 See, Al-Riyadh Development Company Official Website, available at: http://www.ardco.com.sa/index.php?option=com_content&view=article&id=9&Itemid=20&lang=en, [Accessed 1 November 2012].

members more efficient. It is important to note that separating the roles of chairman and chief executive is considered good corporate governance practice, as it minimises potential conflicts of interest.[112] International corporate governance principles have recognised the importance of spreading the board members' powers, specifically those of the board chairman and the chief executive. For instance, the OECD principles of corporate governance presume that:

> Separation of the two posts may be regarded as good practice, as it can help to achieve an appropriate balance of power, increase accountability and improve the board's capacity for decision making independent of management.[113]

More to the point, the Cadbury report recommends that there should be a division of accountabilities at the head of the corporation and that the character of the board chairman should, theoretically, be separate from that of the chief executive.[114] Speck and Tanega remarked that the Cadbury report highlights that the board chairman should not be chief executive at the same time.[115] As a matter of fact, the Cadbury report's recommendation was a consequence of the fact that in corporations where corporate governance was not applied correctly, it was easy to find individuals in the role of both board chairman and chief executive simultaneously, and thus in a position to suppress all board debate.[116] It has been said that the separation of the board chairman and the chief executive posts in a single corporation has noteworthy effects on the corporation.[117]

The Saudi CL regulation used to permit an individual to be both board chairman and chief executive concurrently.[118] However, this trend has since changed somewhat. The CGC prevents the combination of this essential position with other executive positions on the board or top management positions in the corporation; namely the chief executive officer, managing director or general manager.[119] It can be argued, therefore, that the separation of the

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112 *Supra* note 2 at 78.
113 *Supra* note 6 at 63.
114 *Supra* note 79 at 20.
115 Beat Speck and Joseph Tanega, 'UK & Swiss Corporate Governance: Comparing the Role of Independent Non-Executive Directors', *International Company and Commercial Law Review*, 2005,16 (12), p. 469.
116 *Supra* note 22 at 195.
117 James Brickley, Jeffrey Coles, Gregg Jarrell, 'Leadership structure: Separating the CEO and Chairman of the Board', *Journal of Corporate Finance*, 1997, 3 (3), p. 189.
118 Company Law 1965, Art. 78.
119 Corporate Governance Code 2006, Art. 12 (D).

overseeing mission and the managing mission inside the corporation set out by the CGC constitutes an imperative advantage. Furthermore, this ensures accountability and strong values, because the responsibilities of the top executives allow them to handle a diversity of obligations, including signing on behalf of the corporation, formatting commercial agreements and selling or purchasing the corporation's products. Consequently, it appears that by carrying out these responsibilities in accordance with the board controlling equipment and the spreading of the board members' powers, members would not be open to suspicion of corruption, malpractice and conflict of interest in board situations.[120]

Having identified the challenge to the separation of the board chairman position and other board executive positions posed by international corporate governance principles (including those of Saudi Arabia), the Saudi regulator conceded that the corporation's board and the shareholders are equally in charge of selecting the board chairman, the chief executive and other members.[121] However, this approach is ignored by the majority of listed companies, where the family and the government are seen to be the major shareholders or the corporations' owners. For example, *Al Sorayai* Group is a paradigm of the family listed company; the positions of board chairman and chief executive are held by the same individual family member.[122] Government influences can be seen in the National Industrialisation Company, in which the board chairman and chief executive functions are handled by one person.[123] Regarding the separation of the board chairman and other board executive positions, it seems that the effectiveness of the concentrated ownership structure is obvious, as can be appreciated from the two examples above. It seems vital to engage in further explanation about the ownership structure concerning the Saudi practice of the separation of the board chairman and other board executive positions.

There are two significant global ownership structures. The former is the dispersed ownership structure found in common law country corporations, such as the UK and the US.[124] The

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120 *Supra* note 2 at 82.
121 Company Law 1965, Art. 78.
122 See the Official Website of *Al Sorayai* Group, available at: http://www.al-sorayai.com/Action121.htm, [Accessed 1 November 2012].
123 See the Official Website of the National Industrialisation Company, available at: http://www.jazadco.com.sa/en/index.htm, [Accessed 1 November 2012].
124 John Coffee, 'The Future as History: The Prospect for Global Convergence in Corporate Governance and its Implications', *North western University Law Review*, 1999, 93 (3), p. 641. Also, Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact*, Oxford University Press, New York, 2003, p. 28.

dispersed ownership structure is defined as when the public extensively owns corporation shares, and additionally when the management of the corporation has a smaller shareholding, which leads, to some extent, to what is frequently a nominated division of ownership and control. This corporation can thus be expected to have a dispersed ownership structure.[125] The comprehensive nature of the dispersed ownership structure in common law countries is due to several successful factors, including the efficient general legal system, the influential corporate governance regime, the capable security market and finally strict disclosure and transparency requirements.[126] The second ownership structure is that of concentrated ownership, where a small number of shareholders hold the highest proportion of shares. The concentrated ownership structure, specifically, can be understood in developing countries' corporations, including those of Saudi Arabia. It can be argued that the extension of the concentrated ownership structure in less-developed countries' corporations is a consequence of numerous factors, including the complicated general legal systems, the fledgling corporate governance regimes, the weak securities markets and the shortcomings in the conditions for disclosure and transparency.[127]

Bearing this in mind, there is a mirror association between a country's political and legal arrangements and its companies' ownership structures. Certainly, the latter ownership structure and other corporate governance shortcomings would be anticipated if a government were unfair, weak and undemocratic.[128] However, there are also non-political circumstances that affect ownership structure, such as economic enhancement, technological progress, cultural change and legal reform.[129] All these circumstances potentially fit the Saudi context regarding ownership structure and corporate governance aspects. In particular, the Saudi ownership structure is without doubt concentrated ownership based on rich families and government effectiveness.[130]

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125 *Supra* note 22 at 3.
126 Kamalpreet Kaur and Mandeep Kaur, 'Corporate Ownership Structure and Control: Evidence from India', *Lcfai University Journal of Corporate and Securities Law*, 2009, 1, p. 55.
127 Ibid.
128 Elsa Satkunasingam and Bala Shanmugam, 'Disclosure and Governance of Islamic banks: A Case Study of Malaysia', *Journal of International Banking Regulation*, 2004, 6, p. 76. Also, Seward Cooper, 'Corporate Governance in Developing Countries: Shortcomings, Challenges and Impact on Credit', *Modern Law for Global Commerce Conference*, Vienna, 2007, p. 2. Gary Herrigel, 'Guest Editor's Introduction: A New Wave in the History of Corporate Governance', *Oxford University Press*, New York, 2007, p. 478.
129 Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact*, Oxford University Press, New York, 2003, p. 20.
130 Waleed Al Ajlan, *Corporate Governance in Saudi Arabia: The Roles and Responsibilities of the Board of Directors in the Banking Industry*, Unpublished Thesis, University of Nottingham, 2005, p. 362.

The Saudi government has been the greatest investor in a variety of leading Saudi listed corporations. Stock exchange statistics estimate that Saudi government investment comprises approximately 45% of the listed companies' shareholdings, and accounts for 8.8 billion shares with a market capitalisation of $155.92 billion. Saudi government investment in leading listed companies, which have been seen to be an operative cause in converting ownership to the concentrated model, is made by the governmental institutional investors; namely, the Public Investment Fund, the Public Pensions Agency and the General Organisation for Social Insurance. These bodies have invested on behalf of the Saudi government in a variety of listed corporations, such as SABIC and STC. They sometimes own a large percentage of the listed corporations' shares, as these corporations are considered by the government to be on-going concerns. Thus, the government can assure its investments when investing in these corporations through its institutional investors.[131]

On the other hand, in the Saudi market, rich families invest in several listed corporations, and these families always withdraw potential opportunities to recoup on the listed corporations' affairs. Furthermore, a number of family enterprises, which used to be small ventures owned by rich families, have since converted to listed corporations.[132] These listed family corporations can be seen in several stock exchange sectors, such as energy, agriculture, cement and transport. They are usually named after the founding family's name; for example, the *Halwani* Company, *Fitaihi*-Group, *Al Abdullatif* Industrial Investment Company, *Othaim* Company and *Zamil* Industrial Investment Company.[133]

Returning to the impact of rich families and the government on the Saudi ownership structure, several corporate governance issues are endangered by the ownership patterns. The most likely corporate governance issues to be debated are the following:

1. Separation of the board chairman's position and other board executive positions.
2. Appointment and removal of board members.
3. Determined time of the board member in the board seat.
4. Unlimited board memberships.

131 See the Annual Report of the Saudi stock exchange, available at: http://www.tadawul.com.sa/Resources/Reports/Yearly_en.html, [Accessed 1 November 2012].
132 *Supra* note 128 at 365.
133 *Supra* note 128 at 365.

In this regard, Articles 12-B and 12-H of the CGC discuss the fact that the corporation general meeting should appoint and re-appoint board members for the duration provided for in the corporation's articles of association. This duration should not exceed three years. In addition, board members should not appear as board members of more than five listed companies at the same time.[134] The rich families in question have kept the majority of the transmitted listed corporations' shareholdings from their foundation in the stock exchange. Thus, these families' members have occupied these listed corporations' board seats for an undetermined period, and generally have positions on more than five listed corporations' boards simultaneously.[135] Accordingly, members of these rich families are in breach of Articles 12-B and 12-H of the CGC. However, no law case or fine has been issued either by the Capital Market Authority Board or the CRSD (as judicial entities of the Saudi Capital Market) with regard to these families' members who are in breach. This approach can also be argued by the fact that in some countries, politicians and rich families are easily able to obtain business and positions.[136] This is what happens in the vast majority of Saudi listed corporations, and absolutely fits the Saudi context.

It is also apparent that the Saudi government influences Articles 12-B and 12-H of the CGC, as the government is the major shareholder/owner of some brand listed corporations. Accordingly, the government places its representatives in these corporations' board seats regardless of their period of office, as well as placing representatives on the boards of more than five listed corporations. The evidence from Article 65 of the CL obviously shows that the listed corporations' boards' governmental representatives have the power to hand out board seats for undetermined periods.[137]

There is expected debate concerning the ability of the government to enforce its representatives in the listed corporations' board seats for unspecified durations. Supporters of the governmental influences claim that due to the government owning large shareholdings in some listed corporations, it should have more than enough votes to elect and re-elect its representatives in these corporations' boardrooms.[138] For example, the Saudi government appointed five out of the nine members in the Saudi *Arabian* Mining Company because the

134 Corporate Governance Code 2006, Art. 12 (B and H).
135 *Supra* note 128 at 363.
136 *Supra* note 126 at 74.
137 Company Law 1965, Art. 65
138 *Supra* note 76 at 186.

government owns 50% of the shares in this company.[139] Opponents of the governmental influences urge that allowing the board members to avail themselves of an unspecified mandate and duration deteriorates the board members' enthusiasm for corporation involvement. This results in a diversity of corporate governance aspects, as the majority of these corporations' chairmen, members and chief executives are nominated by the government. As a result, it can be said that the government has more dominant power based on its investments and its board representatives. Hence, other shareholders will not have the same power as the government in these corporations. In particular, board members who are not appointed by the government will not be able to challenge the opinions of the elected board members in terms of decision-making.[140]

Therefore, Article 65 of the CL, which permits the government to place its representatives for an undecided time and mandate, is not in line with good corporate governance practices. Thus, it should be removed from the CL in order to avoid being misused by government agencies. Article 12-H of the CGC, which does not allow board members to hold positions on more than five listed corporations' boards simultaneously, should at least be the reference for this matter, even if over five memberships are not recommended as an optimal practice.

To summarise, the researcher is of the view that corporate governance rules should be adhered to by either family-owned corporations or government-owned corporations, especially with regards to the separation of board chairman and other board executives' positions. Thereby, preventing membership of one individual on more than five listed corporations' boards at one time, and the abusing of the system for the appointment and removal of the board members.

7.6 Board Membership Categories

The CGC identifies three categories of board membership; specifically executive members, non-executive members and independent members. First, the CGC defines that the board executive members should have full-time administrative positions in the corporation and

139 See the Official Website of the Saudi *Arabian* Mining Company, available at: http://www.maaden.com.sa/eng/boards_of_directors.htm , [Accessed 1 November 2012].
140 *Supra* note 76 at 123.

obtain monthly salaries.[141] In this regard, the Cadbury report highlights significant elements with reference to the definition of executive members, such as the fact that their contracts should not exceed three years' duration without shareholders' endorsement. In addition, there should be full transparency and disclosure regarding the executive members' income.[142] These conditions cannot be found under the CGC; therefore, amendment of the CGC in accordance with these conditions is needed in order to achieve good corporate governance practices.

The precise role of the executive member is open to debate. The role of executive members is significant, alongside non-executive and independent members of the board of directors, in achieving optimal corporation performance. This is because executive members are usually knowledgeable and experienced in terms of the corporation's affairs and investment opportunities.[143] It is argued, however, that the executive members do not assess strategic decisions much more effectively than non-executive members do. This is due to the fact that the executive members are unlikely to challenge the chief executive strategic decision making during board meetings.[144]

Secondly, the CGC maintains that the non-executive board members neither have full-time administrative position in the corporation nor earn monthly salaries.[145] In this respect, the Cadbury report outlined important issues with regard to the decision that non-executive membership should not be determined for a long period and that they should be independent of the corporation, apart from their payments and their shares. They should also be independent of management and free from any business or other association, which could substantially conflict with the application of their independent judgement.[146] Again, these conditions are not established under the CGC, so it should be amended in accordance with these conditions.

141 Corporate Governance Code 2006, Art. 2.
142 *Supra* note 79 at 58.
143 *Supra* note 72 at 178.
144 James Westphal and Edward Zajac, 'The Symbolic Management of Stockholders: Corporate Governance Reforms and Shareholders Reactions', *Administrative Science Quarterly*, 1998, 43 (1), p. 134.
145 Corporate Governance Code 2006, Art. 2.
146 *Supra* note 79 at 21.

The CGC indicates that non-executive members should occupy the largest number of board seats.[147] They should additionally receive information about the corporation's submissions in a satisfactory manner, thus enabling them to enforce their jurisdictions efficiently.[148] The general notion of placing non-executive members on the board is that, again, they do not have a full-time career in the corporation, so are not reliant on the corporation for their livelihood. As a result, non-executive members should not be influenced by other board members, including the chief executive, as they earn very little from the corporation. Therefore, they do not jeopardise their reputation or their total income capability by getting involved in any corporation mismanagement. Non-executive members, moreover, formulate independent judgements within the board; yet, they not only play a regular administrative role in the management of the corporation, but also exercise an intensive care purpose.[149]

Finally, the independent board members enjoy full independence. Accordingly, there are official regulations that are emphasised in the CGC as breaching this independence:[150]

1) If the member owns a controlling interest or holds the position of senior executive for two years in the company or in one of its subsidiaries.
2) If the member has ownership of 5% or more of the company or its group by the board member or a representative of a legal entity which owns 5% or more of the company or its group.
3) If the member is a board member of any company within the body of the company of which the member is scheduled to be a member of its board.
4) If the member has been an employee and a partner of the company or a partner of any other company including external auditors or senior suppliers for two years.
5) If the member is a relative (namely father, mother, wife, husband or child) of any board member or senior executive of the company or one of its subsidiaries.

The definition of the independent board member is still a doubtful concern among both legislators and the judiciary.[151] This is supported by Brudeny, who emphasised that:

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147 Corporate Governance Code 2006, Art. 12 (C). The Capital Market Authority Board issued resolution, No. 1-36-2008, dated 10 November 2008 making article 12-C mandatory on all the listed corporations effective from year 2009.
148 Corporate Governance Code 2006, Art. 11 (G).
149 *Supra* note 22 at 195.
150 Corporate Governance Code 2006, Art. 2.

> No definition of independence yet offered precludes an independent director from being a social friend of, or a member of the same clubs, associations, or charitable efforts as the persons whose compensation he is asked to assess.[152]

It is almost impossible to verify the independent nature of a company board member in Saudi Arabia. In particular, it is considered that the corporation board nomination and remuneration committee plays a significant role in terms of inspecting the independence of the board members.[153] In addition, the (Capital Market Authority) general department of corporate governance pays great attention to this matter when reviewing the listed corporation boards' annual reports. Recent statistics from the general department of corporate governance show that there are 1,108 listed corporation board members: 606 independent members, 356 non-executive members and 146 executive members.[154]

7.7 Board Meeting

Saudi board meetings are encouraged to be open to debate in order to support the board supervisory tasks as regards the listed corporation's dealings. As Al Jubran pointed out, an open discussion brings to bear the facts and deals with management malpractice if and when it is uncovered.[155] Nevertheless, the CGC has incorporated the following ideas on board meetings:[156]

A. The board arranges its meetings at the request of the board chairman who can convene the board for an immediate meeting following a written request by at least two board members.[157]
B. The board should minute the meeting discussions by reporting the agreeing and disagreeing votes.[158]

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151 'Beyond Independent Directors: A Functional Approach to Board Independence', *Harvard Law Review*, 2006, 119 (5), p. 1556.
152 Victor Brudney, The Independent Director: Heavenly City or Potemkin Village?, *Harvard Law Review*, 1982, 95 (3), p. 613.
153 Corporate Governance Code 2006, Art. 15 (C).
154 See, *Aleqt* Newspaper, February 1, 2011, Issue 6322.
155 *Supra* note 72 at 177.
156 Corporate Governance Code 2006, Art. 16.
157 It corresponds to Company Law 1965, Art. 79.
158 It corresponds to Company Law 1965, Art. 82.

C. The board members should have plenty of time to fulfil their duties including preparation for the board and the board sub-committees' meetings.
D. The board members should receive the board documentations in a suitable and timely fashion before the meeting, to enable them to study this material.

It could be argued that the CGC does not stipulate how many corporation board meetings must be held. This overlooked aspect is, in practice, under the board chairman's command in a variety of listed corporations, and its neglect has been seen as a disadvantage within the CGC, as it leaves the number of the corporation's board meetings during the fiscal year unspecified and weakens the board's overseeing role. This could lead to board executive members having ultimate power in the corporation, and thus the possibility of serious management misdemeanours.[159] It is consequently recommended that the number of corporation board meetings should be incorporated into the CGC as a binding clause that should be taken into account by all listed corporations.[160]

In addition, the CL specifies that meetings of the board of directors are valid only if attended by at least half of the directors, provided the number present is not less than three, unless the corporation's articles of association provide for a higher number. In addition, the resolutions of the board must be adopted by a majority vote of those directors present or represented. In case of a tie, the chairman's vote carries, unless the corporation's articles of association provide otherwise.[161] These prerequisites do not exist in the CGC; therefore, they should be added as measures to protect the board members' civil and criminal liabilities when shareholders litigate against them.

7.8 Board Sub-Committees

7.8.1 General Overview

It is noteworthy that the CGC has comparatively benefitted from transnational corporate governance principles; chiefly the Cadbury report aspects on the formation of board sub-committees. In particular, the Cadbury report states that:

159 *Supra* note 72 at 177.
160 *Supra* note 72 at 177.
161 Company Law 1965, Art. 79 and 80.

> The effectiveness of a board is buttressed by its structure and procedures. One aspect of structure is the appointment of committees of the board such as the audit, remuneration and nomination committees.[162]

In addition, the mandatory Articles 12, 13, 14 and 15 of the CGC[163] can be seen to encourage the setting up of board sub-committees. It is proposed that the board creates a sufficient number of committees pursuant to the corporation circumstances and requirements, as these sub-committees will support the board in carrying out its duties.[164] Therefore, it is possible to criticise the scope of the CGC regarding this obligation; the CGC stems from this obligation in order to enable the corporation to determine which kind of committees are significant for its business dealings along with its general size and the magnitude of its operations. However, the CGC strongly states that there should be two obligatory sub-committees established by the board; explicitly the audit committee and the nomination and remuneration committee. This can be understood from Article 13-B of the CGC when it states:

> The board shall approve by laws – all of the committees of the board, including inter alia, the audit committee, nomination and remuneration committee.[165]

As a consequence, in addition to ensuring the formation of the board sub-committees – mainly the audit committee and the nomination and remuneration committee – the CGC specifies that the corporation's board annual reports should contain the forenames of the chairmen and members of the board sub-committees, as well as the approximate number of their regular meetings.[166]

7.8.2 Audit Committee

The idea of creating a board audit committee came into existence in 1978, when the New York stock exchange required all listed corporations to have a board audit committee comprising independent members. The idea also arose when the 1987 American Treadway

162 *Supra* note 79 at 24.
163 The Capital Market Authority Board issued resolution, No. 1-36-2008, dated 10 November 2008 making articles 12, 13, 14 and 15 of the Corporate Governance Code compulsory on all the listed companies.
164 Corporate Governance Code 2006, Art. 13 (A).
165 Corporate Governance Code 2006, Art. 13 (B).
166 Corporate Governance Code 2006, Art. 9 (D).

Commission report settled that the board audit committee had a critical role to play in ensuring the integrity of US corporations' boards' annual statements.[167]

It is understood that the audit committee aims to monitor the corporation's missions. It is therefore significant, as it constitutes a major internal supervision and auditing tool that improves and directs the decisions made by the board. The audit committee works for the benefit of the board by fulfilling an essential watchdog function that ensures accountability inside the corporation as well as protecting investors.[168] Additionally, Baruch stated that the audit committee's role is to observe the consistency of the corporation's accounting and auditing procedures, thereby safeguarding shareholders' interests.[169]

It is expected that a productively operating audit committee will result in quite a few advantages. These advantages are assumed to include promoting the quality of financial statements, establishing a climate of self-control that lessens the chance of fraud, and empowering non-executive members to make independent decisions, play a constructive part and support the task of the finance director and external auditors.[170]

The Saudi legislator, who took the significance of the audit committee into consideration even before passing the recent CGC, incorporated a piece of legislation that actively encouraged listed corporations to establish an audit committee as one of the board sub-committees, based on its advantages in developing good accounting and auditing practices. This legislation also provided guidelines on the standards regarding an audit committee's membership and overall character, in terms of the choice of external auditors in the listed corporations.[171] The CGC, in principle, has defined four compulsory elements in terms of structuring the audit committee membership:[172]

A. The audit committee must contain at least three members.
B. The audit committee members should be non-executive and independent members.

167 *Supra* note 79 at 26.
168 Zabihollah Rezaee, Kingsley Olibe and George Minmier, 'Improving Corporate Governance: The Role of Audit Committee Disclosures', *Managerial Auditing Journal*, 2003,18, p. 530.
169 Hurd Baruch, 'The Audit Committee: A Guide for Directors', *Harvard Business Review*, 1980, 58, p. 175.
170 *Supra* note 79 at 67.
171 The Ministry of Commerce and Industry, Royal Decree, No. 903, dated 23 January 1994.
172 Corporate Governance Code 2006, Art. 14.

C. The audit committee members should have satisfactory qualifications and skills in the accounting, auditing and finance professions.
D. The audit committee members should not have either direct or indirect interests in the corporation's submissions and contracts.

It is obvious that the requirement for an independent audit committee can be noted in the CGC rather than in the previous legislation mentioned, as independent and non-executive members are highly encouraged to be members of the audit committee. This methodology means that audit committee members fulfil their obligations and submit their reports subjectively and without any prejudice from the board executive members.[173]

A recent legal case concerned the existence of independent members on the board and its audit committee. *Banque Saudi Fransi* was found not to have any independent members on its board or its audit committee. As a result, the Capital Market Authority Board fined the bank $13,333 in accordance with Article 12-E of the CGC.[174] It contended that:

> The independent members of the board of directors and its audit committee shall not be less than two members, or one-third of the members, whichever is greater.[175]

This legal case clearly demonstrates that the Capital Market Authority Board is concerned about implementing good corporate governance practices in listed corporations' boards and audit committees. The presence of independent members is highly recommended by the CML and the Implementing Regulations. *Banque Saudi Fransi*, however, violated a binding clause of the CGC, so the condemnation was legislative. This legal case was, significantly, the earliest verdict regarding a board sub-committees' affairs.[176] It is, however, suggested that the Saudi capital market does not have enough capable individuals to fulfil the character of effective independent members.[177]

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173 Corporate Governance Code 2006, Art. 13 (C).
174 Issued Decision, No. 6-36-2011, dated 11 December 2011 by the Capital Market Authority Board.
175 Corporate Governance Code 2006, Art. 12 (E).
176 Moreover, *Tihama* Advertising and Public Relations Company did the same breach, and it was punished by the Capital Market Authority Board likewise the aforesaid Bank. Issued Decision, No. 6-1-2012, dated 1 January 2012 by the Capital Market Authority Board.
177 *Supra* note 76 at 138.

In this respect, a number of corporate governance studies have found that weakness in an audit committee is more likely if it does not have strong accounting, auditing and finance expertise. Empirical research suggests that there is a strong link between accurate financial accounts and an audit committee with highly qualified accounting, auditing and finance professionals.[178] This ideology can be found under Article 29 of the Listing Rules, which advocates that highly qualified members in accounting, auditing and finance should occupy the board's sub-committee seats.[179] It can also be seen in Article 14-A of the CGC, which includes the provision that one of the audit committee members should be an expert in financial and accounting practices.[180]

Conversely, the Saudi regulator makes no mention of inviting experienced non-members of the audit committee to attend audit committee meetings when necessary. In particular, Al Mataz indicated that outsider expertise in accounting, auditing and finances (i.e. people who are not board non-executive or independent members) should be part of the board audit committee in order to effectively achieve targets.[181] This trend can be found in the Cadbury report, when it advises that:

> Membership of an audit committee is a demanding task requiring commitment, training and skill. The directors concerned need to have sufficient understanding of the issues to be dealt with by the committee to take an active part in its proceedings. This is why committees should, if it is appropriate and within their power, be able to invite outsiders with relevant experience to attend meetings.[182]

It can be further argued that audit committee members usually work part-time, namely as non-executive and independent members. This means that they do not have a strong relationship with the corporation staff, whereas board executive members often work full-time and certainly have a direct relationship with corporation staff.[183] This is one of the

178 *Supra* note 88 at 15.
179 Listing Rules 2004, Art. 29.
180 Corporate Governance Code 2006, Art. 14 (A).
181 Ihsan Al Mataz, 'The Commitment of the Saudi Joint Stock Companies Listed in the stock exchange to Disclose some of the Requirements of the Saudi Corporate Governance Code', *The Scientific Symposium of the Department of Accounting: The Saudi Capital Market: The Way Forward*, Arabic edition, King Khalid University, Abha, 2007, p. 13.
182 *Supra* note 79 at 29.
183 Robert Monks, 'Redesigning Corporate Governance Structures and Systems for the Twenty First Century', *Corporate Governance: An International Review*, 2001, 9 (3), p.146.

disadvantages of the Saudi audit committee, which may not protect shareholder interests in the face of mismanagement and negligence by board executive members.[184]

Recent evidence suggests that the vast majority of the audit committees of listed corporations have failed to enforce one or more clauses of Article 14 of the CGC. For example, the corporation's general meeting, depending on recommendations from the board, forms the standards for selecting the audit committee members and defining the duration of their membership and their work plans.[185] In practice, the listed corporations' boards usually nominate the audit committee members who should comprise an independent commission benefitting shareholders, and this election is usually carried out without the authorisation of the corporation's general meeting.[186]

The Capital Market Authority Board recently charged the Basic Chemicals Industries Company, imposing a fine of $13,333 because the company board failed to propose to ordinary general meeting the rules that should be in place for selecting audit committee members, their membership duration and the audit committee approaches.[187] In the second case, the Capital Market Authority Board penalised the *Tabuk* Cement Company, which was charged with the same violation.[188] The verdicts were in accordance with Article 14-B of the CGC:

> The general meeting of shareholders shall, upon a recommendation of the board of directors, issue rules for appointing the members of the audit committee and define the term of their office and the procedure to be followed by the committee.[189]

In these cases, the fines issued were legislative because they were taken from the mandatory CGC provision. Nevertheless, the violated corporations' boards should form the audit

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184 Abdurrahman Al Twaijry, John Brierley and David Gwilliam, 'An Examination of the Role of Audit Committees in the Saudi Arabian Corporate Sector', *Corporate Governance*, Blackwell Published, 2002, 10 (4), p. 292. Abdurrahman Al Twaijry is a Professor of Economics at King Saud University and has published various academic articles and books aimed at improving the Saudi Capital Market. In addition, he is the chairman of the Capital Market Authority Board and the head of this authority, and a member of the Saudi Economic Council.
185 Corporate Governance Code 2006, Art. 14 (B).
186 *Supra* note 182 at 292.
187 Issued Decision, No. 7-1-2012, dated 1January 2012 by the Capital Market Authority Board.
188 Issued Decision, No. 8-1-2012, dated 1January 2012 by the Capital Market Authority Board.
189 Corporate Governance Code 2006, Art. 14 (B).

committee and outline its responsibilities. They should also appoint audit committee members with regard to the relevant article of the CGC. The fines that were imposed by the Capital Market Authority Board, however, should have been $26,666 rather than $13,333, as the companies in question violated a significant CGC provision.[190]

Then again, the CGC has highlighted several essential functions of the audit committee, stating that it:[191]

1) Assists and plans a written statement to the internal audit system and then controls the corporation's internal audit system in addition to certifying its usefulness.
2) Advocates the discharge and appointment of external auditors with their remunerations to the board.
3) Examines jointly with the external auditor the corporation audit plan.
4) Checks the external auditor's comments in the board's annual financial report and then provides opinions regarding this report.

These functions can be traced back to the Cadbury report. Nevertheless, there are a number of significant points that should be added to the CGC from the Cadbury report concerning the successful accomplishment of the audit committee's work. For example, the Cadbury report affirms that the audit committee examines the half-year and annual reports before submission to the board, with major concern regarding any changes in accounting standards and adherence to stock exchange and legal requests.[192] In addition, many virtual aspects have been specified under the Cadbury report. For instance, the report stipulates that the audit committee should meet at least twice a year, the external auditor and the finance director should regularly attend audit committee meetings and other board members should have the right to do so. Nonetheless, the audit committee and the external auditor should have at least one exceptional meeting without these parties in order to ensure that there is no unsettled concern.[193] From this discussion, it can be suggested that these essential clauses should be brought to the CGC in line with their professionalism for the formation of the board audit committee. The Saudi audit committee is principally a new experience. Therefore, the

190 For more information, see the link, available at: http://www.argaam.com/article/articledetail/246201/, [Accessed 1 November 2012].
191 Corporate Governance Code 2006, Art. 14 (C).
192 *Supra* note 79 at 29.
193 *Supra* note 79 at 29.

promulgation of successful international practices is necessary in order for the audit committee to reach an adequate level of performance.

Alternatively, the CGC provides the audit committee with the right to appoint and discharge the external auditors.[194] It does not enforce any negative impediments, either by the board members or by the top managers, which would meet the external auditors when carrying out their obligations to the corporation and its shareholders. The CL has taken a valuable step towards the effective functioning of the external auditors. It also demonstrates that any board member, executive or employee who tries to obstruct the external auditors will be sued.[195] It is thought that this clause should be codified under the CGC, as it ensures the usefulness of the external auditors regarding the fulfilment of their duties.

7.8.3 Nomination and Remuneration Committee

It is said that the board of directors cannot resolve the remuneration of the board executive members without a possible conflict of interest. In addition, the board members' remuneration should be taken into account in corporate governance progression, because the supervision of the corporation's popularity can have a contradictory consequence on determination within the corporation.[196] Specifically, the interpretation which several US and UK corporations have settled on is the creation of a remuneration committee. This committee should consist of non-executive directors, who do not have personal financial interest, and adopt executive directors' remuneration on their behalf; it should refer directly to the shareholders for its pronouncements, whilst advancing the broader concern of the corporation.[197] In other words, the speculative meaning of the remuneration committee is obvious, because if this sub-committee does not perform properly within the corporation, the executive members will reward themselves financially, which is not always in the interest of shareholders.[198]

This notwithstanding, it is indicated that executive directors' compensation should be in line with the suggestions of the remuneration committee, which should consist predominantly of

194 Corporate Governance Code 2006, Art. 14 (C).
195 Company Law 1965, Art. 230 (4).
196 *Supra* note 22 at 206.
197 *Supra* note 24 at 21.
198 Martin Conyon and Simon Peck, 'Board Control, Remuneration Committees, and Top Management Compensation', *Academy of Management Journal*, 1998, 41 (2), p. 148.

non-executive directors.[199] Still, the independence of the nomination and remuneration committee can be held in doubt, as this sub-committee is established by the corporation board. It is additionally simultaneously in charge of handing out board members' compensations. It can be questioned in what manner the nomination and remuneration committee could prevent board members from deciding what their remuneration would be.[200]

Nonetheless, the CGC outlines the nomination and remuneration committee's prerogatives, stating that it:[201]

1) Advises the appointment of a new board member who should hold a position of honour and honesty.
2) Updates the description of the essential capabilities and qualifications that are required for board membership.
3) Decides the strong points and weaknesses of the board as well as board construction and suggests remedies.
4) Examines the independence of the board's non-executive and independent members.
5) Ensures the absence of any conflicts of interest within the board.
6) Forms identifiable procedures regarding the board members' and top executives' remuneration.

In particular, the CGC overlooks an essential point with respect to the appointment of board members to the nomination and remuneration committee. This is that a board member should not be a public employee unless he or she has been appointed by the government as a governmental representative inside the board.[202] This is so as to prevent outside pressure on the board member to gain advantage, either statutory or otherwise, and to prevent conflicts of interest. This point of view, principally, should be regulated under the CGC and should be part of the nomination and remuneration committee's responsibility.

While the CGC has stipulated that the audit committee members should not number fewer than three,[203] it makes no mention as to how many members should comprise the nomination

199 *Supra* note 79 at 58.
200 *Supra* note 179 at 5.
201 Corporate Governance Code 2006, Art. 15 (C).
202 Saudi Civil Service System 2000, Art. 13 (B).
203 Corporate Governance Code 2006, Art. 14 (A).

and remuneration committee. This reflects good international practice, apart from this clause. In this respect, the Greenbury report insists that the remuneration committee should have three non-executive members, or at least two on the occasion of small corporations. The remuneration committee, however, should state, in its report to shareholders, any reason why this committee should consist of fewer than three members.[204] Consequently, the CGC would gain an advantage when reforming its guidelines with regard to this overlooked aspect, in accordance with the Greenbury report suggestion.

Furthermore, the CGC does not stipulate anything about how the sub-committee members should be compensated. This is a major worry in terms of outstanding members of this sub-committee. Best practice in relation to this tendency would be derived from the Greenbury report's recommendation, which suggests that members' indemnifications of the remuneration committee should typically be of an arrangement of stationary payments fixed by the board, entirely within limits agreed in the corporation's articles of association, which should indicate the amount of time dedicated to the corporation's undertakings.[205]

7.9 Board Members' Compensations

The board members' indemnification is a statutory right based on the principle of no free fee for doing business. The function of the board members resembles the agent's function; acquiring an advantage for their agency's actions as long as these activities are legitimate.[206] It is worth observing the UK Combined Code, which outlines the remuneration level – there is no piece of Saudi legislation representing this idea. The UK Combined Code affirms that:

> Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.[207]

204 Richard Greenbury, *Directors' Remuneration: Report of a Study Group*, 1995, p. 23.
205 Ibid, p. 24.
206 Mohammad Al Jeber, *The Saudi Commercial Law*, Arabic edition, King Fahd National Library, Riyadh, 2007, p. 289.
207 UK Combined Code 2008, s. 1.

Board members' remunerations have recently caught the attention of the Saudi legislator. This is because these remunerations used to comprise 10% of the corporation's yearly net profits. There was, furthermore, a ministerial resolution, which used to be the second reference that measured board members' remunerations. Significantly, this ministerial resolution emphasised that the maximum non-executive and independent members' remunerations should be $53,333 for each member, as well as $800 fees for attending board meetings.[208]

This ministerial resolution was unfortunately ignored by the vast majority of listed corporations. It is nevertheless debated, because it did not highlight a maximum level of remuneration for executive members, which should be a concern owing to their superior level of remuneration compared with that of non-executive and independent members.[209] The Saudi Consultative Council, which has legislative power over the commercial and corporate rules, recently reviewed the maximum level of the board members' yearly compensation and declared that it should be no more than $133,333 for each member, including, significantly, executive members. Time will tell whether executive members will be paid no more than this maximum level of remuneration.[210] This is a problematic area, because many worldwide financial markets have failed to set a limit for executive compensation, as governments are not willing to fix basic pay levels or even to supervise rates of increase in compensation in the private sector of market economies. In addition, checking the remuneration by non-executive and independent board members appears to have been entirely ineffective in this regard.[211]

On the other hand, the CGC gives no suggestions as to the maximum level of compensation for board members. In theory, it reassures the listed corporations before awarding the board members indemnification to submit a written record encompassing any such proposed compensation, which then needs to be voted on by shareholders during the corporation's general meeting. The CGC further requires that the corporation's articles of association

208 The Ministry of Commerce and Industry's Resolution, No. 1071, dated 5 May 1992.
209 See, Al-Riyadh Newspaper, December 20, 2010, Issue 15519.
210 See, *Aleqt* Newspaper, March 15, 2011, Issue 6364. Also, see Al-Riyadh Newspaper, March 15, 2011, Issue 15604.
211 Paul Davies, *The Board of Directors: Composition, Structure, Duties and Powers, Company Law Reform in OECD Countries: A Comparative Outlook of Current Trends*, Stockholm, Sweden, 2000, p. 10.

describe the way in which board members are rewarded compensation – this may take various forms, such as salaries, bonuses and attendance payments.[212]

Therefore, the Saudi model of distributing remuneration encounters some obstacles concerning the remuneration of directors and top executives. It is argued that a major difficulty that has been faced by international corporations is the tying of the remuneration of their directors and top executives to their actual presentation. Therefore, there is an international push to instigate 'say on pay' procedures in order to permit shareholders to remark on planned remunerations of directors and top executives.[213]

The CGC, in particular, advocates that the corporation board's annual report should include the board members' remunerations as part of its significant disclosure and transparency requirements. An investigation of 50 Saudi listed corporations' boards' annual reports reveals that the board members' remunerations are not clearly declared.[214] This investigation finding is not surprising because of the ambiguity of almost all, if not all, listed corporations regarding their board members' compensations.

In addition to demonstrating and recognising the practice of rewarding the board members, the Saudi Cable Company was chosen as an example in this regard. In 2009, this company distributed board members' remunerations of $2,809,000. Moreover, two executive members were given the largest proportion of this, being awarded $2,595,000 between them. Subsequently, the rest of money, totalling $214,000, was paid to four non-executive members.[215] Importantly, these significant figures do not take into account the executive members' salaries and the non-executive members' meeting attendance payments. It is therefore suggested that these payments are examples of corruption within a substantial number of listed corporations. It seems that the Saudi Cable Company mentioned above is not prominent amongst these, and is one of the worst performing in the exchange. Given the company's board members' remunerations, we can ask: how much was retained for the shareholders and the other beneficiaries of the corporation?

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212 Corporate Governance Code 2006, Art. 17

213 Roman Tomasic, 'Company Law Modernisation and Corporate Governance in the UK- Some Recent Issues and Debates', *DICTUM-Victoria Law School Journal*, 2011, 1, p. 56.

214 *Supra* note 179 at 6.

215 See the Annual Report of the Saudi Cable Company, available at: http://www.tadawul.com.sa/Resources/fsPdf/2110_2009_Y.pdf, [Accessed 1 November 2012].

It is worth observing that even though the Capital Market Authority Board does not interfere directly in the compensations of listed companies' board members, the Capital Market Authority Board sent an official reminder to the *Al Ahsa* Development Company about its breaching of Article 43 of the company's articles of association, as well as Article 74 of the CL.[216] This article stipulates that after distribution of a dividend of not less than 5% of the company's capital to shareholders, the company can distribute the board members' compensations. Any determination of the compensation made in violation of this restraint is null and void.[217] In brief, this company was making a loss, while at the same time distributing compensations to board members without distributing any profits to shareholders in accordance with its general meeting resolution No. 21, dated 4th May 2010.

It appears that the board members' compensations of almost, if not all, the listed corporations are considered arbitrarily, and should be less than their current massive proportions. For instance, 33 Saudi listed corporations in 2011 distributed compensation equal to $32,000,000 to their board members while making a loss.[218] Accordingly, why should an individual (i.e. a board member) be able to gain in one fiscal year a total amount of money that would not be obtained over the whole lifetime of a normal person? If these remunerations are actually deserved, then talking about the distribution of social justice and social profits is pointless. These indemnifications raise a critical question about the board members' loyalty.[219] In general, therefore, it seems that the Saudi board members' remunerations bear a resemblance to other global corporations' board members' compensations based on the huge amounts of money paid.[220] It is clear that these global compensations are, to some extent, justified, as they result from global corporations' productivity, whereas some Saudi listed corporations pay immense remunerations despite making a loss, as in the examples above.

7.10 Summary

216 See, Al-Riyadh Newspaper, March 8, 2012, Issue 15963.
217 Company Law 1965, Art. 74
218 See, Al-Riyadh Newspaper, March 20, 2012, Issue 15975.
219 On the other hand, it is argued that when the large traded corporations dismiss a board member, a large remuneration is paid especially if he is the only person being relieved of his position. This is because he would be accused of misconduct by other board members which these corporations would not have revealed. The huge remuneration is, therefore, given to this member (i.e. confidentiality comes at a price), and the public are always mystified when they discover that this person, for example, has been involved in the poor management of the corporation and then rewarded with a payment running into millions due to political necessity. See, *Supra* note 22 at 180.
220 See the link available at: http://www.bbc.co.uk/news/business-12663730, [Accessed 1 November 2012].

This chapter has examined the current board of directors' practices in Saudi corporate governance. It has highlighted a variety of significant aspects of boards of directors, as internal institutions of the corporate governance system. For example, this chapter contains details of the board members' duties, the boards' responsibilities and creation of standards, the separation of the board members' powers, board membership categories, board meetings, board sub-committees (such as audit committee and nomination and remuneration committee) and board members' compensations. All these aspects were referenced from the CGC, the CL and the case law connected to them. The chapter's methodology was analytical and adopted a comparative approach with the international corporate governance codes, such as the OECD principles of corporate governance, the UK Companies Act, the Cadbury report and the Greenbury report, in order to reform the board of directors' practices in the Saudi corporate governance framework.

Chapter Eight

Current Disclosure and Transparency Practices in Saudi Corporate Governance

8.1 Introduction

Disclosure and transparency of corporations' information and annual reports are stimulated by almost all corporate governance principles all over the world. This is due to the advantages gained by investors and all market contributors when there is disclosure and transparency of corporations' information and reports. As a matter of fact, disclosure and transparency are the urgent worldwide principles of corporate governance that it is claimed to be implemented, thus achieving a satisfactory corporate governance framework.[1]

This chapter has been proposed specifically to obtain a proper understanding of current disclosure and transparency practices in the Saudi corporate governance system. It undertakes to answer a vital research question about the implementation of disclosure and transparency in the Saudi context. The chapter is divided into a few sections, the first of which provides a general overview of disclosure and transparency. The second section examines the significance of disclosure and transparency in boards' annual reports. The third section analyses the disclosure and transparency prerequisites in these annual reports. Finally, a summary is given.

8.2 General View of Disclosure and Transparency

In current corporate governance literature, disclosure and transparency concerns play a vital role in the evolution of corporate governance. Disclosure and transparency are defined as a method by which information about the present settings, decisions and activities is made reachable, detectable and comprehensible.[2] Disclosure and transparency are salient features within international corporate governance frameworks. In this respect, they should be the major endeavour of any corporate governance framework.[3] In addition, the law of corporate

1 Tarek Abdel Aal, *Corporate Governance: Concepts, Principles, Experiences*, Arabic edition, University House, Alexandria, 2005, p. 87.
2 International Monetary Fund, Report of the Working Group on Transparency and Accountability, 1998, p. 7.
3 It is argued that whether or not the disclosure of financial information by a corporation ought to be measured as part of company law or part of the law of capital market. It however seems to be fitted to the both, for it

governance should focus on disclosure and transparency as well as berthing a perfect corporate governance framework.[4] The OECD principles of corporate governance state that:

> 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.[5]

The major goal of disclosure and transparency under any corporate governance system is to enable stakeholder groups, including the shareholders, to obtain appropriate information about their corporations' financial situations. Disclosure and transparency also aim to assist the relevant corporate decision makers and share investors to make fully informed decisions. In particular, the disclosure of financial information provides a variety of advantages; namely providing information about the corporation's presentation, preventing fraud and increasing the market's capability to monitor the actions of the management.[6] As Khan stated, the disclosure of financial information is fundamental to all shareholders, as the shareholders are not able to exercise their rights without truthful disclosure and transparency. Specifically, these shareholders need to exercise their right to decide whether to retain or purchase their shares at an up-to-date juncture, in possession of the correct information about the corporation's financial situation.[7]

Once again, the significant role of disclosure in corporate governance is that specified requirements assist in manifesting all the corporation's submissions. In other words, the disclosure is a vital soft-law that requires the corporation to inform the shareholders' and the market contributors of the board members and the top managers conducts. In this respect, the Winter Report showcases substantial assurance of the role of disclosure in corporate governance. It confirms that:

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delivers additional drawing of the in authenticity of the margins between company law and capital market law. See, Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law and Capital Markets Law*, Pearson Education Ltd, 3ed, 2009, p. 182.

4 Robert Monks, 'Redesigning Corporate Governance Structures and Systems for the Twenty-First Century', *Corporate Governance*, Blackwell Publishing, Oxford, 2001, 9, p. 143.

5 Organisation for Economic Co-Operation and Development, *OECD Principles of Corporate Governance,* 2004, p. 17.

6 *Supra* note 4 at 182.

7 Faith Kahn, 'Transparency and Accountability: Rethinking Corporate Fiduciary Law's Relevance to Corporate Disclosure', *Georgia Law Review*, 2000, 34, p. 512.

> 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.[8]

In reference to the Saudi case, the Capital Market Authority Board has taken disclosure and transparency into account. The Board has connected Article 9 of the CGC to disclosure and transparency, binding to all listed corporations.[9] Article 9 of the CGC requires 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.[10]

In addition, Articles 43, 44 and 45 of the Listing Rules, considers disclosure and transparency requirements.[11] Overall, the disclosure and transparency requirements found under the CGC and the Listing Rules come across from the current rules of the London Stock Exchange.[12] Similarly, the UK Corporate Governance Code has acknowledged that the disclosure and transparency requests are incorporated into three piece of legislation; namely the Financial Services Authority (FSA) Disclosure and Transparency Rules, the FSA Listing Rules and the UK Corporate Governance Code.[13] The reference of the UK Corporate Governance Code to these regulations resembles the Saudi CGC reference (Article 9 of the CGC) to the Saudi Listing Rules regarding the disclosure and transparency requirements, which are not stated under the CGC. In particular, the UK Corporate Governance Code has revealed a variety of disclosure and transparency requirements related to many institutions inside the corporation.

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8 Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, 2002, p. 4.

9 The Capital Market Authority Board issued resolution, No. 1-36-2008, dated 10 November 2008 making article 9 of the Corporate Governance Code compulsory on all the listed companies.

10 Corporate Governance Code 2006, Art. 9.

11 The Listing Rules was issued in pursuant to the Capital Market Authority Board resolution, No. 3-11-2004, dated 4 October 2004 and was amended by a resolution of the Capital Market Authority Board, No. 2-128-2006, dated 22 January 2006.

12 Riyadh Chamber of Commerce and Industry, Co*rporate Governance: The Definition, the Principles, and the Saudi Experience*, Arabic edition, 2007, p . 56.

13 The UK Corporate Governance Code, Financial Reporting Council, pp. 27-32.

These requirements can be found under the Saudi CGC and the Listing Rules, but with a little bit of variation in accordance with the advancement of each country's capital market.[14]

The CGC also suggests that the corporation's articles of association should state the board's supervisory rules regarding the corporation's disclosure and transparency policy. For example, the board is responsible for ensuring the corporation's implementation of any policies concerning divulging obvious information to all stakeholder groups.[15] The evidence that the board members and top executives are first responsible for humanising and monitoring the corporation's policies, including disclosure and transparency, supports this.[16]

8.3 Significance of Disclosure and Transparency in the Board Annual Report

The Saudi stock exchange catastrophe in 2006 emanated from annual report scandals. The absence of disclosure and transparency was obvious, and the low number of requirements contained in the board annual report was also criticised. This was because the listed corporations ignored most, if not all, of the disclosure and transparency requirements in the board annual report, with the exception of the corporation's auditor report, the balance sheet and the profit and loss account.[17] The Saudi calamity, therefore, resembled the international financial markets' devastation, where corporations' annual reports did not display reasonable information and predicted risks.[18]

Based on the above, the CGC stipulates that corporations' general information and board annual reports should be up-to-date and readily available. In particular, the shareholders should be able to peruse the corporations' general information and the boards' annual reports without any segregation in terms of major or minor shareholders.[19] It is said that the Saudi

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14 The UK Corporate Governance Code, Financial Reporting Council, pp. 27-32.

15 Corporate Governance Code 2006, Art. 4 (A), 8 and 10 (F).

16 Joseph Carcello, 'Government and the Common Good', *Journal of Business Ethics*, 2009, 89, p. 11.

17 Ibrahim Al Muneef, *Corporate Governance Functions and Duties and Responsibilities of the Board of Directors,* Arabic edition, Dar Al Mouder, Riyadh, 2006, p. 96.

18 Susan Bartlett and Roy Chandler, 'The Private Shareholder, Corporate Governance and the Role of the Annual Report', *Journal of Business Law*, 1999, p. 415.

19 Corporate Governance Code 2006, Art. 4 (B). As a matter of fact, the Company Law can be taken as the reference in terms of enabling the shareholders to have more ability for obtaining the corporation's board annual financial report and other information. Article 89 of the Company Law affirms that the board of directors should at least thirty days prior to the date set for holding of the annual general meeting, prepare for every financial year of the company a balance sheet, a profit and loss account, and a report on the company's operations and financial position and on the method which it proposes for the distribution of net profits. The said documents should be signed by the chairman of the board of directors, and copies thereof should be placed at the disposal

boards' annual reports gain even more importance because they are the single approved information source from which to ascertain corporations' performance. According to a Saudi survey, respondents experienced difficulties in understanding board annual reports.[20] It is therefore apparent that board annual reports should be understandable and logical, as most shareholders are not familiar with financial and legal terminology; this should consequently be explained plainly.[21]

In order to facilitate understanding by all stakeholder groups of corporations' general information and board annual reports, listed corporations should use current communication services, such as websites and emails.[22] In practice, Saudi listed corporations have reached a satisfactory point in terms of using current communication services owing to the CGC stimulating these communication services. For this reason, the majority of the listed corporations display their boards' annual reports on their websites.

Disclosure and transparency in board annual reports is the board members' responsibility;[23] auditors of good standing and internal control are specifically noticeable in this regard, as experienced auditors can support successful disclosure and transparency and then produce a highly-quality board annual report. The successful worldwide corporate governance frameworks consider this ideology. For example, the OECD principles of corporate governance state 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.[24]

In this regard, Bashik estimated that experienced auditors play a major role in terms of applying CGC provisions regarding disclosure and transparency, as well as producing

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of the shareholders the head quarter of the company at least twenty-five days prior to the date set for such general meeting.

20 Mamdouh Ba-Owaidan, *The Contribution of Accounting Information to Investor Decisions in the Saudi Stock Market*, Unpublished PhD Thesis, University of Hull, 1994, p. 124.

21 *Supra* note 18 at 416.

22 Corporate Governance Code 2006, Art. 4 (B).

23 Sweeney Baird, 'The Role of the Non-Executive Director in Modern Corporate Governance', *Company Lawyer*, 2006, 27 (3), p. 69.

24 *Supra* note 5 at 54

positive board annual reports.[25] In addition, Al Mosa and Al Abbas stipulated that the board annual reports of the prevalent Saudi listed corporations, SABIC and STC, must be made available to the public before those of smaller listed corporations, due to their experienced auditors and efficient internal control.[26] Al Saeed further demonstrated that the largest Saudi listed corporations tend to disclose more supplementary information than the smaller ones.[27] All these points were supported by Morris, who went on to say that the highest-quality global corporations produce specific board annual reports covering their operations, predicted risks and forecasting profits, while the lower-quality corporations do not.[28]

8.4 Disclosure and Transparency Prerequisites in the Board Annual Report

In this section, the disclosure and transparency required in the board annual report and the law cases brought by the CRSD and the Capital Market Authority Board covering these facets will both be analysed in detail. The significance of the law cases regarding these disclosure and transparency themes is in seeing how the Capital Market Authority Board dealt with a number of listed companies that were in breach, in terms of passing a reasonable judgement and imposing an appropriate punishment.

The basic Saudi disclosure and transparency requirements can be found under other worldwide corporate governance provisions related to the disclosure and transparency of corporation information and board annual reports. For instance, the UK Corporate Governance Code has paid considerable attention to the disclosure and transparency of corporation information and board annual reports, providing a variety of guidelines regarding these and stipulating that they should be empowered by issuers with either premium or standard listings.[29] In particular, the disclosure and transparency requirements in the board

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25 Abdul Latif Bashik, ‘A List of Corporate Governance and the Relationship with the Quality of Accounting Information and the Saudi Stock Market’, Arabic edition, *Corporate Governance Conference*, King Khalid University, 2009, p. 5.
26 Saad Al Mosa and Mohammad Al Abbas, ‘Audit Delay: Evidence from Listed Joint Stock Companies in Saudi Arabia’, *King Khalid University Journal*, 2005, p. 7.
27 Khalid Al Saeed, ‘The Association between Firm-Specific Characteristics and Disclosure: The Case of Saudi Arabia’, *Managerial Auditing Journal*, 2006, 21 (5), p. 491.
28 Richard Morris, ‘Signalling, Agency Theory and Accounting Policy Choice’, *Accounting and Business Research*, 1987, 18 (69), p. 54.
29 The UK Corporate Governance Code, Financial Reporting Council, p. 27.

annual reports that have not yet been breached by listed corporations can be stated as follows:[30]

1) An explanation of the principal activities of the board.
2) A description of the board's major plans and decisions (including any corporate restructuring, business expansion or discontinuance of operations), the board's future prospects and any risks that would be met.
3) An enlightenment regarding any material differences between the operating results of the last year or any announced forecast made by the board.
4) A clarification regarding any removal from the accounting standards concerned by the Saudi Organisation for Certified Public Accountants.
5) The name of every subsidiary, its main business, its most important country of operation and its country of assimilation.
6) A justification of any adaptation rights under any convertible debt instruments, options, warrants or similar rights issued or granted by the board.
7) The number of board meetings held during the last financial year and the attendance record of each meeting with the names of the participating board members.
8) An account of any engagements under which the board member or the senior executive and the shareholder of the listed company has waived any rights to dividend or compensation.
9) The results of the annual audit of the value of the internal control measures of the corporation.

The number of law cases that was judged either by the CRSD or the Capital Market Authority Board regarding disclosure and transparency is a little bit high. This is because of the ignorance of some listed corporations regarding the application of disclosure and transparency requirements. In particular, it is obvious that the law cases were made entirely subject to Article 9 of the CGC and Articles 43, 44 and 45 of the Listing Rules.[31]

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30 Listing Rules 2004, Art. 43, 44 and 45. Also, Corporate Governance Code 2006, Art. 9. Also, the Capital Market Authority Board issued resolution, No. 1-36-2008, dated 10 November 2008 making article 9 of the Corporate Governance Code compulsory on all the listed companies.

31 Significantly, sanctions and fines are reviewed first of all by the General Department of Corporate Governance. The researcher visited the general department of corporate governance, and the researcher saw its strategy for referencing the Capital Market Authority Board to discipline the listed companies in breach. In actual fact, the punishing process is that the general department of corporate governance analyses the listed companies' articles of associations, their website announcements and their boards' annual reports. Then, when it finds such violations of the Corporate Governance Code and the interconnected articles from the Implementing

It can be seen that the CRSD and the Capital Market Authority Board dispensed all these verdicts, matching Article 59-B of the CML, which indicates that:

> 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.[32]

In general, therefore, it seems that the violated companies failed to put into practice in their boards' annual reports some of the essential disclosure and transparency requirements enacted by both the CGC and the Listing Rules. It is suggested that the ignorance regarding these disclosure and transparency facets is not surprising, as this is often the case with some listed corporations from time to time. Accordingly, it should be noted that the Capital Market Authority Board should be stricter in terms of imposing greater fines, which meet the maximum level (not exceeding $26,666), against the corporation in breach of disclosure and transparency features for a second time, as some listed corporations repeatedly fail to meet disclosure and transparency requirements. The law case should then be mediated by the CRSD instead of the Capital Market Authority Board, in order to tackle any second instance of irresponsible conduct by the listed corporations in violation. In doing so, the listed corporations would carefully consider the disclosure and transparency requirements before issuing their boards' annual reports.

The following are the main disclosure and transparency principles that have been abused by the listed corporations. In addition, some law cases, analyses and examples are debated in

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Regulations, especially the Listing Rules, it sends the issued decision to the Capital Market Authority Board with its suggestions and recommendations along with the articles on which it has based its decisions, and its recommendations as per fines.

32 Capital Market Law 2003, Art. 59 (B).

order to facilitate understanding of how disclosure and transparency requirements are seen to be features that can successfully improve Saudi corporate governance practices if applied correctly and truthfully. In other words, the disclosure and transparency requirements are adequate for the purpose of the Saudi capital market and share-investors when fulfilled by the corporations' top management and board of directors in their information and annual financial reports.

The first main principle is Article 9-F of the CGC:

> 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 [should be enclosed in the board annual financial report].[33]

This legal case was against the Saudi International Petrochemical Company, which failed to reveal in its 2009 annual financial report the sentence imposed upon it by the Capital Market Authority Board, dated 19th January 2009. Therefore, the Capital Market Authority Board imposed a fine of $13,333.[34] The second legal case was against *Al Ahsa* Development Company, which did not display in its 2010 annual financial report and failed to notify the Capital Market Authority about a lawsuit against the company for the amount of $6,533,333. Thus, the Capital Market Authority Board imposed a fine of $26,666.[35]

It is thought that the previous fines for both these legal cases were lawful. They depended on a mandatory provision under Article 9-F of the CGC. In reality, these punishments demonstrate the Capital Market Authority Board's efforts to control the listed companies in terms of putting the CGC into action. All the listed companies are required to include in their annual financial reports any sentences, fines and preventive restrictions imposed either by the Capital Market Authority Board and the CRSD or by other Saudi supervisory, regulatory and judicial organisations.[36]

The second main principle is Article 9-B of the CGC:

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33 Corporate Governance Code 2006, Art. 9 (F).
34 Issued Decision, dated 15 August 2010 by the Capital Market Authority Board.
35 Issued Decision, dated 24 October 2010 by the Capital Market Authority Board.
36 See, Al-Riyadh Newspaper, October 25, 2010, Issue 15463.

> Names of any joint stock company in which the company board of directors' member acts as a member of its board of directors [should be included in the board annual financial report].[37]

This legal case was against *Al Baha* Investment and Development Company, which failed to include in its 2010 board annual financial report the names of other listed companies that had a member of their boards on its own board. As a result, the Capital Market Authority Board imposed a fine of $13,333.[38] The sentence and the fine were accurately completed by the Capital Market Authority Board, as they were pursuant to the mandatory clause of the CGC outlined above. It is however argued that the Capital Market Authority Board should enclose a personal warning or impose a fine on the board member who was a member of two boards, as he or she should have declared his or her membership, either publically or in the board annual financial report. The application of this approach would tackle any malpractices and any suspicion of conflict of interest.[39]

The third main principle is Article 44-C of the Listing Rules:

> 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.[40]

This legal case was against Southern Province Cement Company, which published its profits for the second quarter of 2008 on the Internet by posting the board chairman's speech given during the company general meeting. The Capital Market Authority Board imposed a fine of $13,333, as the company's board neither officially declared the profits on its website or in the official press, nor informed the Capital Market Authority and the stock exchange before the unofficial announcement of its profits.[41] The decision issued also followed Article 9-J of the CGC, which stipulates that:

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37 Corporate Governance Code 2006, Art. 9 (B).
38 Issued Decision, No. 5-32-2011, dated 23 October 2011 by the Capital Market Authority Board.
39 See, Al-Riyadh Newspaper, October 24, 2011, Issue 15827.
40 Listing Rules 2004, Art. 44 (C).
41 Issued Decision, dated 1 December 2010 by the Capital Market Authority Board.

> The stock exchange shall be immediately informed of the results of the corporation general meeting.[42]

This legal case and the imposed fine are without doubt legitimate, because the Capital Market Authority and the stock exchange are the main bodies regulating the listed companies' conduct. Consequently, publishing the board's annual financial report, predicted profits or other significant company information before the appointed time and before informing these official bodies should be punishable in order to ensure the fairness and equity of the market.[43]

The fourth main principle is Article 45-9 of the Listing Rules:

> A description of the listed company dividends policy [should be covered in the board annual financial report].[44]

This legal case was against *Alahli* Takaful Company, which did not explain the company dividend rule in its 2009 annual financial report. Thus, the Capital Market Authority Board imposed a fine of $13,333, in line with Article 45-9 of the Listing Rules, detailed above.[45] In addition to ensuring justice and equality for all stakeholder groups, including the shareholders, the corporation's dividend policy should be clearly written in the board's annual financial report. However, this legal case and its fine were compliant with the Capital Market Authority Board's policy on companies that are in breach. It is also recommended that a larger financial penalty should be imposed on the breaching company. For instance, the fine should be double – $26,666 instead of $13,333 – given the importance of showing the dividend policy in the board's annual financial report. It is said that the dividend comprises shareholders' financial right. However, the CGC and the Listing Rules do not mention how dividends should be distributed and planned. The CGC has left the dividend policy and distribution to the company's articles of association and to its ordinary general meeting. It is consequently suggested that the CGC would do better to regulate the dividend policy and distribution, as will be highlighted in Chapter Nine.[46]

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42 Corporate Governance Code 2006, Art. 9 (J).
43 For more information, see the link, available at: http://www.argaam.com/article/articledetail/87076, [Accessed 1 November 2012].
44 Listing Rules 2004, Art. 45 (9).
45 Issued Decision, dated 16 August 2010 by the Capital Market Authority Board.
46 Said Yahya, *The Summary of the Saudi Arabian Commercial System*, Arabic edition, The Bureau of Modern Arab, Alexandria, 2004, p. 255.

The fifth main principle is Article 45-21 of the Listing Rules:

> 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 [should be enveloped in the board annual financial report].[47]

This legal case was against Saudi Fishers Company, which failed to give explanations about the *zakat* and income tax it had paid in its 2009 annual financial report. Accordingly, the Capital Market Authority Board inflicted a fine of $13,333, in accordance with Article 45-21 of the Listing Rules, reproduced above.[48] The Islamic *zakat* obligation is one of the significant pillars of the Islamic religion. The *zakat* and income tax are additionally noteworthy in terms of supporting the society in which the corporation is operating. As a result, a fine concerning this legal case was imposed, but it should have been more demanding – $26,666 rather than $13,333. That is to say, the *zakat* obligation can be seen as an aid to achieving social harmony as well as a means of assuring the shareholders that the corporation keeps its obligatory commitments related to other groups, including society.

The sixth main principle is Article 45-11 of the Listing Rules:

> 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 [should be included in the board annual financial report].[49]

This legal case concerned the Saudi Telecom Company (STC), which did not include in its 2009 annual financial report the interests, preferences and donation rights of the company's board members and top executives. Consequently, the Capital Market Authority Board imposed a fine of $26,666, consistent with Article 45-11 of the Listing Rules, detailed above.[50] It is thought that the sentence and the fine were statutory. However, it appears that there was a suspicion of conflict of interest within the STC board. For this reason, the STC

47 Listing Rules 2004, Art. 45 (21).
48 Issued Decision, dated 23 August 2010 by the Capital Market Authority Board.
49 Listing Rules 2004, Art. 45 (11).
50 Issued Decision, dated 27 June 2010 by the Capital Market Authority Board.

board attempted to hide this element in its board's annual financial report. It is questionable whether the STC is one of the most prominent listed companies, and this infringement was undoubtedly deliberate. As a result, it would be supposed that the Capital Market Authority Board had the right to bring legal action against the STC, to be arbitrated by the CRSD. However, if the STC encountered a conflict of interest within the board or insider trading perpetrated by the company's board members then the STC would not mind paying the fine rather than repaying a large sum of money or suing its board members. It is thought that if the (Capital Market Authority) general department of corporate governance studied this case thoroughly, it would recommend that the Capital Market Authority Board filed this infringement against the STC in suspicion of either conflict of interest or insider trading before the CRSD.[51]

The seventh main principle is Article 45-3 of the Listing Rules:

> 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 [should be integrated in the board annual financial report].[52]

This legal case was against the *Arabia* Co-Operative Insurance Company, which did not append, in its 2010 board annual financial report, any figures to illustrate the company's assets and liabilities, as well as the business results for the last five financial years. Consequently, the Capital Market Authority Board imposed a fine of $13,333, in accordance with Article 45-3 of the Listing Rules, outlined above.[53] It is worth observing that it is essential to present figures that make boards' annual financial reports easy to follow and understand. It is also estimated that figures displaying the corporation performance for the last five years should be rather substantial. As a consequence, it is understood that the sentence by the Capital Market Authority Board was adequately satisfactory and acceptable

51 For more information, see the link, available at: http://www.argaam.com/article/articledetail/165829/, [Accessed 1 November 2012].
52 Listing Rules 2004, Art. 45 (3).
53 Issued Decision, No. 6-28-2011, dated 18 September 2011 by the Capital Market Authority Board.

to enact disclosure and transparency, as well as to allow investors to compare and contrast the yearly results in terms of corporation productivity.[54]

The Eighth main principle is Article 43-A of the Listing Rules:

> 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.[55]

In particular, Article 43-B-7 of the Listing Rules suggests that:

> The increase or decrease in the net assets of the company equal to or greater than 10% [should be contained in the board annual financial report].[56]

This legal case was against *Al Masafi Saudi Arabian* Company, which delayed informing the Capital Market Authority and the stock exchange about its board recommendation (the delay was caused by the company awaiting general meeting authorisation on13th July 2008, to increase capital). The company declaring this point later, on 27th July 2008 caused the violation. For this reason, the Capital Market Authority Board imposed a fine of $26,666, in line with Article 43-A of the Listing Rules, which is given above.[57] This legal case and the fine are legitimate, as the company increased its capital and should have notified either the Capital Market Authority or the stock exchange immediately about this increase. The fine, nevertheless, should have been less than $26,666 because the delay in announcing the increase in the company capital was possibly unintended, as it was fulfilled later, on 27th July 2008, by the company.[58]

The ninth main principle is Article 43-B-2 of the Listing Rules:

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54 For more information, see the link, available at: http://www.argaam.com/article/articledetail/229910/, [Accessed 1 November 2012].
55 Listing Rules 2004, Art. 43 (A).
56 Listing Rules 2004, Art. 43 (B-7).
57 Issued Decision, dated1 December 2008 by the Capital Market Authority Board.
58 See, *Aleqt* Newspaper, December 1, 2008, Issue 5530.

> 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 [should be included in the board annual financial report].[59]

This legal case was against Saudi Cement Company, which failed to announce the debt that was taken by the company from the *SAMBA* Financial Group in its 2011 board annual financial report. Specifically, the debt was approximately $120,000,000, dated 26th March 2011. Consequently, the Capital Market Authority Board imposed a fine of $13,333, in accordance with Article 43-B-2 of the Listing Rules, above.[60] It could be presumed that the fine should have been larger, as the breaching company transferred the debt without updating the Capital Market Authority and the public. This simply means that the company in breach intended to hide some financial information in its board's annual financial report. It was subsequently suggested that the Capital Market Authority Board should inflict another sort of punishment that was stricter than the previous one. For example, the Capital Market Authority Board could postpone the trade in shares of the breaching company for a period of time in order to consider the exchange and inform the shareholders of the malpractices of the listed company in breach.[61]

8.5 Summary

This chapter investigated the current disclosure and transparency practices in the Saudi corporate governance system. The purpose of this chapter was to examine whether or not the disclosure and transparency requirements are satisfied, adequate and respected by the Saudi listed corporations. Additionally, the significance of disclosure and transparency in boards' annual reports was debated. The disclosure and transparency prerequisites were also measured, and some of the main facets that have been sustained until now by the listed corporations were explored. In particular, a variety of the main disclosure and transparency ideologies that have been violated by some of the listed corporations were provided. The Capital Market Authority Board has consequently imposed fines on these violating listed

59 Listing Rules 2004, Art. 43 (B-2).
60 Issued Decision, No. 4-23-2011, dated 3 July 2008 by the Capital Market Authority Board.
61 For more information, see the link, available at: http://www.argaam.com/article/articledetail/219441/, [Accessed 1 November 2012].

corporations. The Capital Market Authority Board has also taken the defamation approach as a punishment for these listed corporations.[62]

62 See, Al-Riyadh Newspaper, February 26, 2010, Issue 15222.

Chapter Nine

Current Shareholders' Rights Practices in Saudi Corporate Governance

9.1 Introduction

The past twenty years have witnessed increasingly rapid advances in the field of corporate governance. In addition, shareholders' rights as an essential aspect of corporate governance principles as well as the position of shareholders as a crucial internal corporate governance institution have been promoted. A significant section of shareholders has been recognised as being minority shareholders, and it is vital to examine how these can be treated and protected, both from the majority shareholders' and the managers' malpractices.[1] In the Saudi case, it can be seen that shareholders' rights in general and minority shareholders' rights in particular have been mostly incorporated, albeit with several shortcomings. A recent report by the World Bank rated Saudi Arabia seventeenth out of 183 countries across the world in terms of protecting investors, especially minority shareholders.[2]

The Capital Market Authority Board's arrangements for the treatment of shareholders reveal that Article 3 of the CGC broadly indicates shareholders' rights. These rights can be classified as financial rights and administrative rights. The CGC, however, indicates that shareholders should be entitled to all rights attached to the share in the following order:[3]

1. Right to a share of the distributable profits (dividends).
2. Right to a share of the corporation's assets upon liquidation.
3. Right of disposition with respect to shares.
4. Right to attend the general meeting and contribute in discussions and vote on applicable resolutions.
5. Right to oversee the board of directors' activities.
6. Right to file responsibility claims (action in liability) against board members.

1 See Chapter Three, p. 45.
2 See, Al-Riyadh Newspaper, February 14, 2012, Issue 15940.
3 Corporate Governance Code 2006, Art. 3.

7. Right to request and have access to information without prejudice to the corporation's benefits and in a way that does not reverse the CML and the Implementing Regulations.
8. Right to appoint and remove board members.

Comparably, the UK Companies Act argues in favour of shareholders' rights, likewise the Saudi regulator does with some variation. In particular, the Saudi regulator insists on the aforementioned shareholders' rights under Article 3 of the CGC, while the UK Companies Act mentions the shareholders' rights in scattered places in reference to law. Therefore, the upcoming sections will compare and contrast the Saudi regulations and the UK Companies Act and the OECD Principles of Corporate Governance in terms of shareholders' rights. A range of Saudi law articles, issued decisions and related international experiences will be used in this chapter in order to investigate how best to reach a satisfactory level of corporate governance in Saudi Arabia. It will attempt to evaluate current shareholders' rights practices within the Saudi corporate governance framework and suggest ways towards reform where these are possible and required. This chapter has been divided as follows: the first part will appraise shareholders' financial rights and the second part will examine shareholders' administrative rights. The summary concludes the chapter.

9.2 Shareholders' Financial Rights

Shareholders' financial rights include the right to gain dividends, the right to a share of the corporation's assets upon liquidation and the right of disposition with respect to shares. First, and perhaps most significantly, it is widely recognised that the shareholders' right to gain dividends is a substantial financial right that must be honoured by listed corporations. The term dividend, however, means a part of the company's profits that is usually given to the shareholders in relation to the number of shares they hold, and it tends to be awarded either in monetary form or in bonus shares.[4]

From the Saudi regulatory perspective, when a listed corporation makes a decision to hand out part of its profits, it is obliged to pay every individual shareholder their share in the dividend. In this context, the corporation's board draws a clear rule with regard to dividends

4 Mustafa Kamal, *The Joint Stock Company*, Arabic edition, Undergraduate House, Alexandria, 2001, p. 60.

on behalf of the shareholders and in the corporation's favour. In particular, shareholders should be informed about dividend rules through the corporation's general meeting and these rules should be written clearly into the board's annual financial report.[5] It is highly advisable that dividend rules form an essential part of disclosure and transparency concerns. Article 45-9 of the Listing Rules advocates that the board of directors' annual report should include a description of the listed company's dividend policy.[6]

The CL has proposed typical methods for the distribution of the corporation's net profits as follows: firstly, at least five per cent of the net profit should be distributed as dividends to shareholders unless the company's articles of association provide a higher percentage. Secondly, those shareholders who have foundation shares, should be salaried a percentage of the net profits of no more than ten per cent. Thirdly, ten per cent of the net profits should be awarded to the board of directors as remuneration and compensation.[7] The rest of the net profits should be saved as the corporation's operative and standby costs.[8] Regrettably, the CGC does not explain how the corporation's dividends can be separated from the net profits. This has been illustrated by the CL as stated above, and therefore this method should be regulated under the CGC by the Capital Market Authority Board since it relates to indigenous shareholders' financial rights. Specifically, the CGC encourages that:

> The general meeting shall approve the dividends and the date of distribution. These dividends, whether they be in cash or bonus shares shall be given, as of right, to the shareholders who are listed in the records kept at the Securities Depository Centre[9] as they appear at the end of trading session on the day on which the general meeting is convened.[10]

Even though the CGC article gives the corporation's general meeting the right to decide on a circulation date for dividends, it may be deemed incomplete as it does not stipulate a

5 Corporate Governance Code 2006, Art. 7 (A). Company Law 1965, Art. 107.
6 Listing Rules 2004, Art. 45 (9).
7 The percentage of rewarding the board members is recently being reviewed by the Committee on Economic Affairs and Energy which is one of the Consultative Council Committees that has a legislative authority in Saudi Arabia to be exactly not more than $133.333. See, Al-Riyadh Newspaper, March 15, 2011, Issue 15604.
8 Said Yahya, *The Summary of the Saudi Arabian Commercial System*, Arabic edition, the Bureau of Modern Arab, Alexandria, 2004, p. 264. See also Company Law 1965, Art. 74.
9 The Centre is an important premise under the supervision of the Saudi stock exchange as well as having the responsibility to practice the operations of deposit, transfer, settlement, clearing and registering ownership of securities traded on the stock exchange. See Capital Market Law 2003, Art. 26.
10 Corporate Governance Code 2006, Art. 7 (B).

timeframe. It is thus recommended that the CGC determine the circulation date in order to avoid malpractice by listed corporations.[11] For example, as the body responsible for amending the CGC, the Capital Market Authority Board is in a position to change the date of dividends distribution to every three or six months from the beginning or end of the corporation's fiscal year.

A significant number of listed corporations have in fact transformed their dividend circulation dates from yearly to half-yearly or even quarterly. For instance, *Etihad Etisalat* and *SAMBA* Financial Group have changed their dates to a quarterly rather than a yearly basis.[12] This scheme, which constitutes an alteration of the dividends circulation date, can be seen as part of the substance of original listed corporations'. It is widely preferred by a large number of shareholders[13] and has been approved by them.[14] It would be advisable, as well as good practice, for this scheme to be enacted clearly under the CGC.

It could be argued that fines imposed on negligent corporations by the CRSD or the Capital Market Authority Board, are often paid by slashing the shareholders' dividends and this is usually carried out at the behest of the compromised corporation's board members and top executives.[15] It is thus apparent that the system affords no means of protecting either major or minor shareholders' dividends[16] and could be argued that in such cases of malpractice, fines to the Capital Market Authority should be settled by board members and top executives since they, rather than their shareholders, must be accountable for their corporations' misconduct. Furthermore, it is critical that shareholders' dividends should not be decreased in the course of this process while the remunerations of board members and top executives remain at the same high level. Accordingly, the Capital Market Authority Board should ensure that the fines imposed on abusive corporations be paid from the corporations' accounts instead of decreasing the shareholders' dividends, and in particular those held by minority shareholders.

11 *Supra* note 8 at 70.
12 See the Official Website of the Etihad Etisalat Company, available at: http://www.mobily.com.sa/wps/portal, [Accessed 1 November 2012]. Also, See the official website of the Samba Financial Group, available at: http://www.samba.com/ENGLISH/INDEX_01_01_en.html, [Accessed 1 November 2012].
13 Asam Al Ghamdi, *Commercial Law: Business, Dealer, Commercial Companies,* Shaqri Library, Riyadh, Arabic edition, 2007, p. 145.
14 Company Law 1965, Art. 84.
15 See, *Okaz* Newspaper, April 16, 2011, Issue 3590.
16 See, Al-Riyadh Newspaper, May 24, 2008, Issue 14579.

The second significant financial shareholders' right is the right to dispose of shares according to Article 48 of the CL, dividing the corporation's capital contribution into shares of equal value and that trading partners shall be liable only to the extent of the value of their shares. The CL also affirms that each shareholder has the right to waive all or some of their shares for the benefit of others.[17]

The third shareholders' financial right is the right to a share in the corporation's assets upon liquidation. This right is mentioned concisely in both the CGC and the CL. In brief, this right means that if the corporation has entered into liquidation and all its credits are settled, any outstanding assets should be allotted among the corporation's members.[18] Likewise, Article 207 of the CL states that the proposed process for exercising this right is that liquidators have to pay the corporation's debts first of all, before paying back to the partners the value of their shares in the capital and distributing their surplus thereafter in accordance with the provisions of the company's contract and articles of association.[19]

It is concluded here that the lack of transparency surrounding shareholders' financial rights as enshrined in the CGC, requires urgent examination by the Capital Market Authority Board. The shareholders' right to obtain dividends has not been satisfactorily explained by the CGC since it fails to clarify the dividends policy, the exact dividends circulation date and the work plans for dividend distribution. In addition, the right to a share in the corporation's assets upon liquidation and the right to dispose of shares are confusing and lack both clarity and supporting legal articles. Leaving these areas unexamined would be to invite misuse by the corporation's board members and top executives and perhaps major shareholders, especially in relation to the financial rights of minority shareholders'.

9.3 Shareholders' Administrative Rights

Having discussed the shareholders' financial rights as instituted by the CGC and the CL, this section will consider shareholders' administrative rights. Before doing so, it is worth acknowledging that the forum where all shareholders can claim and exercise their rights is undoubtedly the corporation's general meeting. As it has been stated,

17 Company Law 1965, Art. 48.
18 Victor Joffe et all., *Minority Shareholders: Law, Practice and Procedure*, Oxford University Press, New York, 2008, pp. 4-5.
19 Company Law 1965, Art. 207.

> There is no doubt that the shareholders are supposed to be the supreme organ in the company as they are supposed to raise the necessary capital of the company, they are involved in the initiation, formation and direction of policy and they have a duty or role to protect their investment in the company and in such a situation, no doubt that shareholders constitute the governing force in the company and the law is emphatic on this where it says that the general meeting is the company, directors are subordinates.[20]

9.3.1 Corporations' General Meetings

At the time the Capital Market Authority was founded, corporations' general meetings are thought to have been poorly equipped to meet their range of responsibilities. Furthermore, the rights of shareholders, especially minority shareholders, relating to general meetings, were absent since the power to enact policies and manage the corporation's stance used to be held equally by the board members and the executive management, together with the major shareholders, depending on the value and number of shares they held.[21]

The Saudi regulator, accordingly, has paid considerable attention to shareholders' rights to attend and exercise their rights in general meetings. The Saudi regulator further defines the general meeting to be the place where all shareholders should exercise and even better claim their statutory rights fairly and freely. The Saudi regulator also establishes three general meeting types, explicitly the foundation general meeting, the ordinary general meeting and the extraordinary general meeting[22], and each has defined purposes relating to its duties. It is assumed that the UK Companies Act does not mention the foundation general meeting type in the way the Saudi regulator does, indicating that the UK Companies Act contains only the recognised ordinary and extraordinary general meetings' provisions.

Firstly, Article 61 of the CL identifies the foundation general meeting as the first meeting following the establishment of the corporation. All shareholders, regardless of their shareholdings, may attend the foundation general meeting. The foundation general meeting

20 Angualia Daniel, *Balance of Power between Shareholders and the Board in Corporate Governance*, p. 12.
21 Mohammad Al Jeber, *The Saudi Commercial Law*, Arabic edition, King Fahd National Library, Riyadh, 2007, p. 202.
22 Ibid, p. 205.

has several remits. Its role is to ensure that the corporation’s entire capital has been subscribed by all the shareholders, to put in force the final version of the company’s articles of association, to appoint the board members and the external auditors for no more than five years, and to account for the money that has been used in setting up the company.[23]

Secondly, the objectives of the ordinary general meeting are to manage the general company’s activities including appointing and re-appointing board members for no more than three years, to approve the company’s proposed net profits and dividends and the date of their circulation, and to agree on the board’s annual report. Furthermore, the ordinary general meeting has the power to permit either an increase or a decrease in the company’s capital.[24]

Finally, the extraordinary general meeting concerns itself with the same matters as the ordinary general meeting. However, it can be held urgently when the corporation has lost half of its capital and faces potential liquidation and bankruptcy. It can also alter the corporation’s articles of association, with the exception of changes that would negatively impact on the shareholders’ financial and administrative rights. In addition, there are a number of avoidable alterations such as modifying the company’s main purpose, transferring the corporation’s headquarters to a foreign country and changing the corporation’s nationality.[25]

Unless attended by the relevant parties, the corporation general meeting cannot be deemed a statutory meeting. This includes the shareholders, the general meeting chairman, the general meeting secretary, the board members, the external auditors and the supervisory body representatives such as the (Capital Market Authority) general department of corporate governance and the Ministry of Commerce and Industry officials.[26] However, for the general meeting to be accepted as a statutory meeting it is necessary for shareholders who hold half of the corporation’s capital to join the general meeting.[27]

Despite these regulations, however, Article 3 of the CGC provides the shareholders’ right to attend general meetings, participate in debates and vote on appropriate pronouncements.[28] The article does not clarify the differences between the foundation, ordinary and

23 Company Law 1965, Art. 60.
24 Company Law 1965, Art. 84.
25 Company Law 1965, Art. 85.
26 Company Law 1965, Art. 83.
27 Company Law 1965, Art. 61.
28 Corporate Governance Code 2006, Art. 3.

extraordinary general meeting, nor does it detail their areas of jurisdiction. Clearly, these, fall under CL. This would showcase the integration between the CGC and CL. This integration between both pieces of legislation might impact positively on the implementation of corporate governance practices. Nonetheless, it may be advisable for the Capital Market Authority Board to take a step towards codifying the different kinds of general meetings and their legal jurisdictions under the renowned CGC.

9.3.2 Shareholders' Rights Related to General Meetings

Shareholders' rights in relation to general meetings are discussed in several Saudi pieces of legislation including the CL, the Listing Rules and the CGC. This indicates that although these rights are voluntary articles under the CGC, they are legally semi-enforceable articles under the CL and the Listing Rules.

First, the corporation general meeting is organised at least once a year within three months of the end of the corporation's fiscal year.[29] The corporation board is expected to prepare adequate information to allow all shareholders to take a decision.[30] In this regard, the UK Companies Act affirms that:

> Every public company must hold a general meeting as its annual general meeting in each period of 6 months beginning with the day following its accounting reference date (in addition to any other meetings held during that period).[31]

Second, the corporation general meeting is set up on the request of the board. However, its establishment can also be required by either the external auditor or a sufficient number of shareholders, whose total shareholdings account for five per cent of the equity share capital.[32] The UK Companies Act declares that:

> The directors are required to call a general meeting once the company has received requests to do so from members representing at least the required

29 Corporate Governance Code 2006, Art. 5 (A), also this article corresponds to Company Law 1965, Art. 84.
30 Corporate Governance Code 2006, Art. 5 (H).
31 UK Companies Act 2006, s. 336 (1).
32 Corporate Governance Code 2006, Art. 5 (B), also this article corresponds to Company Law 1965, Art. 87.

> percentage of such of the paid-up capital of the company as carries the right of voting at general meetings of the company.[33]

This represents the right of shareholders to call for an extraordinary general meeting. The CGC stipulates that shareholders who obtain five per cent of the corporation's equity share capital have the right to call an extraordinary general meeting. This ruling is in place in several developed countries. For instance, the European Union issued a directive requiring that all the countries' members diminish the threshold for demanding an extraordinary meeting to five per cent.[34] The UK Companies Act, which used to require a minimum of ten per cent until the European directive was passed, was amended in accordance with the said threshold of five per cent.[35] Thus, the CGC's position regarding this clause is compatible with international practices.

Third, those whose shareholdings account for five per cent of the equity share capital can propose one or more topics to the general meeting agenda for explanation.[36] Therefore, the predictable argument is that there is no need to authorise the shareholders who own five per cent of equity share capital to propose an unlimited number of issues on agenda for discussion on the general meeting agenda. In other words, the previously mentioned CGC creative clause is redundant since it opposes good corporate governance practice. In fact, the CL requires that any shareholder who owns at least twenty shares should have the right to attend the general meeting as well as discuss the corporation's affairs.[37] It is apparent under this CL condition that the Saudi regulator is seeking to protect minority shareholders from misconduct by either board members or majority shareholders. Moreover, the CGC creative clause does not match the OECD principles of corporate governance. It declares that shareholders should contribute to the agenda of a general meeting.[38] There is no demand under the OECD principles of corporate governance for five per cent of the equity share capital to exercise this right by the shareholder. The Capital Market Authority Board should

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33 UK Companies Act 2006, s. 303 (2-A).
34 European Community Directive on Shareholders' Rights, URN 08-1362. Also, see Implementation of the Directive on the Exercise of Certain Rights of Shareholders in Listed Companies Government Response to Consultation, 2009.
35 UK Companies Act 2006, s. 303 (2-A). This section has been amended by the EU Directive in 2009.
36 Corporate Governance Code 2006, Art. 5 (F).
37 Company Law 1965, Art. 83.
38 Organisation for Economic Co-Operation and Development, *OECD Principles of Corporate Governance*, 2004, p. 35.

reform the CGC's superfluous clause in accordance with good corporate governance practices.

Fourth, the CGC proudly pronounces that all shareholders, regardless of their shareholding range, ought to be able to ask questions of the board members and the external auditors which should be answered provided this does not affect the corporation's interests.[39] Saudi corporate governance observers argue that it is difficult to respond to questions without adversely influencing the corporation. Observers additionally consider that rational and good practice would dictate that all shareholders, without taking into account the value of their assets, should have the right to argue, discuss and make the final decision during the corporation's general meeting side by side with the board members and top executives. This philosophy is in line with the OECD principles of corporate governance without any restrictions. The OECD principles maintain that shareholders should have the opportunity to make enquiries of the external auditors.[40] Accordingly, this clause should be adjusted in the CGC in order to avoid any ambiguity.

Fifth, the corporation's board provides all shareholders with its annual report, as well as details of the general meeting, namely the date, the location and most importantly the explanatory agenda. These details, together with the board's annual financial report are made available to all shareholders at least twenty-five days prior to the corporation's general meeting. Additionally, they are broadcast on the corporation's website and the stock exchange website and then published in two Saudi daily newspapers.[41] By comparison, the UK Companies Act shows that notice of a company general meeting should include the date, time and venue.[42] Similarly, the OECD principles of corporate governance state that shareholders should be supplied with adequate and appropriate information pertaining to the date, location and agenda of the general meeting.[43]

Being in receipt of information regarding the date, time, location, agenda and the board's annual report in adequate time before the general meeting should assist shareholders in participating successfully in meetings. The *Jarir* Bookstore Company is an example of such

39 Corporate Governance Code 2006, Art. 5 (G), also this article corresponds to Company Law 1965, Art. 95.
40 *Supra* note 38 at 36.
41 Listing Rules 2004, Art. 26 (H), also Corporate Governance Code 2006, Art. 5 (C) and 5 (E).
42 UK Companies Act 2006, s. 311(1-A and B).
43 *Supra* note 38 at 36.

practice: it announced in two daily Saudi newspapers that the corporation's annual report, the subsequent ordinary general meeting agenda and all related information were available on the company's website and at the company's headquarters. Moreover, the announcement was made on 8 March 2012, more than twenty-five days ahead of the scheduled date of 8 April 2012, thus complying fully with CGC stipulations.[44]

The law case against the *SAMBA Financial Group* provides evidence of the significance of this matter. In this case, the Capital Market Authority Board imposed a fine of $13,333 when the company published its board's annual financial report on 16 January 2011, 23 days prior to the general meeting on 8 February.[45] The period between notification and meeting is regulated to be at least twenty-five days; the charge against the *SAMBA Financial Group* was based on Article 26-H of the Listing Rules, which states:

> The company should provide the Capital Market Authority and announce to the shareholders its annual accounts not less than 25 days before the date of the company's annual general meeting.[46]

The Capital Market Authority Board penalised the *SAMBA Financial Group* for this breach since it did not take into account the two-day shortfall before holding its general meeting. The penalty is deemed lawful for the shareholders should have been given sufficient time to study the board's annual report and other general meeting documents to be able to make informed decisions during the general meeting.[47]

With regard to the board's annual report, it is strongly advised that this be published within thirty days after the end of a corporation's fiscal year, although, as previously stated, the general meeting is expected to be held within three months of the end of a corporation's fiscal year. In a legal case against the *Solidarity Saudi Takaful* Company, the Capital Market Authority Board sentenced the company for its breach of regulations[48], as it had missed the deadline for the publication of its board's 2010 annual report. The Capital Market Authority

44 See, Al-Riyadh Newspaper, March 8, 2012, Issue 15963.
45 Issued Decision, dated 3 April 2011 by the Capital Market Authority Board.
46 Listing Rules 2004, Art. 26 (H).
47 For more information, see the link, available at: http://www.argaam.com/article/articledetail/204995/, [Accessed 1 November 2012].
48 Issued Decision, No. 4-15-2011, dated 8 May 2008 by the Capital Market Authority Board.

Board imposed a fine of $13,333, in keeping with article 44-E of the Listing Rules, which maintains that:

> The company should provide the Capital Market Authority and announce to the shareholders its annual accounts as soon as they have been approved and within a period not exceeding 30 days after the end of the annual financial period included in such annual accounts.[49]

This legal case ties in with the above-stated condition of the CGC regarding the general meeting. It is suggested that this period of time is sufficient for the corporation to announce its board's annual financial report, yet the offending company had failed to comply. For this reason, the Capital Market Authority Board imposed a fine to tackle any irresponsible conduct by listed companies when publishing their boards' annual reports. This report is understood to be an impartial guide to assets; it is published to enable share investors to recognise the corporation's financial and administrative positions. It also allows the shareholders to make informed decisions during the general meeting.[50]

Finally, the CGC also demands that upon termination of a company's general meeting the minutes should be made available to shareholders. In addition, a copy of the minutes should be sent to the Capital Market Authority within ten days of the arranged date of any such meeting.[51] The minutes of both general and board meetings are evidence of approval of decisions passed by the majority of board members.[52] Although the Saudi legislator advises keeping the general meeting minutes after ratification by the chairman and secretary, there is no stipulation regarding the number of years for which they should be kept. Since it is left to the corporation's articles of association to decide, it could be argued that this could in fact result in the premature disposal of the minutes to conceal potential wrongdoings.[53] It is therefore considered advisable for the Capital Market Authority Board to stipulate in the CGC the length of time that minutes should be kept. Guidelines on this point can be taken from the jurisprudence of other international companies, including the UK Companies Act. It

49 Listing Rules 2004, Art. 44 (E).
50 For more information, see the link, available at: http://www.argaam.com/article/articledetail/210685/, [Accessed 1 November 2012].
51 Corporate Governance Code 2006, Art. 5 (I).
52 Company Law 1965, Art. 75.
53 Ibrahim Al Muneef, *Corporate Governance Functions and Duties and Responsibilities of the Board of Directors*, Arabic edition, Dar Al Mouder, Riyadh, 2006, p. 115.

advocates that minutes of both general and board meetings should be reserved for at least ten years from the resolution date.[54]

9.3.3 Voting Rights and Applications

The CGC asserts that as one of the most desirable administrative rights held by shareholders, the vote in general meetings should not be denied under any circumstances. Board members and top executives are required to ensure good practice is upheld and enable all shareholders to vote freely and reasonably.[55] It further states that all shareholders should be informed of the format of the general meeting and the voting procedure.[56] This is in accordance with the OECD principles of corporate governance, which declare that:

> The shareholders shall have the ability to participate effectively and vote in general shareholder meeting and shall be informed of the rules including voting procedures that govern general shareholder meetings.[57]

By contrast, the Saudi practice of voting was based on the continental form that allocates one vote per share[58], resulting in the majority shareholders taking over the corporation's affairs. Thus, the appointment of board members during the general meeting used to be in the hands of majority shareholders since they held the greater number of shares.[59]

It is difficult to predict if the continental vote to appoint board members during a corporation's general meeting will be abolished. It is said that even if the cumulative voting technique is an obvious way to promote minority shareholders' representation on the board of directors, it has never been a prevalent compulsory requirement except in some US corporations.[60] However, the CGC recommends the cumulative voting process, which has been supported by the Capital Market Authority Board as likely to enhance minority shareholders' opportunities to nominate their representatives on the board. The cumulative voting process is specifically a voting method for choosing the board members in general

54 UK Companies Act 2006, s. 355 (1-A and B).
55 Corporate Governance Code 2006, Art. 6 (A).
56 Corporate Governance Code 2006, Art. 5 (D).
57 *Supra* note 38 at 34.
58 Company Law 1965, Art. 111.
59 *Supra* note 54 at 123.
60 Jeffery Gordon, 'Institutions as Relational Investors: A New Look at Cumulative Voting', *Columbia Law Review*, 1994, 94, p. 160.

meetings. It secures shareholders voting rights equal to the number of shares they hold, which they can exercise to vote for one candidate or split between candidates.[61]

Furthermore, Article 6-C of the CGC states that any shareholders unable to attend a general meeting may authorise other shareholders who are neither board members nor the corporation's employees to attend on their behalf.[62] However, the CGC does not issue guidance on the subject of voting by proxy, making it potentially problematic for absent shareholders to vote. Nor does it match other international corporate governance codes, namely those of the OECD principles of corporate governance, which permit shareholders with identical involvement to vote either in person or by proxy in the corporation's general meeting.[63] The UK Companies Act advocates that:

> A member of a company is entitled to appoint another person as his proxy to exercise all or any of his rights to attend and to speak and vote at a meeting of the company.[64]

It is of interest that the Capital Market Authority Board announced an electronic distance voting process to allow absent shareholders' to vote electronically, thus increasing participation rates during the corporation's general meeting.[65] If this were implemented, the need to nominate proxies could no longer be claimed in the Saudi case. The electronic process was, successfully established for absent shareholders by the National Shipping Company during its ordinary general meeting in March 2011 and the *Tawuniya* Company during its ordinary general meeting in March 2012.[66] The CGC would be well advised to recognise the electronic technique, so that the aforementioned Article 6-C might be amended to legalise distance voting. Further, the Capital Market Authority Board should regulate voting by proxy under the CGC.

9.3.4 Shareholders' Rights to Appoint and Remove Board Members

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61 Corporate Governance Code 2006, Art. 2.
62 Corporate Governance Code 2006, Art. 6 (C). Also, Company Law 1965, Art. 83.
63 *Supra* note 38 at 35.
64 UK Companies Act 2006, s. 324 (1).
65 See the Official Website of the TADAWUL, available at: http://tadawulaty.tadawul.com.sa/tadawulaty/Electronic_Voting2.htm, [Accessed 1 November 2012].
66 See the Official Website of the National Shipping Company of Saudi Arabia, available at: http://www.nscsa.com/, [Accessed 1 November 2012]. For more information, see Al-Riyadh Newspaper, May 6, 2012, Issue 16022.

The shareholders' right to appoint and remove board members in the corporation general meeting is a critical instrument accorded to the shareholders by both the CGC and the CL. The CGC states that board membership rules on matters such as joining and leaving should be stated clearly in the corporation's articles of association. The shareholders have the right to nominate and dismiss one or more board members even if the corporation's articles of association state otherwise.[67]

Indeed, the shareholders' right to appoint and discharge board members, or at least the majority of those members, is widely recognised in corporate governance literature. As Manne insists, the shareholders' rights to charge and remove the board members are obligations that corporations should not refuse.[68] In addition, Heath and Norman indicate that shareholders' rights to appoint and discharge board members would encourage shareholders to interact with their corporations, thus watching their investments closely.[69] Davies asserts that the shareholders' right to remove board members at any time and for any reason would seem to be an influential tool to make the board of directors accountable to the shareholders.[70] In addition, the OECD principles of corporate governance affirm that:

> Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated.[71]

The shareholders' rights to appoint and remove board members are likely to be debated, especially in the concentrated ownership structure as represented in Saudi listed corporations. This is attributable to the considerable influence of the Saudi government and rich families on the appointment and removal of a high number of listed corporations' board members. For

67 Corporate Governance Code 2006, Art. 10 (D). It is important to note that the Corporate Governance Code and the Company Law have not explained many essential issues that can be found under for example the UK Companies Act. These significant issues include minimum age for appointment, register of directors, resolution to remove directors and director's right to protest against removal. These aspects are really needed to be considered by the Saudi legislator since leaving these aspects without any indications would make an ambiguity and a way to misconduct by the board members. See, UK Companies Act 2006, Part 10 Chapter 1.
68 Henry Manne, 'Some Theoretical Aspects of Share Voting', An Essay in Honor of Adolf A. Berle, *Columbia Law Review*, 1964, 64 (8), p. 128.
69 Joseph Heath and Wayne Norman, 'Stakeholder Theory, Corporate Governance and Public Management: What Can the History of State-Run Enterprises Teach us in the Post-Enron Era?', *Journal of Business Ethics,* 2004, 53, p. 251.
70 Paul Davies, *The Board of Directors: Composition, Structure, Duties and Powers, Company Law Reform in OECD Countries: A Comparative Outlook of Current Trends*, Stockholm, Sweden, 2000, p. 7.
71 *Supra* note 38 at 35.

instance, the *Saudi Electricity Company*'s board chairman, chief executive and two further board members out of six are nominated by the Saudi government, which holds seventy-four per cent of this company's equity share capital.[72] Another example is *Al Khodari* Company's board chairman and two further board members out of six who belong to the same *Al Khodari* family and whose shareholdings account for sixty per cent.[73]

It is also advised that the procedure for removing board members should be stated in the corporation's articles of association. The shareholders have the right to dismiss board members even though the corporation's articles of association advocate otherwise. When dismissing a board member, the Capital Market Authority and the stock exchange should be informed immediately by the corporation and supplied with an explanation.[74]

Examining the removal of board members in other international companies' jurisprudences, the UK Companies Act agrees that corporations may remove board members before the end of their period of office. This can take the form of regular decisions with specific required notes during the company's general meeting, if the shareholders are dissatisfied with the board members' performances, even when the corporation's articles of association may provide otherwise.[75]

It is understood that the power to remove board members by passing a regular resolution is a main shareholder right. This right can be exercised even if the board members have done no wrong, since board membership may be annulled without notice. The removal is, however, often justified during the corporation's general meeting.[76]

In a recent legal case, the Capital Market Authority Board found that the *Saudi Fisheries Company* was in breach of regulations for removing some of its board members without notifying the Capital Market Authority and the stock exchange. The Capital Market Authority Board imposed a fine of $13,333 because the company had not informed the regulatory

72 See the Official Website of the Saudi Electricity Company, available at: http://www.se.com.sa/SEC/English/Menu/Corporate/Company+Management/, [Accessed 1 November 2012].
73 See the Official Website of Abdullah Al *Khodari* Company, available at: http://www.alkhodari.com/organizational.html, [Accessed 1 November 2012].
74 Corporate Governance Code 2006, Art. 12 (F). Also, Listing Rules 2004, Art. 43 (B-5).
75 UK Companies Act 2006, s. 168 (1).
76 Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law and Capital Markets Law*, Pearson Education Ltd, 3ed, 2009, p. 179.

body.[77] The fine was not levied because of the board members' dismissal, but rather because the removal was not accompanied by the required notice. The verdict was in accordance with article 43-B-5 of the Listing Rules, which confirms that:

> A company should notify the Capital Market Authority and the stock exchange 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 company's assets and liabilities or financial position or on the general course of its business and which may include any changes in the composition of the directors or senior management of the company's.[78]

An identical violation of regulations occurred in the *Saudi Investment Bank* when it failed to both appraise the Capital Market Authority of the removal of some of its board members and attach the information in its board's annual report. In consequence, the Capital Market Authority Board imposed a fine of $13,333 in line with Article 43-B-5 of the Listing Rules, as in the previous case.[79]

In these cases, the issued fines were legally binding as they were taken from the mandatory Listing Rules clause. It is held that listed corporations should inform the Capital Market Authority and the stock exchange about the dismissal of their board members since knowledge of such modifications is relevant to market contributors. In the aforementioned breaches, it is unclear if the removal of the board members took place in accordance with shareholders' wishes, although it is important to note that any termination of board membership should be made in consultation with the shareholders at the corporations' general meetings. Therefore, removing the board members should be stated clearly in these boards' annual reports and then made public. The fine for a breach should be raised to $26,666 rather than the current $13,333. The Capital Market Authority Board might consider such an increase an appropriate response to the lack of professionalism demonstrated by the corporations, which are obliged to live up to the necessary standards in order to attract investors and satisfy the public regarding their commercial submissions.

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77 Issued Decision, No. 6-34-2011, dated 20 November 2011 by the Capital Market Authority Board.
78 Listing Rules 2004, Art. 43 (B-5).
79 Issued Decision, dated 16 May 2008 by the Capital Market Authority Board.

9.3.5 Shareholders' Right to Litigate against Board Members

The shareholders' right to litigate against board members is paramount since it renders them answerable to misconduct and negligence submissions and offers minority shareholders the opportunity to guard their interests.[80] In order to enable shareholders to claim and protect their rights, it provides for them to challenge the board members' expropriation in the courts, subject to specific requirements.[81] This is termed derivative action under the UK Companies Act and has the noteworthy task of protecting shareholders' rights. Derivative action is also defined as a lawsuit that might be brought by a corporation shareholder on behalf of the corporation to hold the board members liable for a violation of their duties.[82] However, the Saudi regulator has not identified the exact meaning of derivative action in the way that the UK Companies Act does. The Saudi regulator cites suing and litigating against the board member by the shareholders as action in liability cases.

Article 78 of the CL reads that every shareholder shall have the right to institute an action in liability cases against directors on behalf of the company if 'the wrongful act' committed by them is of a nature to 'cause him personal prejudice'. However, the shareholder may institute such action only if the company's right to institute is still valid and after notifying the company of his intention to do so. If a shareholder institutes such action, he shall be compensated only to the extent of the prejudice caused to him.[83] Accordingly, Article 78 of the CL offers shareholders the right to sue board members on behalf of the corporation. However, it can be understood from the said article that this right is limited to specific circumstances, which can be summarised as follows:

1) There should be a wrongdoing to the corporation that has been committed by the board member.
2) The wrongdoing has affected the shareholder interest specifically.
3) The shareholder, before submitting his case to the court, should inform the corporation about his intention to pass such action.

80 *Supra* note 21 at 253.
81 Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, 'The Law and Economics of Self-Dealing', *Journal of Financial Economics*, 2008, 88, p. 430.
82 *Supra* note 78 at 222.
83 Company Law 1965, Art. 78.

4) If the corporation can sue the board member with regard to the wrongdoing, the shareholder is not eligible to claim on behalf of the corporation.

In order to evaluate Article 78 of the CL, which grants the shareholder the right to litigate against the board members action in liability cases, it is important to note that the meaning of 'cause him personal prejudice' under this article is to be understood in a wider sense. An outline of this can also be found under Section 994 of the UK Companies Act, since it also refers to shareholders' interest.[84]

> A member of a company may apply to the court by petition for an order under this part on the ground that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself).[85]

Returning to the meaning of 'derivative action' in the UK context, it is based on the case of *Foss v. Harbottle,* in which the court enacted policies to be presented in any derivative suit to be effected. Two significant rules are required as follows: Firstly, the derivative action should be brought in the corporation's name since the corporation is the proper plaintiff with regard to any delinquency within the corporation. Secondly, the shareholder cannot bring a derivative action on behalf of the corporation if the misconduct could be ratified by the majority votes of shareholders in the general meeting.[86]

In addition, the derivative action is implemented by a member of a corporation respecting a foundation of a deed devolved by the corporation, and looking for reprieve on behalf of the corporation.[87] The shareholder can bring such an action on behalf of the corporation against any of its board members in line with the suspicion of negligence or breach of trust and duty.[88] However, the shareholder should ensure that he would gain permission from the court to bring a derivative action.[89] Again, under Section 994 of the UK Companies Act, the

84 Xiaoning Li, *A Comparative Study of Shareholders' Derivative Action: England, the US, Germany and China*, Kluwer, Deventer, UK, 2007, p. 36.
85 UK Companies Act 2006, s. 994 (1-A).
86 UK Companies Act 2006, s. 260. Also, Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law and Capital Markets Law*, Pearson Education Ltd, 3ed, 2009, p. 212.
87 UK Companies Act 2006, s. 260 (1-A and B).
88 Charles Wild and Stuart Weinstein, *Smith & Keenan's: Company Law*, Pearson Education Ltd, Edinburgh, 2009, p. 262.
89 Ibid, p. 263.

shareholder can appeal to the court if the corporation's dealings have been conducted in a way unfairly prejudicial to the interests of the corporation affiliates, including the shareholder himself.[90] The UK Companies Act proclaims that:

> A member of a company who brings a derivative claim must apply to the court for permission to continue it.[91]

As before, Article 78 of the CL provides that if the wrongful act is committed by board members who harm shareholder interests, a shareholder is permitted to litigate against a board member. Again, the expression 'the wrongful act' is very wide and potentially ambiguous, and the court will interpret the meaning as it sees fit. On the other hand, the non-expert shareholder is unlikely to be able to explain to the court specific aspects.[92] It has been acknowledged that litigation is a costly and prolonged way of monitoring board members; moreover, judges are not necessarily knowledgeable in the area of settling the monitoring role.[93] Thus, the Saudi regulator should define the word 'the wrongful act' under the CL in order to avoid the ambiguity surrounding this term, which affects shareholders' right to litigate against board members. To illustrate this point, the UK Companies Act declares that a derivative claim would be passed before the court in respect to default, omission, negligence, breach of duty or breach of trust by either a corporation's board member or any other person.[94] Therefore, it seems clear that negligence, breach of duty or breach of trust are examples of wrongful acts under the UK Companies Act, which the Saudi regulator could take advantage of in reforming the shareholders' right to litigate against board members.

By law, when shareholders sue board members and those members have pleaded guilty, the CRSD can impose a variety of punishments including fines, imprisonment, seizing property and issuing an execution, travel bans and prohibition from working with the listed corporations for a period of time.[95] The CML mandates the fine to be not less than $2,666

90 Ibid, p. 272.
91 UK Companies Act 2006, s. 261 (1).
92 *Supra* note 21 at 257.
93 *Supra* note 71 at 10.
94 UK Companies Act 2006, s. 260 (3).
95 Capital Market Law 2003, Art. 59 (A).

and not more than $26,666.[96] It also stipulates that the length of time in prison should not exceed five years.[97]

A current case of action in liability against a board member is still being mediated by the CRSD.[98] In this case, the *Saudi Transport and Investment Company* shareholders have presented a legal suit against the former board chairman who was in office from 2004 until 2010. The shareholders have asked for compensation of $2,475,988 from the former board chairman since he invested the company capital on his own behalf. His abusive investment was, additionally, seen as the main factor behind the company loss and constituted an obvious breach of contract (trust and duty of good faith), as laid down in the company's articles of association, the CL, the CML and the Implementing Regulations. It is thought that the board chairman was abusing his authority very seriously without taking notice of the corporation's or the shareholders' interests. The company shareholders have obtained the permission of the current board to take the case before the CRSD.[99]

Due to its association with the shareholders' right to litigate against the board members, a substantial number of shareholders do not acquit (i.e. relieve) board members during the corporation's general meeting. This occurs more frequently in Saudi listed corporation general meetings. It should nevertheless be pointed out that acquitting board members is not effective with regard to their legal liabilities unless it is followed up by filing action in liability against them.[100] In other words, if the shareholders have voted during the corporation's general meeting against the relief from liability of the board of directors, those shareholders should have the right to report a lawsuit against the board members. This restraint is intended to support both minority and majority shareholders since they are able to challenge the board members' liability in court, even when those board members have been relieved.[101] Legal liability for any harmful action can then be extended to the board members if this is discovered within five years.[102] In addition, Article 58 of the CML arranges that:

96 Capital Market Law 2003, Art. 59 (B).
97 Capital Market Law 2003, Art. 57 (C).
98 Legal Complain before the Committee for the Resolution of Securities Disputes, dated 2 October 2011.
99 For more information, see the link, available at: http://www.argaam.com/article/articledetail/232121/, [Accessed 1 November 2012].
100 *Supra* note 8 at 256.
101 *Supra* note 8 at 257.
102 Company Law 1965, Art. 75.

> A suit shall not be heard if the complaint is filed with the Capital Market Authority after the elapse of one year from the date when the claimant should reasonably have been aware of facts causing him to believe he had been the victim of a violation, and in no case may such complaint be heard by the CRSD after five years from the occurrence of the violation subject of the claim.[103]

9.4 Summary

This chapter has analysed the shareholders' rights. In particular, the shareholders' rights were considered by focusing on the legitimate articles of the CGC, the CL and law cases related to shareholders' rights. Analytical and comparative approaches were employed in this chapter, examining the OECD principles of corporate governance and the UK Companies Act provisions with a view to reforming shareholders' rights in the Saudi corporate governance system. In addition, the shareholders' rights were divided into financial and administrative rights. The former contained the right to obtain dividends, the right to a share of the corporation's assets upon liquidation and the right of disposition with respect to shares. The latter consisted of other shareholders' rights including those related to the corporation's general meeting, voting rights and applications, the right to appoint and remove board members and, significantly, the right to litigate against board members. Several international examples of good practice connected to shareholders' rights are not recognised under Saudi legislation, both in the CGC or the CL. Therefore, a number of recommendations were made in the chapter sections regarding shareholders' rights in the Saudi context.

103 Capital Market Law 2003, Art. 58.

Chapter Ten

Conclusion and Recommendations

The final chapter summarises and brings together the main areas covered in this study. It provides recommendations for reforming and improving corporate governance in Saudi Arabia. It further suggests future research avenues and presents the contribution of this study to research knowledge.

10.1 Conclusion

The main purpose of this study was to propose a reform of the Saudi corporate governance framework from a legal perspective. The research set out to provide a general understanding of how current corporate governance preparations are perceived by listed corporations, as well as to investigate the adequacy of the current corporate governance framework. The paper consists of ten chapters.

Chapter One offered an introduction outlining the research significance, problem, aims, methodology, questions, scope, limitations and structure.

Chapter Two provided the background to Saudi Arabia. It sought to highlight the country's legal structure, which can affect corporate governance practices there, and to ensure that the ambiguities and unique qualities inherent in the Saudi legal structure are recognised. The introduction to Saudi Arabia was presented in the first section. It was mentioned that Saudi Arabia has a special position in the Islamic realm since it hosts the two holy places of *Makka* and *Medina*. The Basic Law of Governance, which is deemed to be the major Saudi constitutional law with significance in relation to a variety of Saudi laws and authorities, was studied in Section Three. The country's executive, legislative and judicial authorities were addressed in Section Four, concentrating on the executive authority held by the King, the Council of Ministers, local government and the public independent and quasi-independent administrative organisations. It was emphasised that legislative authority rested with the King, the Council of Ministers, the Consultative Council and the Board of Senior Council of *Ulama*. The judicial authority was stated as observing the *Shari'a* courts system, the Board of Grievances and quasi-judicial committees. A discussion about reforming quasi-judicial committees under the *Shari'a* courts system was demanded because the judgement of these committees can be noted as a mixture of *Shari'a* legislation and the statutory regulations that do not reflect Islamic public policy.

Chapter Three gave an account of corporate governance to extend our understanding of the subject. The intention of this chapter was to review past research in order to provide a general representation of recent corporate governance themes, thus building a vital cornerstone as a basis for the next chapters. This chapter mainly examined corporate governance in the literature by focusing on justification sections related to corporate governance. Definitions of corporate governance were presented in the second section, and then evaluated in order to determine a definition with a degree of exactitude. Moreover, for the purposes of this research an attempt was made to formulate the author's definition of corporate governance from the legal point of view. It was defined as the process of ensuring compliance with the norms, restrictions and standards that regulate relations between a corporation and its external environment, as well as between the principal corporate participants in a corporation (principally between shareholders and management), in order to protect their legitimate rights and interests and to optimally solve problems concerning the separation of control (ownership) from management.

International efforts for establishing corporate governance standards were investigated in the third section. It was found that corporate governance today is an area under discussion as the different international corporate governance codes in most countries, both developed or developing, are currently between the pilot and assessment stages. Many countries have, however, made some corporate governance provisions mandatory, especially provisions in connection with transparency and disclosure, in accordance with the 'comply or explain' principle. In this section, the UK corporate governance committees and their main reports were reviewed. In addition, the OECD principles of corporate governance and the Sarbanes-Oxley Act were considered.

In Section Four corporate governance law was studied in the light of corporate governance models. In brief, there are two main global models of corporate governance. The first is the Anglo-American shareholder corporate governance model, which concentrates on the notion that shareholders' rights that must be respected and implemented by board members and top executives. The second is the Continental European stakeholder corporate governance model which focuses on the stakeholders' rights, including those of employees, creditors, debtors, suppliers, customers, the whole community and shareholders as an essential category of stakeholders.

Corporate governance theories were reported in Section Five. Agency theory was shown as a cornerstone theory for defining the scope of corporate governance. Shareholder theory was discussed with regard to shareholder rights, i.e. shareholders can manage and control corporations by themselves if necessary. Further, shareholders are able to appoint and dismiss one or all of the board members and top executives of corporations and have voting rights in general meetings. Furthermore, shareholders have the right to equality and fairness, which is deemed to resolve the differences between majority shareholders and minority shareholders. Shareholders' rights are defined in corporate governance provisions in almost all countries that follow the Anglo-American shareholder corporate governance model.

Stakeholder theory and corporate social responsibility (CSR) were also investigated in this section. It posited that stakeholder theory is implemented by the Continental European stakeholder corporate governance model as well as by some other countries, for instance Japan. Also, stakeholder theory proposes that the board of directors and top executives should act on behalf of all stakeholders including creditors, debtors, suppliers, employees, customers and shareholders. CSR has become a major concern and in the era of globalisation it is imperative that corporations should protect and observe its principles. International corporate governance codes, such as the OECD principles of corporate governance, have provided a broad picture of the importance of CSR. It is understood that corporations should respect human life and needs as well as sustaining the environment. It is therefore advised that corporations should respect international human rights' declarations and protocols. Several corporations across the world have been culpable of serious breaches of the CSR, one example being BP, which caused a catastrophe in the Gulf of Mexico in 2011. Slave labour is another significant example concerning human rights violations at global level, manifested in children, women and workers from poor countries working for low wages, in unfavourable working conditions and without health or pension protection. It is advised that policies on CSR should first be established by the board of directors, and then included in the corporation's articles of association. The Saudi practice of CSR was clarified. The insignificant number of listed corporations is a concern but the positive impact of their activities, which endorse this principle, is obvious when seen in the context of their support of the health care system, charities, the disabled and orphans. On the other hand, a large number of listed corporations are discounting CSR. The evidence reveals that *Jubail* city has approximately 352 manufacturers responsible for harming human health. The evidence also shows that the Saudi environment urgently needs CSR criteria to be implemented.

Chapter Four analysed the theory of corporate governance from an Islamic perspective. The chapter's aims were to observe to what level the Saudi corporate governance framework can gain benefit from existing theory in relation to corporate governance. It highlighted this from an Islamic perspective in order to convey the significance of Islamic legislation and values when implementing corporate governance practices, and to examine whether or not the principles of corporate governance supplemented by Islamic Law can be satisfactory.

Islam and its law sources were emphasised by concentrating on primary Islamic law sources such as the *Qur'an* (the book of God) and the *Sunna* (the traditions of the Prophet Mohammad), and on secondary sources as the *Ijma* (the consensus of opinion) and the *Qiyas* (the analogical deduction). Further explanations about the correlation of these original sources with the theory of corporate governance from the Islamic perspective were highlighted in the second section. The *Sunna* is considered the most important source of Islamic law for the purposes of clarifying Islamic values since it contains several of the Prophet's traditions and customs that illustrate the importance of these values.

Islamic objectives (*maqasid al Shari'a*) were described in the third section, which focused on the principles of wealth (*mal*) and the Islamic objective of unity with God (*tawheed*). All the Islamic objectives were discussed, as they constitute key elements of corporate governance. Therefore, justifications regarding the acceptance of contracts, the prohibition of usury or interest (*riba*), the prohibition of gambling (*qimar*), the prohibition of uncertainty (*qharar*) and the encouragement of paying alms (*zakat*) were detailed.

Islamic values were investigated in Section Four by spotlighting Islamic accountability, justice, consultation, secretariat, truthfulness, sincerity and brotherhood. Most importantly, the question to what extent the principles of corporate governance supplemented by Islamic Law achieve their purpose was considered in Section Five. Evidence from Saudi Arabia was analysed in Section Six. Overall, it appears that corporate governance from an Islamic perspective is a satisfactory theory for encouraging Islamic legislation and values in day-today business activities compared with the recent corporate governance model. It is, however, an admirable attempt in the literature of corporate governance.

Chapter Five presented the development of the Saudi corporate governance framework. To trace the evolution of the Saudi corporate governance framework, the CGC was examined together with the factors that gave rise to the development of the Saudi corporate governance framework. The CGC in its phase between the pilot and assessment was deliberated in the second section. Although the CGC was initially not binding, the Capital Market Authority Board has the power to make one or more article of the CGC mandatory in instances where corporate governance standards were of concern. The Capital Market Authority Board has promulgated ten out of nineteen articles of the CGC that should be adhered to in all listed corporations' dealings.

The Capital Market Authority Board has called on all listed corporations to acknowledge both the voluntary CGC articles they have implemented, as well as those they have failed to implement, when announcing their boards' annual reports. With regard to the binding articles of the CGC, all listed corporations are expected to implement these and record their application in their board's annual report. Failure to comply results in the Capital Market Authority Board imposing a fine or litigating against the corporations in breach of conduct before the CRSD. The Capital Market Authority Board has fined several listed corporations, such as *Petro Rabigh* Company and *Food Products* for breach of these regulations. The Capital Market Authority Board declared that 96% of listed corporations' had adhered to the CGC in 2009, although this figure is debated in light of the World Bank's monitoring of the implementation and accuracy of the CGC. In practice, it is unlikely that the Capital Market Authority Board announcement would be rated as highly in a developed market as in the Saudi context, which is assumed to represent one of the emerging markets.

The duplication of applications between the CL and the CGC was considered. It has been mentioned that the corporate governance arrangements in both the CL and the CGC are unclear regarding a number of legal articles that control these preparations. Furthermore, the role of listed corporations' self-regulatory corporate governance policies was simplified. Corporate governance policies are based on self-regulation and soft law theories and the CGC has been particularly influenced by these. It advises that all listed corporations' boards should create and instigate their own self-regulatory corporate governance policies, which do not replicate the CGC. Should boards fail to do so, shareholders would be able to call for the creation and implementation of self-regulatory policies at the corporation's general meetings. It has also been suggested that listed corporations that have created self-regulatory corporate governance policies are more likely to attract investment. In particular, these corporations' representatives are assumed to perceive their corporations' self-regulatory policies as optimal applications of corporate governance practices.

It was argued that such self-regulatory policies were found to have been copied and pasted from the CGC without any modification without taking into account the successful application of international principles, such as the OECD principles of corporate governance and the last Combined Code, especially with regard to weak aspects of the CGC which require development. These policies were thus established in line with the CGC guidelines for self-regulatory policies. This gave rise to a fierce debate on the infringement committed by these listed corporations in relation to their self-regulatory policies and to the CGC with respect to good corporate governance practices. It was furthermore thought that listed corporations were hampered by a lack of legal advisors and legislators who could assist and produce good-quality self-regulatory corporate governance policies.

Chapter Six gave an account of the Saudi external institutional framework for corporate governance. The chapter responded to a vital research question to explore which external body has responsibility for ensuring corporate governance provision in Saudi Arabia and thus attaining satisfactory levels of corporate governance performance. The second section analysed the requirement that the Capital Market Authority Board should comprise five highly qualified members. The legal expertise of the Capital Market Authority Board should facilitate and accelerate the process of passing new regulations that adjust the Saudi market since the proposal regulations do not require approval by the formal legislative bodies, i.e. the Council of Ministers and the Consultative Council. The responsibilities of the Capital Market Authority for the market were elucidated fully. It was stressed that the Capital Market Authority lays down policies and work plans and promulgates the necessary regulations to satisfy the Capital Market Authority objectives. It also alters the application regulations as required to put them into effect and grants the flotation of securities. It adjourns the stock exchange actions for a period of time, bans any securities trading on the stock exchange and formulates vital principles for external auditors. In this respect, the Capital Market Authority Board can endorse any penalties indicated in Article 59-B of the CML in relation to offending corporations or individuals to the CML, the Implementing Regulations and the stock exchange policies. Like the Committees for the Resolution of Securities Disputes, the Capital Market Authority Board has the power to penalise corporations and individuals.

It was stated that the General Department of Corporate Governance is a central Capital Market Authority department. Its objectives are to enhance disclosure and transparency mechanisms, to increase public knowledge of both corporations or investors regarding corporate governance standards, to connect with domestic and international bodies with the aim of promulgating good corporate governance practices, and to monitor the creation and implementation of self-regulatory corporate governance policies of listed corporations.

Section Three analysed issues regarding the Committees for the Resolution of Securities Disputes. These are quasi-judicial financial commissions within the Saudi judicial system, which are also comprised of the *Shari'a* courts system and the Board of Grievances. These quasi-judicial committees are responsible for the CML, the Implementing Regulations and the stock exchange policies.

The CRSD is the first of the committees listed above. It comprises of several legal advisors who are experts in law, Islamic financial transactions and capital market laws; their membership lasts three years but is subject to renewal. They are expected to have no interest or relationship in the cases they arbitrate. The independence of the CRSD is debated, particularly since any legal cases should be subject to the Capital Market Authority decision for ninety days unless the latter provides for the defendant to submit their plea or case before the CRSD. Therefore, cases must first be filed with the Capital Market Authority before the defendant can approach the CRSD. The CRSD members' appointment and remuneration are decided by the Capital Market Authority, although they should at least match those of the members of the Appeal Committee for the Resolution of Securities Conflicts, whose terms are determined by the Council of Ministers. The CRSD can judge different kinds of cases including public, private, and temporary cases, and grievances. The CRSD should commence judging any legal case within fourteen days of presenting. Any legal case presented after one year of discovering the action is rejected by the CRSD. Moreover, current electronic communications can be used as approved evidence by the CRSD as an exception in the Saudi evidence system. The CRSD has a variety of penalties that can be imposed on the accused corporations or individuals, including travel bans, imprisonment and compulsory repayments to the Capital Market Authority of the consequent interest. On the other hand, the Appeal Committee for the Resolution of Securities Conflicts consists of three members, whose membership is limited to three years and who represent the Ministry of Commerce and Industry, and the Ministry of Finance. If the appellant brings his case before the Appeal Committee for the Resolution of Securities Conflicts, this committee can pronounce the final verdict.

Section Four studied the stock exchange, which was first established in 1984 by the Ministry of Commerce and Industry and then re-established in 2003 by the Capital Market Authority, the body now solely responsible for the Saudi exchange. The formation of the exchange in Saudi Arabia coincided with numerous challenging circumstances such as the launching of exchanges in bordering Arab countries, the increase in public knowledge of the stock and the privatisation plans of several Saudi corporations. The stock exchange has several responsibilities such as guaranteeing equity of listing requirements and ensuring impartiality of transactions. It takes transparency requirements and certifies technical mechanisms and information for securities listed in the stock exchange. It also resolves any disputes, approves regulations, and establishes and enforces professional standards for brokers and their representatives.

It is suggested in Section Five that the Ministry of Commerce and Industry is an important institution for corporate governance. It has a department with responsibility for granting permission for the establishment of corporations whose general meetings are then normally attended by departmental representatives to ensure that adequate corporate governance practices are in place.

Section Six reviewed the role of accounting and auditing firms, which are seen to be significant external institutions for corporate governance. These firms were behind several international financial market scandals, including the Saudi market scandal in 2006. The first accounting and auditing firm was created in Saudi Arabia in 1957 by the Ministry of Finance; this was followed rapidly by seven further licensed firms, one of which is Saudi and the remainder foreign. The CL is disappointing for Saudi domestic need of accounting and auditing standards. Therefore, the Saudi regulator assigns the task of improving accounting and auditing standards to the Saudi Organisation for Certified Public Accountants. This body has a variety of responsibilities. As the external institution for corporate governance, it improves accounting and auditing standards and arranges current education programmes and training workshops. It contributes to regional and international seminars and symposiums linked to the accounting and auditing profession. It additionally conducts and publishes specific subject-related research.

The Saudi National Anti-Corruption Commission was presented in Section Seven. It is considered to play a major role in fighting corruption and wrongdoings within many listed corporations. Conflicts of interest and insider trading are examples of conduct that should be investigated by the National Anti-Corruption Commission, thus satisfying good corporate governance practices.

It was concluded that applying good corporate governance practice is a challenge for Saudi governmental and semi-governmental organisations in charge of implementing these provisions through their executive, legislative and judicial bodies, since corporate governance experience can be described as being subject to contemporary soft law in many developed and less developed countries in the world, including Saudi Arabia. Admittedly, the Saudi institutional framework for corporate governance does not differ much from other regional institutional frameworks, but the dissemination regulations, as well as the integration of the jurisdictions of these institutions, may cause some ambiguity and confusion.

Chapter Seven analysed the current board of directors' practices in Saudi corporate governance. The major aim was to study the board of directors in addition to clarifying a variety of indispensable features related to the board. The board duties, interpreted in Section Two, were shown to be the duty of care, the duty of loyalty and the duty to act within the power. The duty of care has not been explained in either the CGC or the CL. Therefore, the duty of care can be promulgated to Saudi legislation from other international companies' jurisprudences, such as the UK Companies Act. In addition, the duty to act within the constraints of their powers is mentioned briefly in the CGC and the CL. However, the board of directors is entitled to delegate some of its work to other board members and sub-committees, such as the audit committee and the nomination and remuneration committee. Unless delegated pieces of work are determined in terms of length and specific power, they are null and void. The CGC also introduces a beneficial clause regarding the duty not to exceed their powers, which seeks to prevent corporations from providing cash mortgages to board members or certifying cash mortgages to board members via a third party. This is designed to protect the capital of both shareholders and corporation.

On the other hand, the duty of loyalty has been put in question by conflicts of interests within the board and insider trading. A conflict of interests is defined as a position that would strain the impartiality of members owing to personal benefits, both material and moral, or those pertaining to their relatives. Non-executive board members are observed to have a conflict of interests within the board when they hold positions on various corporations' boards and have options and shares in those corporations. As regards the Saudi situation, the law cases introduced in this section prove that conflicts of interest were experienced by both executive and non-executive board members. The CGC has sought to manage conflicts of interests within the board by proposing three significant objectives. It advises that the board should create a written policy that controls the related groups and resolves any conflict of interests when it arises. It also excludes board members from either competing or trading in the corporation's commercial transactions. On the other hand, the CGC has needlessly provided the following points of exception:

1. When the board member has established prior approval from the corporation's general meeting to do so, subject to annual renewal.
2. When the board member notifies the board and the shareholders about any secret activities and commercial contracts that are concluded for the corporation.
3. When the board member is the best bidder through public bidding.

Critics of the CGC's exceptions argue that it is wrong to allow board members with conflicts of interests to compete and trade in the corporation's affairs where they can submit the optimal offer through public bidding, as detailed insider knowledge of the corporation and its activities makes their offer the most likely to win a general bidding contest. The futility of this exception signifies the need for this clause of the CGC to be amended by the Capital Market Authority Board in order to inspire good corporate governance practices.

The second matter open to challenge is insider trading which contravenes the meaning of duty of loyalty by the board members. Insider trading is defined as information obtained by the insider that is not available to the general public, has not been disclosed, and whose release and availability would have a material effect on the price or value of a security related to such information. Furthermore, that the insider knows that such information is not generally available and that, if it were available, it would have a material effect on the price or value of the security. It is thought that insider trading is very difficult to prove and investigate, although a number of bodies are in a position to both prove and prevent it. These include the Capital Market Authority Board, the General Department of Corporate Governance, the CRSD, a corporation's board nomination and remuneration sub-committee and the Saudi National Anti-Corruption Commission. Legal cases relating to insider trading were described and evaluated in this section. The CRSD imposed fines and prevented the violating board members from working with listed corporations for three years. The CRSD also forced these board members to pay back to the Capital Market Authority the venture that was gained in accordance with their insider dealings. It is worth observing that the CRSD issued a penalty of imprisonment against the chairman of the *Bishah Agriculture Development* Company's board because he was litigated against for breach of duty and insider trading. Saudi corporate governance observers have debated this case. They argue that the CRSD should not have the right to pass prison sentences since this constitutes a criminal sanction, which should not be imposed by a quasi-judicial committee such as the CRSD. Instead, penalties should be imposed by the Saudi Criminal Prosecution, which is responsible for determining criminal sanctions. Similarly, UK law has assigned insider dealing to the Criminal Prosecution Service.

The board's responsibilities were discussed in Section Three. It was argued that these responsibilities should be included in the corporation's articles of association and that board members had a duty to fulfil their responsibilities effectively. Moreover, board members should not distinguish between major and minor shareholders when gathering information, making decisions and producing the board's annual report. In addition, the board is responsible for all the corporation's policies including the financial plan, the budget, the performance strategy, the internal audit plan and the financial annual statements. In particular, the board should develop the relevant policies to regulate relationships with the different stakeholder groups, namely the suppliers, consumers, lenders, shareholders and the whole of society.

The creation for boards was considered in Section Four. It was noted that the CGC insists that the minimum number of board seats should be three and the maximum eleven. The dual and unitary board forms were covered. Although neither the CGC nor the CL advise any board restriction, because of the adoption of the Anglo-American corporate governance model by the Saudi regulator some listed corporations have unitary boards comparable to US corporations.

Section Five focused on the separation of the powers held by board members. Saudi Arabia adopted this method following the Cadbury report, which suggested a separation of the board members' powers. The CGC naturally favours the separation of the board's chairman and chief executive positions. Since the separation of the board members' powers is affected by the Saudi ownership structure, this was thought to merit discussion and a presentation of the definitions of dispersed and concentrated ownership. Dispersed ownership implies that a large number of shareholders own the corporation's shareholdings. The reasons for the spread of this ownership structure in developed markets are based on competent general legal orders, effective corporate governance systems, capable securities' markets and stringent disclosure and transparency requests. By contrast, in the concentrated ownership structure a major or a small number of shareholders hold the corporation's shareholdings. This type of ownership has flourished in emerging markets because of their problematical general legal structures, inexperienced corporate governance systems, weak securities markets and inadequacies in the settings for disclosure and transparency. Concentrated ownership structures are to be expected where the government is undemocratic and unfair. However, it may also be found in situations of economic improvement, technological advancement, cultural variations and legal modifications.

In the Saudi case, the ownership structure has been influenced by rich Saudi families and the Saudi government. The government holds forty-five per cent of the shares listed on the Saudi exchange. The shares total 8.8 billion and the capitalisation amounts to $155.92 billion. The government has formed many institutional funds that invest in several Saudi listed corporations and owns these shares through its institutional funds. There are many governmental funds and the main institutional investors in Saudi Arabia comprise the Public Investment Fund, the Public Pension Agency and the General Organisations for Social Insurance. It has been argued that wealthy families that used to own small ventures, which were transferred to listed corporations, were able to retain a significant number of shareholdings inside those corporations. These listed family corporations are active in different stock exchange sectors, including energy and communication.

The argument against the Saudi ownership structure is that the CGC provides the listed corporations' articles of association that should state clearly the appointment and removal of the board members and their length in office. The board member should not join the board for more than three years although this is subject to renewal. Board members should not occupy board seats in more than five listed corporations at the same time. The practice of these lawful clauses is undermined by the influence held by rich families and the government. Rich families usually nominate board members for an unlimited period, and they often represent more than five listed corporations simultaneously. In contrast, the government usually influences the appointment and removal of board members in the listed corporations where it holds a significant number of its shareholdings. The supporters of government ownership argue that the government has more than enough votes to replace its representatives in those listed corporations' boards. In the case of the *Saudi Arabian Mining* Company, the government was able to elect five out of nine of its board members on the basis of its ownership of fifty per cent of the company's shares. Opponents of the government and rich families' impact on the ownership structure argue that permitting the board members to work for an indeterminate mandate and time weakens the board members' contribution to the corporation. In particular, the shareholders' representatives on the board would not be able to challenge those sent by the government and the rich families when making decisions given the power imbalance.

The categories of board membership were examined in Section Six. The CGC recognises the implications surrounding the presence of executive, non-executive and independent members on the listed corporations' boards. It was demonstrated that a corporation board's Nomination and Remuneration Committee plays a major role in selecting non-executive and independent members to join the corporation's general meeting. The Capital Market Authority's General Department of Corporate Governance also carries out an important task when evaluating listed corporations' boards' annual reports in order to check for non-executive and independent members.

The board sub-committees were the focus of Section Eight. The CGC is flexible in terms of encouraging the board to decide what kinds of co-operative committees should be created. However, it advises that the board should at least establish an audit committee and a nomination and remuneration committee. These co-operative committees need to be stated clearly in the board annual report. Although the board can delegate some of its jurisdictions to be managed by the co-operative committees, it still has ultimate responsibility for any delegated work undertaken by them. The Capital Market Authority Board has mandated Articles 13, 14 and 15 of the CGC, which are related to board sub-committees, good auditing and accounting measures and which are expected to be feasible in listed corporations. However, the audit committee should contain at least three members, both non-executive and independent, who are experts in finance, auditing and accounting, to be part of this committee. Specifically, the audit committee is accountable for checking the usefulness of the internal audit system, charging and discharging the external auditors, examining jointly with the external auditors the corporation's audit plan and the board's annual report. The Capital Market Authority Board has recently begun to list companies in breach of audit committee requirements as stated in the CGC. However, it does not indicate whether the external auditors encounter difficulties from board members or corporation employees when carrying out their duties. The Nomination and Remuneration Committee's remit was also outlined, including recommending new board members, updating the required certificates for board membership, discussing the board's strengths and weaknesses, checking the independence of non-executive and independent members, ensuring the absence of conflicts of interest and proposing board members' compensations.

Board members' compensation was debated in Section Nine. Saudi board members' compensation arrangements are in a very poor state. The Consultative Council recently evaluated remuneration as not more than $133,333 per member, including, surprisingly, executive members. The CGC indicates that the board members' compensation policy should be stated in the corporation's articles of association. Compensations can be awarded as salaries, bonuses and attendance payments. The CGC does not define the maximum amount for remunerations, but states as a condition that they should be approved by the general meeting and included in the board's annual report.

Chapter Eight debated current disclosure and transparency practices in the Saudi corporate governance framework. This subject occupies much space in the corporate governance literature. Some corporate governance observers contend that corporate governance law should concentrate more on the subject of disclosure and transparency. Disclosure and transparency was defined as the methodology by which information about current sets, decisions and actions is made obtainable and understandable. The OECD principles of corporate governance concentrate on disclosure and transparency and provide guidelines on the subject. Disclosure and transparency aim to assist shareholders in obtaining correct information about their corporations' financial situations to enable them to take appropriate decisions, to display the corporation's actions, to identify any fraud and manipulation dealings and to make the capital market more equitable in terms of monitoring the corporations' managements and their submissions. Article 9 of the CGC and Articles 43, 44 and 45 of the Listing Rules offer a variety of disclosure and transparency aspects that are supposed to meet the London stock exchange standards in regard to good practice. The CGC also states that the corporation's articles of association should illustrate the board's supervisory mechanisms for disclosure and transparency, as well as their implementation.

The significance of disclosure and transparency in the boards' annual reports was deliberated. It was demonstrated that the boards' annual reports were thought to be a major reason behind the Saudi market catastrophe in 2006. The boards' annual reports at the time did not fulfil disclosure and transparency requirements since the stipulations then related only to balance sheets, auditors' reports, and profit and loss accounts. Internationally, it was found that boards' annual reports did not predict risks and did not display correct information in cases of corporate scandals, as in the Saudi case.

The CGC insists that a corporation's information and its board's annual report should be up-to-date and available. Shareholders should have the same right of access to their corporations' information and annual reports as board members and top management. The CGC is thought to be satisfied with this restriction as the annual report is the only singular evidence of the corporation's board and management performance. It has been revealed that most Saudi shareholders may encounter barriers to understanding annual reports, especially in terms of some financial and legal terminology; in consequence, the board's annual report should be comprehensible and logical with regard to financial and legal features. The CGC instructs that listed corporations should use current technology to inform their shareholders about information and annual reports. In particular, the employment of reputable external auditors and reliable internal audit systems is strongly advised in order to produce annual reports and information of a high standard. The CGC does not comment on this matter, despite the consideration given to the matter by international corporate governance ideologies, namely the OECD principles of corporate governance. Several corporate governance researchers, who have found the largest corporations to produce higher quality annual reports than smaller ones, support the presence of reputable external auditors and internal audit systems.

Chapter Nine examined current shareholders' rights practices in the Saudi corporate governance framework. This chapter responded to a significant question of the study, namely to what extent shareholders' rights are looked after in the current Saudi corporate governance system and how shareholders' rights are met by listed corporations. The financial rights of shareholders were accounted in Section Two, including the right to gain dividends, the right to a share of the corporation's assets upon liquidation and the right of disposition with respect to shares. It was stated that the dividends policy is discussed under the CL rather than the CGC. Moreover, the dividends circulation date is left to the corporation's general meeting under the CGC, although some listed corporations including *Etihad Etisalat* and *SAMBA Financial Group* have started to circulate dividends on a half-year and quarterly basis instead of annually. Overall, therefore, the CGC has a lack of legal articles that promote shareholders' financial rights, especially rights related to a share of the corporation's assets upon liquidation and disposition with respect to shares.

The administrative rights of shareholders were explained in Section Three. It was indicated that the forum where shareholders can claim their rights is the corporation general meeting. The discussion focused on three kinds of general meeting: the foundation general meeting, the ordinary general meeting and the extraordinary general meeting, each of which has been accorded a variety of responsibilities by the Saudi legislator. The foundation general meeting is liable for ensuring all the corporation's capital has been subscribed by all the shareholders, for finalising the company's articles of association, for appointing the board members and the external auditors for no more than five years, and for accounting for the money used in setting up the company. Moreover, the ordinary general meeting is responsible for appointing and reappointing board members for no more than three years, approving the company's proposed net profits and dividends and the date of circulation, agreeing on the board's annual report and permitting either an increase or a decrease in the company's capital. Furthermore, the extraordinary general meeting is responsible for altering the corporation's articles of association, except alterations that would negatively influence the shareholders' financial and administrative rights. In particular, there are a number of avoidable alterations including the power to modify the company's main purpose, transferring the corporation's headquarters to a foreign country and changing the corporation's nationality.

Shareholders' rights relating to the general meeting have been assessed by the CGC as semi-enforceable articles since they are supported by both the CL and the Listing Rules. It is advised that the general meeting be held within three months after the end of the corporation's fiscal year. The board is liable for calling a general meeting; this may be undertaken by the external auditor and at least two shareholders who hold five per cent of the corporation's shareholdings. The CGC gives the shareholders who have five per cent of the corporation's shareholdings the right to add one or more items to the agenda of the general meeting. This right is disputed since it does not support the right of minority shareholders to add to the agenda in the same way as majority shareholders.

Furthermore, information regarding the place and date on which general meetings are to be held, official documentation and the board's annual report should be sent to all shareholders and related parties at least twenty-five days before the general meeting. The Capital Market Authority Board recently penalised some listed corporations for holding the general meeting less than twenty-five days from the date of sending the above-mentioned prerequisites. The Capital Market Authority Board has also disciplined corporations that failed to issue their board's annual reports within thirty days of finishing their fiscal year. The minutes of general meetings are not published under the CGC; therefore, all shareholders and the Capital Market Authority should be informed of the content of the minutes within ten days of the general meeting. However, unlike the UK Companies Act, which insists that these minutes should be kept for at least ten years, the CGC makes no recommendations regarding the period of time.

Shareholders' voting rights have been contended. The CGC prompts the corporation's board to safeguard this essential right. The CGC also encourages the cumulative voting process during general meetings instead of the continental voting method. The cumulative voting method supports minority shareholders' chances of having their representatives on the corporation's board, as absent shareholders can delegate other individuals, except other board members and corporation employees, to represent them in the general meeting by providing a letter of authorisation. Voting by proxy is not recognised by the CGC, suggesting that the CGC does not keep track of international corporate governance practices regarding this matter. With the permission of the Capital Market Authority Board, some listed corporations have embarked upon the process of setting up distance voting for absent shareholders. This process would lessen the need for a proxy if it were adequate and applied appropriately.

The shareholders' right to appoint and remove board members has been stated under both the CGC and the CL. It has been explained that the Saudi concentrated ownership pattern is very evident regarding the nomination and dismissal of board members since the government and the rich families substantially affect shareholders' rights to appoint and remove board members. The CGC designates that shareholders' rights of approval and dismissal of board members should be stated clearly in the corporation's articles of association and that shareholders should retain full control over this right even if the corporation's articles of association provide otherwise. This trend can be found under the UK Companies Act, which states that board members may be dismissed without justification. However, in practice, a written letter from the general meeting usually supports the dismissal. The Capital Market Authority Board recently launched punitive measures against some listed corporations in violation of the requirement to appoint and remove board members without informing the Capital Market Authority Board and the stock exchange about alterations in their board members' positions.

On the other hand, the shareholders' right to sue (action in liability) board members is significant and has been highlighted by the CL. The board member has two legal responsibilities: the first is criminal responsibility, which includes any cheating and stealing; the second is civil responsibility, which relates to any negligence and breach of duty and trust. Article 78 of the CL refers to litigation against board members by shareholders. This article assures shareholders of the right to sue board members on behalf of the corporation in the event of harm done to the shareholder. The shareholder is expected to inform the corporation about their intention to sue and litigate on behalf of the corporation prior to taking action.

10.2 Recommendations for the Reform and Improvement of Corporate Governance in Saudi Arabia

Some recommendations and suggestions emerged from the research, which relate to advancing the practices of a diverse range of corporate governance issues in Saudi Arabia. These are outlined below.

10.2.1 Specific Recommendations

There is a need to create a separate, independent organisation to look after corporate governance aspects in Saudi Arabia. This body's aims would be to increase the awareness of corporate governance, to assist the listed corporations in implementing and overseeing corporate governance practices, and to connect with local and international organisations that are working to inspire good corporate governance practices. Thus, the General Department of Corporate Governance under the supervision of the Capital Market Authority would be suggested as a sector-based option for the Saudi external corporate governance institutions. Nevertheless, in order to ensure the independency and the separation of power between this department and the Capital Market Authority, a general independent body for corporate governance is strongly recommended.

It is also necessary for Saudi academic attitudes to improve towards corporate governance practices. Therefore, corporate governance publications, conferences, workshops and seminars are called for. In addition, Saudi public and private universities should teach corporate governance as an academic module in line with international universities and academic institutes where it is taught and its significance in contemporary business society recognised. Several UK universities teach corporate governance as an academic model to develop a business society that raises the value of corporate governance.

There is additionally a need to mandate all CGC articles on all listed corporations' dealings by the Capital Market Authority Board. In particular, CGC should include sanctions for non-compliant listed corporations with its articles. Given the authority of the Committees for the Resolution of Securities Disputes and the Capital Market Authority Board to impose sanctions, it would be appropriate to differentiate when issuing penalties between first and second offences committed by listed corporations and individuals. The General Department of Corporate Governance was found to be faced with a major task in reviewing listed corporations' board annual reports; any listed corporation in breach is then fined by the Capital Market Authority Board. Were the General Department of Corporate Governance to distinguish between first or second violations, arbitrations relating to the latter could be carried out by the CRSD instead.

The Saudi corporate legal structure should be reformed to embrace the current and future large wave of international corporate laws. In particular, the Saudi regulator should consider corporate governance from an Islamic perspective, since *Shari'a* legislation is declared by the regulator to be the primary law.

10.2.2 Recommendation on the Definition of Corporate Governance

Further to the discussion in Chapter Three, the CGC does not have a definition for the term 'corporate governance'. Therefore, the Capital Market Authority Board could draft a definition into the CGC based on current international corporate governance principles including those of the OECD principles of corporate governance or the Cadbury report. Significantly, in the vast majority of Arabic books and articles on corporate governance, there is a need for a general and acceptable term to relay the English 'corporate governance' in order to eliminate the ambiguities inherent in the Arabic translation '*hawkama'*. Such a term should be used consistently.

10.2.3 Recommendation on Corporate Social Responsibility

The CGC should stress and clarify the importance of CSR with the aim of achieving good corporate governance practices. Furthermore, CSR should be taken seriously by listed corporations. This can be achieved if the Capital Market Authority Board requires listed corporations to record in their board's annual reports, as part of disclosure and transparency requirements, the corporation's contribution in terms of CSR.

10.2.4 Recommendation on Corporate Governance Self-Regulatory Policies

The number of Saudi listed corporations that have created self-regulatory corporate governance policies is still small, numbering around twenty-five out of 150 listed corporations. Therefore, more efforts by the Capital Market Authority Board are strongly recommended to encourage listed corporations to establish and implement their own self-regulatory corporate governance policies. At present, any self-regulatory corporate governance policies found are copied and pasted from the CGC without alteration and as such are typical examples of company window-dressing which do not assure good corporate governance practices. Saudi market contributors continuously note such violations of either the CGC or any self-regulatory corporate governance policies where they have been established. Hence, it is difficult to expect listed corporations to be well-informed about the practical aspects of self-regulatory policies. Self-regulatory policies of this nature should therefore be subject to the successful application of global corporate governance codes such as the OECD principles of corporate governance and the UK Corporate Governance Code.

10.2.5 Recommendations on Board of Directors

Further to the discussion in Chapter Seven, board members should be highly and appropriately qualified in finance, law, management and economics. Accordingly, the CGC should make this a mandatory condition for all board members and top executives. Board members and top executives should be trained in a designated institute of directors as found in the UK but which has yet to be established in Saudi Arabia. The institute of directors would take on a range of useful roles and responsibilities, including raising awareness of the advantages of corporate governance among directors and top executives and enhancing their management skills.

Moreover, even though the CGC supported the separation of the roles of board chairman and chief executive, this step has not been fully translated into practice, largely due to the presence of the rich families and the government ownership pattern throughout the vast majority of listed corporations. Hence, the Capital Market Authority Board should make greater efforts to ensure this regulation is implemented, in order to minimise the negative influence exerted by the rich families and the government on the nomination of board members for an indeterminate period of time and board mandate. On the other hand, a clear classification of the board members' duties including the duty of care, the duty of loyalty and the duty to act within their powers would inspire the board members to control the corporation responsibly and to behave truthfully and accountably to all the groups beneficial to the corporation. Therefore, the CGC should comprise requirements to clearly profile these duties.

Further, the Capital Market Authority Board should cancel the CGC exceptions regarding conflicts of interest within the board under Article 18, as these concessions allow board members to compete and trade in their corporations' submissions. In contrast, the Committees for the Resolution of Securities Disputes should not have the right to imprison individuals in breach of the regulations on conflict of interests and insider trading. Good practice regarding this fundamental principle is exemplified in the UK Companies Act, which transmits these deeds to be a matter for the Criminal Prosecution Service.

The CGC should enact specific points to define executive members: they should not hold positions for more than three years without the shareholders' agreement and there should be full transparency and disclosure of the board executive members' revenue. These significant points can be regulated based on the Cadbury report.

The Saudi board meeting aims to be an open discussion, yet the CGC does not frame noteworthy criteria for board meetings. Questions to be addressed include; how often board members should meet, how many members should be present at a meeting for it to be legally acceptable, and how many votes should be combined to shape the board's final decision. The CL specifies that the meeting of the board of directors shall be valid only if attended by at least one half of the directors, provided that the number of those present shall be not less than three, unless the corporation's articles of association provide for a higher number. In addition, the resolutions of the board shall be adopted by a majority vote of the directors present or represented. In the event of a tie, the chairman's vote shall carry, unless the corporation's articles of association provide otherwise. None of these requisites appear in the CGC. In view of their significance in civil and criminal liabilities when shareholders litigate against board members, they should be transmitted under the CGC.

10.2.6 Recommendations on Board of Directors Sub-Committees

In order to give the board of directors more power to fulfil its duties and responsibilities effectively, the CGC should suggest several board sub-committees such as a risk committee, a finance and investment committee, a quality committee and a workforce committee to operate alongside the aforesaid audit and the nomination and remuneration committees.

The CGC does not comment on inviting experienced non-members to join the audit committee meeting as required. This is good practice, as suggested in the Cadbury report, and should be promulgated by the CGC. It is one of a number of noteworthy items from the Cadbury report that the CGC would be well advised to consider. Others include the stipulation that the audit committee should meet at least twice a year, that the external auditor and finance manager as well as other board members should frequently join the audit committee meetings, and that the audit committee and the external auditor should have at least one special meeting without the above-mentioned groups present in order to eliminate any confusion over members' concerns.

The CGC should also highlight difficulties, which should not be presented when the external auditors review the corporation's information and annual report. The CL takes a valuable step towards the active operational role of the external auditors. It also validates that any board member, executive or employee attempting to hinder the external auditors will be sued. It is thought that this clause should also be adopted by the CGC.

In addition, the CGC omits to mention how many members the nomination and remuneration committee should consist of. This is not in line with the recommendations for good practice found in the Greenbury report, which calls for three non-executive members. In addition, it is of concern that the CGC does not discuss how the nomination and remuneration committee members should be rewarded. Again, guidance on good practice may be gleaned from the Greenbury report's recommendations that committee members be compensated with fixed lump sum payments determined by the board within the limits agreed in the corporation's articles of association and which should reflect the amount of time they commit to corporation business.

10.2.7 Recommendation on Disclosure and Transparency

Further to the discussion in Chapter Eight, the disclosure and transparency requirements under the CGC and the Listing Rules are adequate if implemented. Failure to do so, however, renders them ineffective for the purposes of promoting corporate governance practices. In particular, the majority of Saudi share investors encounter difficulties in understanding the financial and legal terminology contained in the board's annual report; according to the requirements for disclosure and transparency, such language should be presented accessibly in the annual report.

10.2.8 Recommendations on General Meetings and Voting

General meeting and board minutes should be kept for a long period of time, initially ten years, according to the UK Companies Act. The Capital Market Authority Board should incorporate this measure in the CGC since the minutes can serve as important evidence for or against board members in disputes. In addition, the CL instead of the CGC deliberate on the types and jurisdictions of Saudi general meetings (foundation, ordinary and extraordinary). It has been shown that these are well-structured pieces of regulation in accordance with successful international practices. It would therefore be advisable for them to be reiterated in the CGC by the Capital Market Authority Board.

It has been argued that the cumulative voting process is sustained by the CGC; it should thus be used and mandated in a general meeting instead of using the continental voting method, since it supports the likelihood of minority shareholders locating their representatives in the boardroom. Moreover, the distance voting process, which is now used by the majority of Saudi listed corporations in their general meetings should be codified under the CGC to make electronic voting lawful for absent shareholders during the general meetings. The CGC should also recognise voting by proxy as it reflects global corporate governance principles in support of this method.

10.2.9 Recommendations on Shareholders

Arising from the discussion in Chapter Nine, creating a shareholders' association, which is in existence in many developed countries, particularly the UK, would be recommended, as it would aid shareholders in achieving and exercising their rights. It could also provide training and advice on matters conducive to asserting shareholders' rights as an essential internal part of corporate governance.

The CL rather than the CGC have hitherto regulated corporation dividend policies. Accordingly, the dividend policy should be structured under the CGC in order to avoid abuse by the listed corporations' board members and top executives. Currently the corporation's dividend circulation date is left to the corporation's ordinary general meeting to adopt but this element should be added to the CGC to legalise the details. Shareholders' financial rights related to a share of the corporation's assets upon liquidation and disposition with respect of shares should be clarified in detail under the CGC by the Capital Market Authority Board as a Saudi market regulator, since at present neither the CGC nor the CL explain these features.

In addition, the CGC demonstrates a lack of articulacy regarding the shareholders' right to sue and litigate against board members (action in liability). The Capital Market Authority Board should promulgate the UK derivative actions under the CGC since the present article in the CGC regarding the litigation of board members by the shareholders is insufficient and fundamentally unclear.

The Capital Market Authority Board should amend Article 5-F of the CGC in order to protect minority shareholders' rights. The article gives shareholders who hold five per cent of the corporation's shares the right to add one or more item to the agenda to be discussed when the general meeting takes place, thus allowing majority shareholders to shape the agenda freely. Furthermore, the Capital Market Authority Board should amend Article 5-B of the CGC. The article does not define the extent to which shareholders are eligible to put forward specific questions during the general meeting, whereas both board members and external auditors have the right to ignore certain questions if they consider that these questions would damage the corporation's interests.

10.3 Future Research Avenues

Corporate governance provisions and practices in Saudi Arabia have been considered by few studies in accordance with the research knowledge. The current study is one of the first to investigate corporate governance provisions and practices from a law perspective. Therefore, there is a need both for more research from different fields of law, as well as for literature to fill the gap relating to corporate governance in Saudi Arabia. Some suggestions for future research regarding corporate governance in Saudi Arabia are as follows:

1. Ways to incorporate an Islamic perspective of corporate governance inside either Islamic or conventional institutions.

2. Ways to reform the roles of the boards of directors in Saudi listed corporations. This might include reform of the real impartiality of non-executive members, the duties and responsibilities of boards of directors, and the board of directors' sub-committees.

3. Assisting minority shareholders in exercising their rights within the Saudi corporate governance framework.

4. Encouraging and improving the application of CSR criteria in the Saudi market.

5. Promoting and advancing the self-regulatory corporate governance policies of Saudi listed corporations.

10.4 Contribution to Knowledge

The first contribution of this study consists of it assisting to fill the gap in the literature concerning current corporate governance practices in Saudi Arabia from a law perspective. The second contribution is to reform the current Saudi corporate governance system to align with international standards. The third contribution is the involvement of an Islamic perspective for corporate governance in order to achieve valuable corporate governance preparations. The final contribution lies in identifying the development of a Saudi corporate governance framework and the Saudi institutional framework of corporate governance.

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Appendices

Capital Market Authority

Corporate Governance Regulations in the Kingdom of Saudi Arabia

Issued by the Board of Capital Market Authority Pursuant to Resolution No. 1/212/2006 dated 21/10/1427AH (corresponding to 12/11/2006) based on the Capital Market Law issued by Royal Decree No. M/30 dated 2/6/1424AH

Amended by Resolution of the Board of the Capital Market Authority Number 1-10-2010 Dated 30/3/1431H corresponding to 16/3/2010G

English Translation of the Official Arabic Text Arabic is the official language of the Capital Market Authority

The current version of these Rules, as may be amended, can be found at on the CMA website: www.cma.org.sa

CONTENTS

PART 1
Preliminary Provisions

Article 1: Preamble

a) These Regulations include the rules and standards that regulate the management of joint stock companies listed in the Exchange to ensure their compliance with the best governance practices that would ensure the protection of shareholders' rights as well as the rights of stakeholders.
b) These Regulations constitute the guiding principles for all companies listed in the Exchange unless any other regulations, rules or resolutions of the Board of the Authority provide for the binding effect of some of the provisions herein contained.
c) As an exception of paragraph (b) of this article, a company must disclose in the Board of Directors` report, the provisions that have been implemented and the provisions that have not been implemented as well as the reasons for not implementing them.

Article 2: Definitions

a) Expression and terms in these regulations have the meanings they bear in the Capital Market Law and in the glossary of defined terms used in the regulations and the rules of the Capital Market Authority unless otherwise stated in these regulations.
b) For the purpose of implementing these regulations, the following expressions and terms shall have the meaning they bear as follows unless the contrary intention appears:

Independent Member: A member of the Board of Directors who enjoys complete independence. By way of example, the following shall constitute an infringement of such independence:

1. He/she holds a five per cent or more of the issued shares of the company or any of its group.
2. Being a representative of a legal person that holds a five per cent or more of the issued shares of the company or any of its group.
3. He/she, during the preceding two years, has been a senior executive of the company or of any other company within that company's group.

4. He/she is a first-degree relative of any board member of the company or of any other company within that company’s group.
5. He/she is first-degree relative of any of senior executives of the company or of any other company within that company’s group.
6. He/she is a board member of any company within the group of the company which he is nominated to be a member of its board.
7. If he/she, during the preceding two years, has been an employee with an affiliate of the company or an affiliate of any company of its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, had a controlling interest in any such party.

Non-executive director: A member of the Board of Directors who does not have a full-time management position at the company, or who does not receive monthly or yearly salary.

First-degree relatives: father, mother, spouse and children.

Stakeholders: Any person who has an interest in the company, such as shareholders, employees, creditors, customers, suppliers, community.

Accumulative Voting: a method of voting for electing directors, which gives each shareholder a voting rights equivalent to the number of shares he/she holds. He/she has the right to use them all for one nominee or to divide them between his/her selected nominees without any duplication of these votes. This method increases the chances of the minority shareholders to appoint their representatives in the board through the right to accumulate votes for one nominee.

Minority Shareholders: Those shareholders who represent a class of shareholders that does not control the company and hence they are unable to influence the company.

PART 2
Rights of Shareholders and the General Assembly

Article 3: General Rights of Shareholders

A Shareholder shall be entitled to all rights attached to the share, in particular, the right to a share of the distributable profits, the right to a share of the company's assets upon liquidation; the right to attend the General Assembly and participate in deliberations and vote on relevant decisions; the right of disposition with respect to shares; the right to supervise the Board of Directors activities, and file responsibility claims against board members; the right to inquire and have access to information without prejudice to the company's interests and in a manner that does not contradict the Capital Market Law and the Implementing Rules.

Article 4: Facilitation of Shareholders Exercise of Rights and Access to Information

a) The company in its Articles of Association and by-laws shall specify the procedures and precautions that are necessary for the shareholders' exercise of all their lawful rights.
b) All information which enable shareholders to properly exercise their rights shall be made available and such information shall be comprehensive and accurate; it must be provided and updated regularly and within the prescribed times; the company shall use the most effective means in communicating with shareholders. No discrepancy shall be exercised with respect to shareholders in relation to providing information.

Article 5: Shareholders Rights related to the General Assembly

a) A General Assembly shall convene once a year at least within the six months following the end of the company's financial year.
b) The General Assembly shall convene upon a request of the Board of Directors. The Board of Directors shall invite a General Assembly to convene pursuant to a request of the auditor or a number of shareholders whose shareholdings represent at least 5% of the equity share capital.
c) Date, place, and agenda of the General Assembly shall be specified and announced by a notice, at least 20 days prior to the date the meeting; invitation for the meeting shall

be published in the Exchange' website, the company's website and in two newspapers of voluminous distribution in the Kingdom. Modern high tech means shall be used in communicating with shareholders.

d) Shareholders shall be allowed the opportunity to effectively participate and vote in the General Assembly; they shall be informed about the rules governing the meetings and the voting procedure.

e) Arrangements shall be made for facilitating the participation of the greatest number of shareholders in the General Assembly, including *inter alia* determination of the appropriate place and time.

f) In preparing the General Assembly's agenda, the Board of Directors shall take into consideration matters shareholders require to be listed in that agenda; shareholders holding not less than 5% of the company's shares are entitled to add one or more items to the agenda upon its preparation.

g) Shareholders shall be entitled to discuss matters listed in the agenda of the General Assembly and raise relevant questions to the board members and to the external auditor. The Board of Directors or the external auditor shall answer the questions raised by shareholders in a manner that does not prejudice the company's interest.

h) Matters presented to the General Assembly shall be accompanied by sufficient information to enable shareholders to make decisions.

i) Shareholders shall be enabled to peruse the minutes of the General Assembly; the company shall provide the Authority with a copy of those minutes within 10 days of the convening date of any such meeting.

j) The Exchange shall be immediately informed of the results of the General Assembly.

Article 6: Voting Rights

a) Voting is deemed to be a fundamental right of a shareholder, which shall not, in any way, be denied. The company must avoid taking any action which might hamper the use of the voting right; a shareholder must be afforded all possible assistance as may facilitate the exercise of such right.
b) In voting in the General Assembly for the nomination to the board members, the accumulative voting method shall be applied.
c) A shareholder may, in writing, appoint any other shareholder who is not a board member and who is not an employee of the company to attend the General Assembly on his behalf.
d) Investors who are judicial persons and who act on behalf of others - e.g. investment funds- shall disclose in their annual reports their voting policies, actual voting, and ways of dealing with any material conflict of interests that may affect the practice of the fundamental rights in relation to their investments.

Article 7: Dividends Rights of Shareholders

a) The Board of Directors shall lay down a clear policy regarding dividends, in a manner that may realize the interests of shareholders and those of the company; shareholders shall be informed of that policy during the General Assembly and reference thereto shall be made in the report of the Board of Directors.
b) The General Assembly shall approve the dividends and the date of distribution. These dividends, whether they be in cash or bonus shares shall be given, as of right, to the shareholders who are listed in the records kept at the Securities Depository Centre as they appear at the end of trading session on the day on which the General Assembly is convened.

PART 3
Disclosure and Transparency

Article 8: Policies and Procedure related to Disclosure

The company shall lay down in writing the policies, procedures and supervisory rules related to disclosure, pursuant to law.

Article 9: Disclosure in the Board of Directors' Report

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 the following:

a) The implemented provisions of these Regulations as well as the provisions which have not been implemented, and the justifications for not implementing them.
b) Names of any joint stock company or companies in which the company Board of Directors member acts as a member of its Board of directors.
c) Formation of the Board of Directors and classification of its members as follows: executive board member, non-executive board member, or independent board member**.**
d) A brief description of the jurisdictions and duties of the Board's main committees such as the Audit Committee, the Nomination and Remuneration Committee; indicating their names, names of their chairmen, names of their members, and the aggregate of their respective meetings.
e) Details of compensation and remuneration paid to each of the following:
    1. The Chairman and members of the Board of Directors.
    2. The Top Five executives who have received the highest compensation and remuneration from the company. The CEO and the chief finance officer shall be included if they are not within the top five.
    3. For the purpose of this paragraph, "compensation and remuneration" means salaries, allowances, profits and any of the same; annual and periodic bonuses related to performance; long or short- term incentive schemes; and any other rights *in rem*.

a) Any punishment or penalty or preventive restriction imposed on the company by the Authority or any other supervisory or regulatory or judiciary body.
b) Results of the annual audit of the effectiveness of the internal control procedures of the company.

PART 4

Board of Directors

Article 10: Main Functions of the Board of Directors

Among the main functions of the Board is the following:

a) Approving the strategic plans and main objectives of the company and supervising their implementation; this includes:
   1. Laying down a comprehensive strategy for the company, the main work plans and the policy related to risk management, reviewing and updating of such policy.
   2. Determining the most appropriate capital structure of the company, its strategies and financial objectives and approving its annual budgets.
   3. Supervising the main capital expenses of the company and acquisition/disposal of assets.
   4. Deciding the performance objectives to be achieved and supervising the implementation thereof and the overall performance of the company.
   5. Reviewing and approving the organizational and functional structures of the company on a periodical basis.

b) Lay down rules for internal control systems and supervising them; this includes:
   1. Developing a written policy that would regulates conflict of interest and remedy any possible cases of conflict by members of the Board of Directors, executive management and shareholders. This includes misuse of the company's assets and facilities and the arbitrary disposition resulting from dealings with the related parties.
   2. Ensuring the integrity of the financial and accounting procedures including procedures related to the preparation of the financial reports.
   3. Ensuring the implementation of control procedures appropriate for risk management by forecasting the risks that the company could encounter and disclosing them with transparency.
   4. Reviewing annually the effectiveness of the internal control systems.

c) Drafting a Corporate Governance Code for the company that does not contradict the provisions of this regulation, supervising and monitoring in general the effectiveness of the code and amending it whenever necessary.

d) Laying down specific and explicit policies, standards and procedures, for the membership of the Board of Directors and implementing them after they have been approved by the General Assembly.

e) Outlining a written policy that regulate the relationship with stakeholders with a view to protecting their respective rights; in particular, such policy must cover the following:

    1. Mechanisms for indemnifying the stakeholders in case of contravening their rights under the law and their respective contracts.
    2. Mechanisms for settlement of complaints or disputes that might arise between the company and the stakeholders.
    3. Suitable mechanisms for maintaining good relationships with customers and suppliers and protecting the confidentiality of information related to them.
    4. A code of conduct for the company's executives and employees compatible with the proper professional and ethical standards, and regulate their relationship with the stakeholders. The Board of Directors lays down procedures for supervising this code and ensuring compliance there with.
    5. The Company's social contributions.

a) Deciding policies and procedures to ensure the company's compliance with the laws and regulations and the company's obligation to disclose material information to shareholders, creditors and other stakeholders.

Article 11: Responsibilities of the Board

a) Without prejudice to the competences of the General Assembly, the company's Board of Directors shall assume all the necessary powers for the company's management. The ultimate responsibility for the company rests with the Board even if it sets up committees or delegates some of its powers to a third party. The Board of Directors shall avoid issuing general or indefinite power of attorney.

b) The responsibilities of the Board of Directors must be clearly stated in the company's Articles of Association.

c) The Board of Directors must carry out its duties in a responsible manner, in good faith and with due diligence. Its decisions should be based on sufficient information from the executive management, or from any other reliable source.

d) A member of the Board of Directors represents all shareholders; he undertakes to carry out whatever may be in the general interest of the company, but not the interests of the group he represents or that which voted in favour of his appointment to the Board of Directors.
e) The Board of Directors shall determine the powers to be delegated to the executive management and the procedures for taking any action and the validity of such delegation. It shall also determine matters reserved for decision by the Board of Directors. The executive management shall submit to the Board of Directors periodic reports on the exercise of the delegated powers.
f) The Board of Directors shall ensure that a procedure is laid down for orienting the new board members of the company's business and, in particular, the financial and legal aspects, in addition to their training, where necessary.
g) The Board of Directors shall ensure that sufficient information about the company is made available to all members of the Board of Directors, generally, and, in particular, to the non-executive members, to enable them to discharge their duties and responsibilities in an effective manner.
h) The Board of Directors shall not be entitled to enter into loans which spans more than three years, and shall not sell or mortgage real estate of the company, or drop the company's debts, unless it is authorized to do so by the company's Articles of Association. In the case where the company's Articles of Association includes no provisions to this respect, the Board should not act without the approval of the General Assembly, unless such acts fall within the normal scope of the company's business.

Article 12: Formation of the Board

Formation of the Board of Directors shall be subject to the following:

a) The Articles of Association of the company shall specify the number of the Board of Directors members, provided that such number shall not be less than three and not more than eleven.
b) The General Assembly shall appoint the members of the Board of Directors for the duration provided for in the Articles of Association of the company, provided that such duration shall not exceed three years. Unless otherwise provided for in the Articles of Association of the company, members of the Board may be reappointed.

c) The majority of the members of the Board of Directors shall be non-executive members.
d) It is prohibited to conjoin the position of the Chairman of the Board of Directors with any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager.
e) The independent members of the Board of Directors shall not be less than two members, or one-third of the members, whichever is greater.
f) The Articles of Association of the company shall specify the manner in which membership of the Board of Directors terminates. At all times, the General Assembly may dismiss all or any of the members of the Board of Directors even though the Articles of Association provide otherwise.
g) On termination of membership of a board member in any of the ways of termination, the company shall promptly notify the Authority and the Exchange and shall specify the reasons for such termination.
h) A member of the Board of Directors shall not act as a member of the Board of Directors of more than five joint stock companies at the same time.
i) Judicial person who is entitled under the company's Articles of Association to appoint representatives in the Board of Directors, is not entitled to nomination vote of other members of the Board of Directors.

Article 13: Committees of the Board

a) A suitable number of committees shall be set up in accordance with the company's requirements and circumstances, in order to enable the Board of Directors to perform its duties in an effective manner.
b) The formation of committees subordinate to the Board of Directors shall be according to general procedures laid down by the Board, indicating the duties, the duration and the powers of each committee, and the manner in which the Board monitors its activities. The committee shall notify the Board of its activities, findings or decisions with complete transparency. The Board shall periodically pursue the activities of such committees so as to ensure that the activities entrusted to those committees are duly performed. The Board shall approve the by-laws of all committees of the Board, including, *inter alia*, the Audit Committee, Nomination and Remuneration Committee.

c) A sufficient number of the non-executive members of the Board of Directors shall be appointed in committees that are concerned with activities that might involve a conflict of interest, such as ensuring the integrity of the financial and non-financial reports, reviewing the deals concluded by related parties, nomination to membership of the Board, appointment of executive directors, and determination of remuneration.

Article 14: Audit Committee

a) The Board of Directors shall set up a committee to be named the "Audit Committee". Its members shall not be less than three, including a specialist in financial and accounting matters. Executive board members are not eligible for Audit Committee membership.
b) The General Assembly of shareholders shall, upon a recommendation of the Board of Directors, issue rules for appointing the members of the Audit Committee and define the term of their office and the procedure to be followed by the Committee.
c) The duties and responsibilities of the Audit Committee include the following:
    1. To supervise the company's internal audit department to ensure its effectiveness in executing the activities and duties specified by the Board of Directors.
    2. To review the internal audit procedure and prepare a written report on such audit and its recommendations with respect to it.
    3. To review the internal audit reports and pursue the implementation of the corrective measures in respect of the comments included in them.
    4. To recommend to the Board of Directors the appointment, dismissal and the Remuneration of external auditors; upon any such recommendation, regard must be made to their independence.
    5. To supervise the activities of the external auditors and approve any activity beyond the scope of the audit work assigned to them during the performance of their duties.
    6. To review together with the external auditor the audit plan and make any comments thereon.
    7. To review the external auditor's comments on the financial statements and follow up the actions taken about them.

8. To review the interim and annual financial statements prior to presentation to the Board of Directors; and to give opinion and recommendations with respect thereto.
9. To review the accounting policies in force and advise the Board of Directors of any recommendation regarding them.

Article 15: Nomination and Remuneration Committee

a) The Board of Directors shall set up a committee to be named “Nomination and Remuneration Committee”.
b) The General Assembly shall, upon a recommendation of the Board of Directors, issue rules for the appointment of the members of the Nomination and Remuneration Committee, terms of office and the procedure to be followed by such committee.
c) The duties and responsibilities of the Nomination and Remuneration Committee include the following:
    1. Recommend to the Board of Directors appointments to membership of the Board in accordance with the approved policies and standards; the Committee shall ensure that no person who has been previously convicted of any offense affecting honour or honesty is nominated for such membership.
    2. Annual review of the requirement of suitable skills for membership of the Board of Directors and the preparation of a description of the required capabilities and qualifications for such membership, including, *inter alia*, the time that a Board member should reserve for the activities of the Board.
    3. Review the structure of the Board of Directors and recommend changes.
    4. Determine the points of strength and weakness in the Board of Directors and recommend remedies that are compatible with the company’s interest.
    5. Ensure on an annual basis the independence of the independent members and the absence of any conflict of interest in case a Board member also acts as a member of the Board of Directors of another company.
    6. Draw clear policies regarding the indemnities and remunerations of the Board members and top executives; in laying down such policies, the standards related to performance shall be followed.

Article 16: Meetings of the Board

1. The Board members shall allot ample time for performing their responsibilities, including the preparation for the meetings of the Board and the permanent and ad hoc committees, and shall endeavour to attend such meetings.
2. The Board shall convene its ordinary meetings regularly upon a request by the Chairman. The Chairman shall call the Board for an unforeseen meeting upon a written request by two of its members.
3. When preparing a specified agenda to be presented to the Board, the Chairman should consult the other members of the Board and the CEO. The agenda and other documentation should be sent to the members in a sufficient time prior to the meeting so that they may be able to consider such matters and prepare themselves for the meeting. Once convened, the Board shall approve the agenda; should any member of the Board raise any objection to this agenda, the details of such objection shall be entered in the minutes of the meeting.
4. The Board shall document its meetings and prepare records of the deliberations and the voting, and arrange for these records to be kept in chapters for ease of reference.

Article 17: Remuneration and Indemnification of Board Members

The Articles of Association of the company shall set forth the manner of remunerating the Board members; such remuneration may take the form of a lump sum amount, attendance allowance, rights *in rem* or a certain percentage of the profits. Any two or more of these privileges may be conjoined.

Article 18: Conflict of Interest within the Board

a) A Board member shall not, without a prior authorization from the General Assembly, to 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 best bidder. A Board member shall notify the Board of Directors of any personal interest he/she may have in the business and contracts that are completed for the company's account. Such notification shall be entered in the minutes of the meeting. A Board member who is an interested party shall not be entitled to vote on the resolution to be adopted in this regard neither in the General Assembly nor in the Board of Directors. The Chairman of the Board of Directors shall notify the General Assembly, when convened, of the activities and contracts in respect of which a Board member may have a personal interest and shall attach to such notification a special report prepared by the company's auditor.

b) A Board member shall not, without a prior authorization of the General Assembly, to be renewed annually, participate in any activity which may likely compete with the activities of the company, or trade in any branch of the activities carried out by the company.

c) The company shall not grant cash loan whatsoever to any of its Board members or render guarantee in respect of any loan entered into by a Board member with third parties, excluding banks and other fiduciary companies.

PART 5

Closing Provisions

Article 19: Publication and Entry into Force

These regulations shall be effective upon the date of their publication.