Corporate Governance in a Developing World

As they shift towards more market-based economies, Arab companies can no longer afford to neglect demands for greater accountability and transparency in the boardroom.

Ten years ago there was no Arabic term for "corporate governance" in the Middle East and North Africa (MENA) – a region dominated by family and state-owned enterprises.

Attention to governance was piecemeal. Companies had their own practices and policies addressing accountability and social responsibility but there were no regulatory precepts and little attention paid to details of transparency or conflict of interest – issues crucial to the running of a modern business.

Much has changed since then. Today 14 of the 17 MENA economies have a corporate code of some description and "hawkamah" (the recently coined Arabic word for governance) is becoming more than just a catchphrase. But while some countries are making great strides improving accountability and transparency, in many of the countries that need it most - those experiencing political, social and economic transition with an urgent need for foreign investment and jobs - the process has faltered.

Missed opportunity

"They've missed an opportunity," says Nasser Saidi, Middle East economist and government reform advocate. "The Arab Spring – or Arab Firestorm as I call it – has pointed to waste, inefficiencies and lack of transparency in government and the public sector." But despite the perfect timing - history has shown times of crisis present the perfect opportunity for policy change - new governments in these economies are failing to address the issues or pose them to the public.

There has been, says Saidi, too much focus and public debate on politics and not enough on the economy.

Saidi himself is not inexperienced in both the practicalities and the philosophy behind good economic practice. He's been an economics professor (University of Chicago, Institut Universitaire de Hautes Etudes Internationales in Geneva), First Vice-Governor of the Lebanese Central Bank, Minister of Economy & Trade as well as Minister of Industry in Lebanon, a member of the UN Committee for Development Policy, and Chief Economist for the Dubai International Financial Corporation.

As the founder and former CEO of the Dubai-based Hawkamah Corporate Governance Institute, he has realistic expectations. "It's going to be a long drawn-out process. The West is deluding itself if it thinks the issues can be addressed quickly… (but) we shouldn't be impatient. What we've learned through (similar) processes in Eastern Europe, Asia and Latin America is that these things take time."

While deep change in a political, societal and economic context could take five years (at least), integration of corporate governance into the local practice and business culture will take 10 years or more, says Ludo Van der Heyden, the Mubadala Professor of Corporate Governance and Strategy at INSEAD, noting effective management of these developments, and persistent and enlightened commitment of government and business leaders are essential for better practices to take root and become sustainable.

"One should not be too harsh, things are changing, but more effort and time will be required. Governance is an answer to a question, or to a set of questions – and one ought to know and be clear on what these questions are, and how they can best be answered, including what contribution must be made through changed regulation."

"So far in the Gulf, a lot of changed banking regulation has been discussed – but then, somehow, banks were exempted from particular regulations. This is one area where it will be useful for a clearer governance regime to exist."

Governance is a cultural process

The trend towards more stringent corporate governance in the Middle East predates the economic crisis. It began in the early 2000s in response to an evolving financial sector, a shift towards market-based economies, international competitiveness and, in the case of family entities, a desire to shore up succession planning and create strong sustainable companies for future generations.

"Successful companies want to internationalise," insists Leonardo Peklar, Hawkamah's current CEO, noting corporate governance is the noblesse oblige of the business world.

"Some people still understand corporate governance as a window dressing; they would like to do it as fast as possible but that never works. It's a process, you have to embed it, anchor it in your culture."

Capital market regulators and private sector-backed regional initiatives like the Hawkamah Institute and the Pearl Initiative have been instrumental in moving corporate governance across the Middle East and North Africa, from a vague idea into practice. They promote awareness and provide a "how-to" guide and a platform where companies and regulators can share ideas and their experiences implementing policies in the boardroom and workplace.

Family governance

For family businesses, the case for better governance is gaining traction as companies move into the third or fourth generation – a period when problems start. In the Middle East around 45 percent of companies still maintain a family-only board and with dozens of cousins involved there is great complexity in the algorithm of running the business.

Families have always looked with concern to demands for more board "independence", notes Van der Heyden. "The challenge is to make families firms - whether they are European, Singaporean or from the Gulf - understand that having outsiders who are not afraid to speak their mind leads to better business decisions."

The introduction of very basic policies relating to dividends, employment of family members, investments, conflict-resolution and boardroom composition will give companies a much greater chance of sustainability, adds Peklar.

Influence runs deep

The Hawkamah Institute provides analysis, research and technical assistance to family firms and other companies and governments looking to introduce better corporate governance policies as well as providing training programmes and workshops to put governance concepts into reality. The Institute's influence is deep. Its white papers and annual conferences have, on at least two occasions, coincided with the release of pivotal laws influencing corporate governance: legislation on board composition requirements in the United Arab Emirates and the introduction of a corporate governance code in Qatar.

In 2008 in partnership with Standard & Poor's, Hawkamah created the region's first ESG Pan Arab Index assessing listed companies from 11 MENA economies. The tradable index comprising the top 50 companies in the region aims to give asset managers an additional layer of assurance when they invest in the region.

"If you want to attract investors you need to have certain reporting standards and if you are in an emerging market which is perceived to have weaker legal frameworks, the argument goes that you have to go the extra mile to instill confidence in your company," says Peklar.

Van der Heyden agrees. "Weak governance regimes give few rights to investors and shareholders – and that invariably reduces foreign investments. Of course the question is whether one needs foreign investors: if the answer is no, then the governance regime need not pay attention to the demands of foreign investors."

Focus on collective decision-making

In 2013, Hawkamah is focusing its priorities in the boardroom, encouraging the move from "shareholder-centric to board-centric governance".

In other words, a focus on collective decision-making where resolutions are based on what's best for the long-term growth and sustainability of the company rather than what's best for the short-term interest of individual shareholders. "It's a very different dynamic," notes Peklar. "But fortunately lots of companies are realising that corporate governance is not just window dressing or a mere compliance exercise, it's really contributing to better strategic decisions."

Meawhile a case being developed by INSEAD on one of Abu Dhabi's major banks attests to the strong link between improved governance, better business decision-making, and stronger corporate performance. "There is no question that good governance pays in the medium and longer term," concludes Van der Heyden.

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