



**Middle East and North Africa
Corporate Governance Workshop**



**CORPORATE GOVERNANCE
IN
MOROCCO, EGYPT, LEBANON, AND JORDAN
Countries of the MENA Region**

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Regional Corporate Governance Working Group

in collaboration with

**Egyptian Ministry of Foreign Trade
Egyptian Center for Economic Studies
Confederation of Moroccan Employers (CGEM)
Private Sector Task Force on Corporate Governance in Lebanon,
(Lebanese Transparency Association, Secretariat)
Jordanian Forum for Economic Development**

EXECUTIVE SUMMARY

The Global Corporate Governance Forum, the Center for International Private Enterprise (CIPE), and local partners in Egypt, Jordan, Lebanon and Morocco launched a region-wide initiative to assess the state of corporate governance in the Middle East & North Africa (MENA). Meetings in Lebanon, Morocco, and Jordan were attended by representatives from both the private and public sector, including corporate governance practitioners, auditors, and regulatory authorities. Egypt conducted a series of workshops and conferences and developed a report in conjunction with the World Bank assessing the state of corporate governance in Egypt. A regional experts meeting was convened in Cairo in September 2003 to discuss regional challenges and trends in corporate governance and to field recommendations on implementing corporate governance in MENA. The transcripts drawn from these nation-wide and regional meetings provide a candid view of the state of corporate governance in MENA. This paper summarizes the trends and recommendations on corporate governance in the region.

Corporate governance has been promoted at different levels in the countries of the Middle East & North Africa. However, the issue has been approached differently and with distinct depth depending on the sophistication of the country's financial sector. In Egypt, despite its bank-based financial sector, corporate governance has been approached from securities market perspective. Egypt and Morocco progressively worked on developing the rules and regulations that govern the securities market in compliance with corporate governance principles and practices. Lebanon, however, approached the corporate governance issue from a banking perspective, which is more developed than the Lebanese securities market (that is considered small relatively to the country's economy and to other markets in the region.) Although corporate governance has been approached from securities market viewpoint in Jordan, the vehicle for improving corporate governance practices in Jordan is its integration to the world economy with its bi-lateral trade agreements aiming to attract international direct and portfolio investments.

The regional discussions advanced the following recommendations on the corporate governance principles:

1. **Implementation and costs:** markets in the region are in early stages of development. Corporate governance principles should be a vehicle for markets to grow rather than impediment which is costly to adhere to. Rules should allow for incentives to companies that adhere to corporate governance standards.
2. **Addressing family owned companies:** since family companies are the dominant characteristic in regional markets, it is recommended that corporate governance principles address this issue and be geared to suit this type of companies. Principles should not be an obstacle for the establishment and development of family companies as they represent the backbone of several economies in Asia, Africa, Europe, Latin America, and to an extent North America. However, there should be clear and enforceable principles that protect minority shareholders.
3. **Bankruptcy and exit strategy:** with exception of few countries in the region¹, bankruptcy procedures and exit strategy pose a problem for stakeholders and shareholders. Thus, it is recommended that the principles address this issue in depth.
4. **Separation of ownership and control:** governance systems in the MENA region are insider systems, that are characterized by majority or concentrated ownership. In these systems, there is no separation of ownership and control. Complete separation between ownership and control might not be realistic and it might hinder further development of the family business environment. Thus, it is recommended that the principles should consider dilution of major shareholders voting rights to the extent that provides a room for minority shareholders and other stakeholders' rights.
5. **Owner's wealth and company's financial position:** it is recommended to address the issue of separating owners' wealth from the companies' financial position and extracting private benefits from the company such as extending credit to major shareholders.
6. **Board of directors:** a number of reports and codes of corporate governance² have addressed this issue extensively, especially on family owned firms. Regardless of the board structure model (unitary or two-tier), the principles should address the issue of board independence. There should be a unified

¹ Jordan and Lebanon adopted bankruptcy regulations to protect stakeholders.

²Example, Cadbury report in 1992 and Higgs report in 2002 from UK, Winter report in 2002 from EC, and Bouton report in 2002 from France.

clear definition of the non-executive director³ and the criteria for ensuring independence. Minorities should have the right to appoint representatives to the board for better governance.

7. **Accounting and auditing practices:** it is recommended that the principles address the issue of differences in adopted accounting standards across the countries. Thus, unification of accounting standards is crucial for better disclosure and transparency. In addition, principles should promote monitoring the practices of accountants and auditors by an independent oversight board. Accounting and auditing practices should be supervised so as to confirm independent, sound and fair practices.
8. **Internal Audit Committees:** few markets in the region require the formation of an independent audit committee as a condition to be listed in their exchange⁴. It is recommended that the principles explicitly state the need for internal audit committees and to be composed only of independent non-executive directors.
9. **Governance Culture:** introducing corporate governance as part of the culture of the country will constitute a good and practical solution for the problem of ownership-management mix and it will allow for separate ownership from management, which is in the best interest of the company. Authorities in securities markets, whether government or private business, should provide training opportunities for companies' management and staff as well as other parties with a view to introducing new management techniques and risk assessment methods and strategies.
10. **Strict Bank Supervision:** the introduction of a two-tiered approach to the corporate structure of family owned companies, particularly banks, whereby a board of commissioners representing the minority would supervise the board to ensure transparent dealings.
11. **Stages of Development:** there should be principles of corporate governance applicable to firms at every stage of their development and growth, from homegrown business to multinational corporations.

³ Definition among countries differs according to their regulations, example the case of US versus some European countries.

⁴ The amended Capital Market Law in Jordan and the new Listing and Delisting Rules in Egypt stated this condition explicitly.

12. **Ethics and Incentives:** means should be developed for the establishment and enforcement of code of ethics regarding the moral aspect of company operations. Operators need to believe in moralities and should be helped for this purpose by relevant training and education. The civil society could be the moral qualifier in this respect with the support of an incentive system and self-regulation framework.

Corporate Governance in
Morocco, Egypt, Lebanon and Jordan

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Preface

A series of events over the last two decades has made corporate governance issues a priority for both the business community and international financial institutions around the world. Spectacular business failures have driven the demand for change in many countries. More recently, high profile scandals, financial crises, or institutional failures in East Asia, Russia, and the United States have brought corporate governance issues to the forefront in developing countries, emerging markets and transitional economies⁵.

Since the declaration of the G7 Summit Meeting in 1998 regarding the new focus on “Corporate Behavior and Incentives”, and the adoption of a set of principles of corporate governance by the the Organization for Economic Cooperation and Development (OECD) in mid-1999, many countries have developed codes of best practice or have initiated legal, regulatory, and institutional corporate governance reform projects and programs. Globalization and financial market liberalization have also opened up profitable new markets and have exposed companies to fierce competition and to considerable capital fluctuations.

Corporate governance is about the relationship between a company’s management and its shareholders. As a company grows, as the number of shareholders increases, and as the activities of the firm become more complex (particularly during the transition to market economy), the problem of how the owners monitor and control the management’s activities becomes important.

There is no universally accepted definition of corporate governance. What is more representative to the concept is the statement that “corporate governance refers to a set of rules and incentives by which the management of a company is directed and controlled. Good corporate governance maximizes the profitability and long-term value of the firm for shareholders”⁶. As a basic framework, particularly in the

⁵ Kuchta-Helbling, C., and John D. Sullivan. (2003). “Introduction: Instituting Corporate Governance in Developing, Emerging, and Transitional Economies.” In *Search for Good Directors. A Guide to Building Corporate Governance in the 21 Century*. CIPE, Washington D.C., p. 1.

⁶ Stone, A., Hurly, K., and Khumani, R. (1998). “Business Environment and Corporate Governance: Strengthening Incentives for Private Sector Performance.” *The World Bank/IMF Annual Meetings, 1998 Background Papers*

view of emerging economies, corporate governance means many things to many people.

Many developing countries' economies are in transition, placing corporate governance issues in the heat of the debates on economic change⁷. Good corporate governance in these economies is part of their reform efforts and widely recognized as essential for the creation of a better and more attractive investment climate, and the provision of incentives to the private sector become the engine of economic growth.

In November 2003, The Organization for Economic Co-operation and Development will review and update their OECD Principles of Corporate Governance. Simultaneously, the Global Corporate Governance Forum will host an International Meeting on Corporate Governance. The meeting, which will be held in Paris, will undergo the first review for the OECD Principles of Corporate Governance, which were issued in 1999. In preparation for this meeting, the Center for International Private Enterprise (CIPE) and the Global Corporate Governance Forum supported a number of regional corporate governance focus group discussions. Country focus group discussions were organized in Egypt, Jordan, Lebanon, and Morocco and the recommendations from these meetings were presented in Cairo on September 7, 2003 at the Middle East & North Africa Corporate Governance Workshop. The purpose of these meetings was to assess the state of corporate governance in the Middle East and North Africa (MENA) and to provide recommendations on implementing governance principles. Participants at the roundtables included current and former-ministers, chairs of capital market authorities and other regulators from the financial sector, chairs and managing directors of a number of regional stock exchanges, accountants, auditors, investment bankers, commercial bankers, issuers, and financial intermediaries as well as representatives from corporate boards of listed companies and business associations.

This report attempts to benchmark regional corporate governance practices and to identify areas for improvement. It is based on the review of the regulatory frameworks, laws and regulations and the outcome of the discussions held in the aforementioned roundtables; two Reports on the Observance of Standards and Codes (ROSC) issued jointly by the IMF and the World Bank on

⁷ Usually, two basic types of conflict of interest are possible in emerging economies:

- 1- In closely held companies, which is the prevailing pattern of ownership structure, minority shareholders are expropriated by big owners or majority shareholders;
- 2- In widely held companies, conflicts of interest exist between management and shareholders.

Egypt and Morocco⁸, the working paper “Evaluating Corporate Governance in Egypt” issued by the Egyptian Center for Economic Studies; and additional research on the state of corporate governance in the region⁹.

While the entire MENA region faces similar challenges to adopting corporate governance reform, this paper focuses on the experiences and recommendations of Morocco, Egypt, Jordan, and Lebanon. Therefore, for the purpose of this paper, the MENA region refers to these four countries.

The reasons for choosing these four countries as a case for study are: 1) they are good examples of emerging economies that have recently carried out successful economic reform programs with noticeable progress; 2) they are good examples of emerging capital markets that have demonstrated considerable success in market liberalization and the attraction for domestic and foreign investments; 3) they are signatories of partnership agreements with the EU and, thus, are potentially a normal extension of European business into African and Asian markets; 4) they have similar legal, economic and cultural contexts but with varying capacities to practice and enforce compliance with corporate governance principles and 5) their recognition of corporate governance as a concept and the implementation of the underlying principles signal their intention to become part of the global economy.

⁸ ROSC reports for Egypt was published in 2001 and for Morocco in 2003

⁹ Among others, presentation by Daniel Blume (Principle Administrator, OECD), research paper by Mr. Jalil Tarif (Managing Director of Amman Stock Exchange) and presentation by Dr. Nasser El Saidi (former Minister of Economy & Trade in Lebanon)

Corporate Governance In Morocco, Egypt, Lebanon, and Jordan

Introduction

The Arab countries in the Middle East and North Africa Region (MENA)¹⁰ are an economically diverse group that includes countries with a common heritage and culture. These countries can be categorized into three distinct economic groups. The first group is the early reformers such as Egypt, Jordan, and Morocco. These countries have embarked on economic reform programs since mid-1980s and are capital importers. Securities markets in these countries were established and revitalized¹¹ to be the main vehicle for implementing a privatization program and to be a source of medium and long-term finance.

The second group is oil-exporting countries, mainly members of the Gulf Cooperation Council (GCC)¹². These countries achieved macroeconomic stability mainly because of the continuous increase in oil prices. They are income surplus countries and capital exporters. In the past, access of their capital markets was limited to GCC nationals and residents. However, since 2000 they have started to allow foreign investment in their market.

The third group is the countries which are economically unstable because of political instability (the West Bank and Gaza and Iraq), or are in their early stages of economic reform (Lebanon, Syria, Algeria, Sudan, Libya and Yemen). Securities markets in these countries are either relatively small or non-existent.

The GDP in the MENA region is about US\$ 600 billion or nearly 2% on average of the World's GDP in 2001 and 2002¹³. Due to the substantial increase in oil prices, national savings in the oil producing countries exceeded investments, which resulted in a substantial accumulation of financial assets

¹⁰ Arab countries of MENA region are Algeria, Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, United Arab of Emirates, the West Bank and Gaza and Yemen (18 countries). According to the World Bank classification, the MENA region includes Iran and Djibouti. According to the IMF classification, the MENA region comprises of 24 countries including Mauritania, Somalia, Afghanistan, and Pakistan.

¹¹ The Cairo & Alexandria Stock Exchanges in Egypt are among the oldest in the world. Both have been established in 1883 and 1903 respectively. They experienced stagnation for almost 40 years since the nationalization regime and has been revitalized in 1992 as one entity with two trading floors.

¹² Formed in early 1980s, comprises of six countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

¹³ The World Bank, World Development Indicators (WDI), online database.

abroad. Saudi Arabia and Kuwait constituted 3.3% and 2.4% respectively of total global export of capital flows in year 2001¹⁴.

Traditionally, the financial sector in the MENA region countries is a bank-based sector and the securities markets are still in an early stage of development, playing a limited role in economic growth.

The stock exchange is either governmental or quasi-governmental supervised by a securities regulator, as is the case in Egypt, and Oman. In Lebanon, the stock exchange is regulated and run by a committee appointed by a decree from the Council of Ministers. A number of stock exchanges in the region experienced the transformation to a private entity as steps towards demutualization such as in Morocco and Jordan.

The capitalization of securities markets in MENA region amounts to US\$ 209 million in 2002, about 1% of world market capitalization¹⁵ and about 35% of MENA's GDP (table 1). Saudi Arabia is the largest in terms of capitalization with 36% of total market capitalization of MENA markets in 2002, followed by Kuwait and Egypt with a share of 17% and 12% respectively. With the exclusion of closely held companies listed in the Egyptian Stock Exchange¹⁶, the Egyptian market was the most active during 2002 with a turnover rate of 90%. The capital markets of Egypt, Jordan, Lebanon, and Morocco represent about 22% of total market capitalization of the MENA region. Among the four, Egypt's market is the largest and most active. Markets in Egypt and Morocco have been assessed by the IMF and the World Bank. Egypt, Jordan and Morocco are represented in the international indices such as S&P/IFC index and in the MSCI EMF index.

Morocco, Egypt, Jordan, and Lebanon are committed to build the structural policy foundations needed for sustainable growth and reform in order to create a robust market economy and encourage private investment. The four countries have declared their commitments to corporate governance reform and

¹⁴ The International Monetary Fund (2003) "Global Financial Stability Report", World Economic and Financial Surveys, March & September 2003 issues.

¹⁵ Arab Monetary Fund (2002) "Annual Report, 2002" AMF and the World bank, World Development Indicators (WDI), online database.

¹⁶ Closely held companies constitute about 75% of total market capitalization of Egypt.

pursuance. The development of capital markets and their ever-improving performance signals credibility of the machinery through which the governance principles are best introduced, implemented, enforced, and monitored.

(in million USD)

	Country	Country Rating		Market Name	Listed Companies (2002)	Value Traded (2002)	Turnover Ratio (2002)	Market Capitalization (2002)	GDP (2002)	Market Cap as % GDP (2002)	Market Cap as % of MENA Region	Value Traded (Jan - June 2003)	Market Capitalization (End of June 2003)	MSCI-EMF	IFCG
		Moody's	S&P												
1	Egypt	Ba1	BB+	Cairo & Alexandria Stock Exchange	1150	6443.71	24.46%	26,338.70	89,844.65	29.32%	12.61%	2,144.18	24,728.89	√	√
2	Jordan	Ba2	BB	Amman Stock Exchange	158	1334.67	18.83%	7,087.00	9,295.91	76.24%	3.39%	731.46	8,306.35	√	√
3	Lebanon	B2	B-	Beirut Stock Exchange	13	114.93	8.24%	1,395.00	17,293.94	8.07%	0.67%	82.24	1,534.47	×	×
4	Morocco	Ba1	BB	Casablanca Stock Exchange	55	1440.46	16.82%	8,564.00	37,263.13	22.98%	4.10%	505.91	11,010.41	√	√
5	United Arab Emirates			Abu Dhabi Securities Market	24	363.08	1.78%	20,375.76			9.76%	300.93	24,287.11	×	×

(in million USD)

	Country	Country Rating		Market Name	Listed Companies (2002)	Value Traded (2002)	Turnover Ratio (2002)	Market Capitalization (2002)	GDP (2002)	Market Cap as % GDP (2002)	Market Cap as % of MENA Region	Value Traded (Jan - June 2003)	Market Capitalization (End of June 2003)	MSCI-EMF	IFCG
		Moody's	S&P												
6	United Arab Emirates			Dubai Financial Market	12	687.80	7.26%	9,469.52			4.53%	260.57	11,209.63	x	x
7	Bahrain	Baa3	A-	Bahrain Stock Market	40	206.28	2.67%	7,716.39			3.69%	116.45	8,059.17	x	√
8	Saudi Arabia	Baa2	A	Saudi Stock Exchange	68	30974.47	41.38%	74,851.38			35.84%	57,196.85	127,239.25	x	√
9	Kuwait	A2	A+	Kuwait Securities Market	95	22123.49	63.03%	35,098.89			16.81%	24,850.53	48,362.03	x	x
10	Tunisia	Baa2	BBB	Tunis Stock Exchange	46	246.47	11.59%	2,125.68	21,169.00	10.04%	1.02%	88.84	2,202.81	x	x

(in million USD)

	Country	Country Rating	Market Name	Listed Companies (2002)	Value Traded (2002)	Turnover Ratio (2002)	Market Capitalization (2002)	GDP (2002)	Market Cap as % GDP (2002)	Market Cap as % of MENA Region	Value Traded (Jan - June 2003)	Market Capitalization (End of June 2003)	MSCI-EMF	IFCG
		Moody's												
		S&P												
11	Oman	Baa2	Muscat Securities Market	140	581.67	11.04%	5,268.05	20,073.00	26.24%	2.52%	553.34	6,232.73	x	√
12	Qatar	A3	Doha Securities Market	25	883.07	8.36%	10,567.22			5.06%	1,098.75	14,672.55	x	x
13	MENA Region		MENA Region	1826	65400.10	31.31%	208,858.11			100.00%				
14	World Markets		World Markets				22,077,400	32,163,700						

15	MENA Region as % of the World Markets																		

0.95%

Sources: Arab Monetary Funds, World Bank, Emerging Stock Markets Review, MSCI, JP Morgan.
 Country Ratings on September 5 2003.
 () Not Available

Countries Economic Overview

Morocco

Morocco has achieved macroeconomic stability in the 1990s. However, the economic performance was not favorable because economic growth was heavily dependant on agriculture, which employed 45 % of the labor force and accounted only for 16% of the GDP¹⁷. The service sector accounts for 58% of GDP. Economic reforms progressed slowly during the second half of the 1990s since the authorities essentially focused on democratization and political reforms.

In 2002, the macroeconomic conditions remained stable with a low inflation rate of 0.6% and high external reserve coverage. The fiscal position improved, the central government deficit narrowed by one percentage point of GDP, and the debt to GDP declined to 70.6%. The GDP of Morocco in 2002 reached 37.3 billion USD although the annual GDP growth decreased in 2002 to reach 4.55% compared to 6.5% in 2001¹⁸.

As for the capital market, the Casablanca Stock Exchange was inaugurated in 1929. It now operates two markets: the central market and the block trade market. Transactions are settled in cash following the (T+3) system with central depository facilities.

There are 55 listed companies in the Casablanca Stock Exchange, which in 2002 had a market capitalization of USD 8.56 billion and approximate trade value of USD 1.44 billion with a turnover rate of 16.82%¹⁹.

Egypt

During most of the 1990s, Egypt made considerable progress in macroeconomic stabilization and structural reform. The fiscal deficit was greatly reduced, inflation fell to low single digits under a currency peg to the U.S. dollar, and debt service indicators strengthened substantially. In the late-1990s, however, macroeconomic performance weakened due to a combination of internal and external factors. On the policy side, credit growth remained rapid and structural reform slowed. Measures of the fiscal deficit were revised upward,

¹⁷ The International Monetary Fund, Morocco Article IV Consultation, Staff Report, 2003.

¹⁸ The World Bank, World Development Indicators (WDI), Country Data, Online database.

¹⁹ Arab Monetary Fund (2002), "Annual Report, 2002".

though the deficit of the general government was still low at the end of the decade²⁰.

By the end of 2002, Egypt's GDP decreased to USD 83.7 billion with a growth rate 3% in comparison to US \$91.1 billion in 2001, with a growth rate of 3.5%²¹. In the year 2003, the government adopted a floating exchange rate, which provided a momentum for the Egyptian capital market.

The Egyptian Stock Exchange maintains trading floors in Cairo and Alexandria and operates one electronic trading system. The branch exchanges were established in 1883 and 1903 respectively. After decades of low market activity, both stock exchanges started to grow in 1992 spurred by economic reforms, privatization and changes in the regulatory environment. The Egyptian Stock Exchange is a quasi-governmental body under the supervision of the Capital Market Authority (CMA).

There are 1150 listed companies in the Cairo and Alexandria Stock Exchange. The market capitalization, at the end of year 2002 was USD 26.34 billion, and the value traded during 2002 was USD 6.444 billion with a turnover rate of 24.46%²².

Lebanon

Macroeconomic conditions became particularly difficult in the spring of 2002, when the international reserve position reached its lowest level, but have since considerably improved. Market confidence was bolstered by the meeting held in Paris under the auspices of the French Government, to mobilize international financial assistance for Lebanon (Paris II) in November 2002²³. The real GDP grew by about 2 % in 2002 with inflation rate of 1.75 %. The GDP reached USD 17.3 billion in 2002 in comparison to US\$16.7 billion in the previous year²⁴. Significant progress has been made in the public finances since 2000. Following an adjustment of 5.2 % in 2001, the overall fiscal deficit has been reduced from 19.4 % of GDP in 2001 to 15.7 % in 2002.

The primary fiscal balance (which excludes interest payments) shifted from a deficit of 7.6 % of GDP in 2000 to a surplus of 2.1 % of GDP in 2002.

²⁰ The International Monetary Fund, "Egypt Article IV Consultation, Staff Report, 2001", IMF

²¹ World Bank – Country Data, Egypt

²² Arab Monetary Fund (2002) "Annual report, 2002", AMF

²³ The International Monetary Fund, "Lebanon Article IV Consultation, Staff Report, 2002", IMF

²⁴ World Bank, World Development Indicators (WDI), Country Data, Online database.

The Beirut Stock Exchange is managed by a committee formed of a Chairman, a Vice-Chairman and eight members appointed by the Council of Ministers, in accordance with a proposal by the Minister of Finance. A Government Commissioner is appointed to supervise the Stock Exchange and to insure its compliance with laws and regulations.

There are 13 listed companies on the Beirut Stock Exchange. The market capitalization for Beirut Stock Exchange by the end of December 2002 was USD 1.39 billion and the value traded during the year 2002 was USD 114.92 million with a turnover rate of 8.24%²⁵.

The Beirut Stock Exchange is divided into 3 markets; an official market for companies with a capital equivalent to USD 3 million, a junior market for companies with a capital equivalent of USD 1 million, and an over the counter market with a minimum capital of USD100, 000²⁶. The Beirut Stock Exchange adopts the pricing system known as the “Fixing System” using the Stock Exchange computerized trading system.

One of the problems relating to corporate governance codes and practices in Lebanon was the case of a bank which was accused of money laundering. The Central Bank in Lebanon took action after US\$300 million of the bank’s own funds was transferred abroad. An earlier case against the bank filed in February was dropped after one of the owners pledged to deposit US\$150 million with the central bank to cope with the withdrawals by the customers. It is worth mentioning that it was the lack of proper control by the banking authorities that led to the current crisis of that bank. It was run by two people who are the owners of the bank and there was no board of directors to review policies and transactions. That is one of the main reasons for such crisis to take place.

Jordan

Despite the adverse effects of the ongoing conflict in the area, Jordan's economy performed relatively well (4.9% real GDP growth) in 2002 compared to other regional countries. It was characterized by strong export-led growth, continued low inflation, a substantial strengthening of the balance of payments position, and increased confidence in the Jordanian Dinar (JD).

²⁵ Beirut Stock Exchange website <http://www.lebanon.com/financial/stocks/bse/index.htm>

²⁶ *ibid.*

A sound banking system dominates the financial sector in Jordan. In 2002, the average risk-weighted capital adequacy rate stood at 17.5 %, and net nonperforming loans was 13.1 % of total loans. A large proportion of these nonperforming loans are secured against sound collateral. Two of the three banks that had trouble in the first half of 2002 implemented a corrective action program mandated by the CBJ.²⁷

With the increasing need to attract more investments, and as a means of implementing the privatization program, the Amman Stock Exchange was established in March 11 1999 as a private and non-profit organization. This was a result of the restructuring process of the Jordanian Capital Market during which three institutions were established the Amman Stock Exchange (ASE), the Jordan Securities Commission (JSC), and the Securities Depository Center (SDC).

There are 158 listed companies on the Amman Stock Exchange of which 40% to 50% are actively traded and is comprised of four different sectors. The dominant feature of the ownership structure of listed companies is family companies. There is only one GDR listed in the international markets. The market capitalization for Amman Stock Exchange by the end of 2002 was US\$7.1 billion and the value traded during the year 2002 was US\$1.3 billion with a turnover rate of 18.83%²⁸.

The privatization program maintained its momentum despite the adverse regional security environment. Through number of initial public offerings (IPOs), the government succeeded to divest its shares in major companies.

Foreign investment is allowed in the Jordanian Stock Market without any restrictions. Previous restrictions related to the percentage of ownership by foreigners as well as the minimum amount invested have been removed. The percentage of foreign ownership is 37.5% of the total market.

Corporate Governance in the MENA Region – An Overview

Corporate governance in the region is best understood through the attitude and behavior of shareholders, the use of modern management techniques in corporate board structure and the ability to enforce the country's laws and regulations. The majority of shareholders are not owners in the real sense but

²⁷ The International Monetary Fund, *Memorandum of Economic and Financial Policies 2002-03*, Letter of Intent (LOI) of the Government of Jordan, June 19, 2003.

²⁸ Amman Stock Exchange, *Capital Market Profile*, Amman Stock Exchange website <http://www.ammanstockex.com/>.

rather financial investors. They seldom exercise their shareholding rights, as they tend to be short-term investors who often do not pay attention to the concepts of governance. The system could be said to work reasonably well at a formal level, i.e. shareholders vote at annual general meetings and boards of directors meetings with little substantive participation. There is, therefore, a need for corporate governance reform. Although much has been done, countries in the region have some distance to go. A comparison of the present corporate governance practices in the region with present international standards would indicate the level of required reforms. Corporate governance reform attacks the core problem of the economic transition, which is the mean to convince economic players to act differently and become efficient, to look outwards, and to search for new opportunities. Because it involves changing a long history of behavior and tradition, corporate governance reform is bound to be a long-term process.

Many countries in the region are economies in transition and are moving towards market-based governance. During 1990's, Morocco, Egypt, and Jordan have successfully undertaken a comprehensive reform, and have decisively shifted towards the market economy model. In Lebanon, corporate governance implementation was put on hold for about 20 years because of domestic war and political turbulence. An aggressive economic reform program started recently and much attention is being paid to corporate sector development.

The economic reform programs in these countries and the focus on large-scale privatization of state-owned companies have stimulated the development of the capital market, and the creation of modern institutions supporting it. The emergence of organized capital markets, in turn, has been instrumental in the implementation of privatization schemes. However, the transition is still in progress.

The Regional Corporate Sector

Looking at the entire population of joint stock companies in the region, the ownership structure, cross-holdings, and Board structure generally reveal that the regional corporate sector is characterized by the following:

- Many large companies are closely held and often controlled by "family groups" or by individuals. Few companies could be defined as "widely held" and many listed companies meet the "closely-held" test of having at least one shareholder with more than 20% of the shares. This is considered to be the main barrier to the implementation of corporate governance principles as managers lack autonomy, flexibility, and objectivity to monitor company activities and to achieve its objectives;

- The dominance of family-owned firms and the absence of a system that prevents family members from dominating the decision making process has resulted in the poor protection of minority shareholders' rights;
- Most countries in the MENA have privatized state-owned companies; yet many of these companies tend to have considerable state ownership and control²⁹;
- The free float (shares available for trading) of listed companies on the stock exchanges is small; and most shares are controlled by strategic investors, the state, or other stakeholders³⁰; and
- Small and medium sized companies, which constitute a majority among companies in the region. Unlike large firms, they do not have the institutional capacity, making it more costly for them to implement corporate governance principles. There is a need to develop corporate governance standards that can be applicable without difficulty to these types of companies.

The Legal Framework

The foundation of any corporate governance framework is provided by the basic legal framework, as reflected in the basic company, civil, and securities laws, the regulations of the stock exchange (especially the listing rules), and the basic accounting standards in place. These laws are the basic rules for board and management behavior and in the long term tend to reflect the values of the underlying business culture.

The basic corporate governance legal framework in the four countries in the region is contained mainly in two laws and their supporting Executive Regulations:

²⁹ For example, in Egypt of the 40 large companies listed, the State held more than 20% of the shares in 21 companies, and more than 50% of the shares in 12 companies. In Jordan, the State holds more than 20% of the shares in 13 % of the total number of privatized companies listed on the exchange.

³⁰ Two forms of employees ownership prevails; the established legal vehicle of the Employee Shareholder Association (ESA) and the Employees Stock Option Plans (ESOP). In ESA, they receive shares ("stacks") in the Association, and the Association (as the sole legal shareholder) receives the employee shares in the company. In Egypt, this form of ownership was introduced through privatized companies. As in all employee ownership schemes, the corporate governance resulting from employee ownership is weak. Employees will tend to resist change and discourage major restructuring. Management will be in effective control of the company.

1. The Company Law, which is considered the “Corporate Law”, contains provisions on the type of companies. Provisions apply to most commercial companies, unless specified otherwise.
2. The Capital or Securities Market Law, which is the principle law regulating the securities markets³¹.

Earlier versions of commercial laws lack sufficient and detailed provisions of shareholder protection, which explains the tendency towards concentrated ownership structures. Morocco, Egypt, Lebanon, and Jordan appear to have overcome this initial disadvantage, as Company Laws are relatively recent and have been updated and revised. Basic conclusion emerges from their review. Although some provisions are weaker than expected, basic legal protections appear to be in place and support many basic shareholder rights. However, effective protection of basic rights depends on how laws are enforced. Enforcement is a key issue in these markets particularly in a new dematerialized environment within good systems of clearing and settlement of traded shares are in place. The promulgation of capital market laws has made the legal framework more conducive to corporate governance implementation as they provide the required rules that were missing from commercial laws.

A review of the capital market laws and regulations reveals that almost all of the legal aspects of corporate governance are well articulated. Although these aspects are based on the OECD Principles, they go further to examine many issues that may be specific to Morocco, Egypt, Lebanon, and Jordan.

1. Basic Organization /Assignment of Responsibilities

Like in its international counterparts, a joint stock company in the four countries is a common type of company where shareholders have limited liability and shares are freely transferable. The company is organized around two main institutional bodies: the shareholders and the Board of Directors. The Board oversees the management of the company, and its members are elected by shareholders who meet in General Assemblies (GAs). It has a managing director (sometimes referred to as delegated member) who is the Board member responsible for the Board's detailed oversight of the company. The Board can also hire a general manager who is an employee of the company to run the operations.

2. Ownership Registration, Recordkeeping and Settlement

³¹ Other laws are supplementing the securities law such as the "Depository Law" (Egypt and Morocco) as well as the Listing Rules of the stock exchanges in the four countries of the region. These rules were promulgated with the goal of improving and enforcing disclosure requirements.

A modern shareholder recordkeeping system is central to the protection of shareholder rights. The system is able to transfer shares within international norms (e.g. "T +3") and is accountable to the securities regulator. Egypt, Morocco, Jordan, and Lebanon have well-organized central depositories which are equipped with proper risk management tools such as Settlement Guarantee Funds (SGF) and, in many cases, swift payment systems.

While the markets are moving towards the dematerialization of securities, central depositories also plan to be a central registration that maintains an updated shareholder database.

3. Equitable protection of all shareholders

One-share/one-vote

The laws are relatively clear on the notion that, within a given share class, all shareholders have the same rights. Any interference with voting rights within the class is illegal. However, company laws appear to comply with the basic standard of one-share one vote.

Insider trading

Insider trading is, in many laws, explicitly illegal. Such action is heavily penalized. The national capacity of securities market regulator must be strengthened in order to detect these activities.

The role of custodians

Some of MENA countries' current law does not recognize nominee ownership, creating a voting rights problem for shareholders who hold their shares with custodians, especially those who hold Global Depository Receipts (GDRs) of the respective companies. With the recognition of nominee ownership, such a problem will be solved. Depository Laws in Morocco and Egypt have addressed this issue since their securities markets are open to international investment. It is crucial to provide voting rights to international investors.

Minority Protection

Provisions under the Company Law or the Securities Law in Morocco, Egypt, Jordan, and Lebanon provide for the protection of Minority shareholders. The regulating agency of the securities market is entrusted with the enforcement of the law. In Egypt for example, the CMA is empowered by the Capital Markets Law to "suspend resolutions" of the General Assembly (GA) if they are issued for the benefit of a certain category of shareholders. These provisions are

important for shareholders rights, as it gives a regulatory body direct responsibility for enforcing shareholders rights.

4. Voting of shares

Although shareholders are explicitly given the right to vote and participate in the general assembly of the company, some practical restrictions are placed on the voting exercise. Shareholders are entitled to attend the general assembly personally or by proxy. Voting by mail or electronically is not allowed or not practiced and in some cases, shares must be blocked before the meeting. With the development of the central depository, international standards suggest that procedures should not make it unduly difficult or expensive to cast votes³². Efforts are now devoted to introduce innovative and modern voting procedures such as voting by mail and even electronically. In addition, a new approach to tabulate votes is also being explored.

With cumulative voting, shareholders can concentrate their votes on a single candidate, and elect him or her onto the Board. Cumulative voting addresses several problems as it allows minority shareholders a voice in Board actions and reinforces the principle that directors owe their allegiance to the shareholders.

5. Responsibilities of the Annual General Assembly (GA)

As a common practice in the MENA region and by virtue of the governing laws, the GA is supposed to be held once a year, no later than six months after the end of the company's fiscal year. Also, a small group of shareholders (5%) can also call for the meeting to be held. Prior to the GA, the Board must publish the financial statements of the company, the Board report and the auditors' report. In most of the cases, the information can be mailed to shareholders before the GA.

Minority shareholders are usually protected in this respect by the laws that allow those representing more than a certain percentage of the capital to force a specific topic onto the agenda at the GA and call it to a vote, even if it is not already on the agenda.

6. Fiduciary Responsibilities

³² In Egypt and in Jordan, the custodian can vote on behalf of their clients.

No obligations (fiduciary duty) appear to be imposed on managers or large shareholders. Board members are required to disclose various conflicts of interest as stated in company laws³³.

7. Takeovers

In most of the MENA region, relatively detailed rules regulate takeovers of listed publicly traded companies. Regulation could be considered excessive, and may discourage future takeovers. The threat of a takeover ensures that companies with widely distributed shareholdings are managed according to the public interest. Takeover restrictions tend to be viewed as anti-shareholder rights, and the threat of a takeover is often seen as critical to the development of a market in corporate control and a positive incentive to corporate governance.

8. Enforcement

In general, enforcement of company and securities laws is an area that needs continuous strengthening and capacity upgrading. The powers of the regulator are important to support and complement the court system.

Corporate Governance Principle-By-Principle Implementation

While the issue of corporate governance is fully recognized in a number of MENA countries, it has been approached differently and with distinct depths depending on the sophistication of the country's financial sector. In Egypt, despite it being a bank-based financial sector, corporate governance issue has been approached from the securities market perspective. Egypt and Morocco have progressively worked on developing the rules and regulations that govern the securities market in compliance with corporate governance principles and practices. A similar approach was followed in Morocco.

Lebanon, however, approached the corporate governance issue from the perspective of the banking sector, which is more developed than the Lebanese securities market (that it is considered small relatively to the countries economy and to other markets in the region). Although corporate governance has been approached from securities market viewpoint in Jordan, the vehicle for improving corporate governance practices resides in its integration in the world

³³ In Egypt, fiduciary responsibilities of managers are defined by company's statutes in accordance to the civil and the criminal laws.

economy, mainly because of the great number of bilateral trade agreements aiming to attract international direct and portfolio investments.³⁴

I. The Rights of shareholders

Shareholders rights are stated clearly in the laws and by-laws of securities markets and companies law. There is a regulation that outlines shareholders rights in securing ownership registration, participating and voting in general shareholders meetings, as well as involvement in decisions concerning fundamental corporate changes. In a number of the MENA markets for proxy voting through registered ownership and a beneficial ownership concept is allowed. However, this is not yet a means for voting for all markets because of technological differences.

Although shareholders rights are clearly identified in the rules and regulations in MENA markets, there is a gap between what law states and what is practiced.

1- Ownership and Control:

In the MENA region, as in many other regions, most of the controlling shareholders are individuals, institutions, or families. A single family may have controlling stakes over a number of companies either directly or indirectly. Controlling shareholders have strong incentives to monitor the company and its management and can have positive impact on the governance of the company. However, their interests may also conflict with the interest of minority shareholders. The conflict is evident when controlling shareholders abuse the company's resources for private benefits. Such examples of abuse were observed in the corporate crises in mature markets and recently in the MENA region³⁵. In some cases, shares with special voting rights influence decisions in their favor. They may also influence decisions indirectly with indirect ownership of the company (pyramid ownership where a family or members of the family have controlling ownerships in a number of holding companies as well as in subsidiaries).

2- Shareholders participation:

³⁴ Sourial, M. Shawky "The future of Corporate Governance in Arab Countries", unpublished.

³⁵ The case of Al-Medina Bank in Beirut and Al-Shamayleh Company in Jordan, a global business that tricked a number of Jordanian banks to obtain credit facilities amounted for US\$ 1 billion.

In general, shareholder participation is weak. This could be attributed to the lack of culture, poor awareness among small investors, and the speculative nature of stock trading. The consequences of this situation are unfavorable qualitative and quantitative participation of shareholders in the decision making process. The power is dominated by controlling shareholders.

3- Legal environment and enforcement:

Research findings³⁶ argue that the Anglo-Saxon Common Law legal system provide better protection for shareholder rights and that enforcement of law is more effective compared to other legal systems such as the French Civil Code and the German/Scandinavian Civil Law. With the exception of Jordan, the dominant legal system in Morocco, Egypt, and Lebanon is the French Civil Law³⁷. However, adopting a different legal system might interrupt the internal legal system as a whole. Preserving and maintaining the legal system within the countries' traditions and investment culture is important.

Most of the rules and regulations that govern the MENA markets either were either recently issued or updated in conjunction with international practices. The problem of misappropriation of rules and regulations, therefore, does not pose a significant problem. A number of MENA stock exchanges are structured as private self-regulated entities³⁸ with enough flexibility to upgrade governing rules.

The power to rule and regulate should be supported by an equal power to enforce these same rules. It is agreed that the regulator should be institutionally empowered to regulate, investigate and penalize effectively in order to protect shareholders rights. However, it is evident that not all regulatory agencies in the MENA markets have the same power. In Morocco, according to the ROSC report, the CDVM has very limited power to take actions against market participants abusing minorities. On the other hand, according to the capital market law in Egypt, the Capital Market Authority has the power to undertake actions in favor of minorities to the court. In addition, it has the power to stop general assembly decisions if it has been proven that minority shareholders have been negatively affected.

³⁶ Porta Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer. (1999) "Investor protection and Corporate Valuation", National Bureau of Economic Research (NBER), Working Paper No. 7403, 1999

³⁷ Sourial, M. Shawky (2003, "Corporate Governance in the MENA Region and Future Challenges", 10th symposium on Accounting Disclosure and Transparency, King Saod University, October 2003.

³⁸ Example: Jordan, Bahrain and Dubai.

4- *Market discipline:*

In a number of world securities markets the concept of "market discipline" as a tool of self-enforcement of better corporate governance practices is well established. This requires high level of market efficiency, which is not the case yet in markets of the MENA region.³⁹ Market discipline approach has not yet been developed to assist in the enforcement of law and to promote sound corporate governance practices.

II. The Equitable Treatment of Shareholders

1. *Voting Rights*

The legal framework in some MENA countries allows for multiple share classes. Within a given class, shareholders should be treated equally⁴⁰ as they have the same voting rights. There are two types of shares which are usually common in these markets, the ordinary shares that are either registered or bearer shares⁴¹ and preferred shares. Capital may be increased through the issuance of preference shares if permitted in the company statutes and approved by the extraordinary general assembly meeting.

The regulations governing the central depository system differentiate between registered owners and beneficial owners. Registered owners cast votes in a manner agreed upon with the beneficial owners. In Jordan, while public shareholding companies issue only one class of stocks, Private Shareholding Companies are allowed to issue different types of securities⁴².

While each shareholder has the right to vote (one share one vote), he or she has the right to file a complaint with the regulating agency regarding the violation of the Company Law. In Egypt, a shareholder who attends the

³⁹ See, among others, El-Erian, M.A., and M. S. Kumar (1995) "Emerging Equity Markets in Middle Eastern Countries". IMF Staff Papers, vol 42, No. 2, pp. 313-343; Mecagni, M. and M. Sourial (1999) "The Egyptian stock market efficiency tests and volatility effects", IMF Working Papers, WP/99/48; Dahel, Riad (1999) "Volatility of Arab Stock Markets", Arab Planning Institute, working paper No. 5, and Dahel, Riad, and Belkacem Laabas (1999) "The Behavior of Stock Prices in GCC Markets", Journal of Development and Economic Policies, vol. 2, No. 1.

⁴⁰ In Jordan, there is only one class of shares – ordinary shares.

⁴¹ Bearer shares were introduced in Egypt as share capital, which should not exceed 25% of the total share capital, and the value of these shares must be fully paid up with no voting rights.

⁴² In Jordan, the Company Law was amended to allow the establishment of a new type of companies called, "Private Shareholding Companies", which can issue different types of securities providing that such rights and responsibilities are determined in the Memorandum of Association.

AGM and registers his opposition to a decision in the minutes can initiate a case in court within one year from the meeting⁴³. In addition, shareholders can initiate action to inspect the company.

Minority shareholders are protected by the courts as they can request the nullification of a resolution issued for the benefit of a certain category of shareholders, causing harm to the minority shareholders, or bringing special benefit to the board of directors. The regulating agency in Egypt has the power to suspend resolutions of the general assembly of the company that cause harm to minority shareholders.

2. Participation in fundamental corporate decisions

A majority two-thirds vote of shareholders is required for major and fundamental decisions such as capital increase, the disapplication of preemptive rights and amending the original corporate objectives. Similarly, two thirds of shareholders in the same class must agree to any variation in voting rights. Company laws in most of the four countries provide a clear procedure for corporate actions in this respect and for the organization of two-thirds of shareholders assembly meeting.

Information should be made available to shareholders well ahead in time for major decisions of this nature.

3. Market for corporate control

To protect shareholder rights, tender offering is well organized in many of the MENA securities markets. While in Jordan, an offer shall be a public tender offer if it is made for the purchase of 40 % or more of the securities of one issuer, in Egypt the increase of ownership to 10 % of capital requires a tender offer. In addition, tender offers, which provide majority shares to one buyer, are rejected in Egypt unless the offer includes 100% of the shares; this is to protect minority shareholders.

4. Insider trading and self-dealing

⁴³ According to the Company Law in Egypt.

The applicable laws address insider trading and self-dealing. This unlawful action is penalized by imprisonment and fines. In some markets such as Egypt, the breach of confidentiality by staff of the regulating agency and market institutions is considered insider information. Misstatement or omission of material information in reports is an action punishable by law. Disclosure procedures apply to inside traders and self-dealing persons as part of the listing rules of the Egyptian Stock Exchange.

Board members or officers of a company or persons having access to information not available to the public and affecting the price of the company's securities are prohibited from trading.

5. Related party transactions

Disclosure rules covering related party transactions are rather detailed in many securities markets and are strictly enforced by the regulating agencies as well as the stock exchanges. The company, the directors and managers are legally required to disclose any material interest in transactions or other matters affecting the company, irrespective of whether such transactions have taken place. Related procedures do differ from one market to the other in the region. Disclosure must be made in the notes to the financial statements or notified to the stock exchange, which will disseminate such information to market participants. In some cases, the director with conflicting interests must notify the board, have it recorded in the minutes of the meeting, and abstain from voting. The board must notify the general assembly meeting about any related party transaction. Moreover, the listing rules of the stock exchanges in the region have established disclosures requirements and procedures for related party transactions disclosure.

III. The Role of Stakeholders

The role of stakeholders in corporate governance in the MENA is not as developed as in many other countries. It is a question of culture and requires education, increased awareness and in most of the cases, a wider and much comprehensive coverage in laws, rules and regulations. The definition of stakeholders in the region is confined to those who have direct and explicit legal rights such as employees, and bondholders, and other debtors.

Rules and regulations in the region specify the legal rights of stakeholders. For example, the law in Jordan requires that the reduction of a company's capital should be approved by its creditors. In Egypt, the employees

have the right to the lower of either 10 % profits or the equivalent of one annual salary each year. This right is only exercised if profits are distributed. Employees of joint stock companies shall participate in “management” of such a company. Usually, an employee committee or a similar body is established to deal with all matters related to employees, including salary and other compensation issues. A director is assigned the task to liaise with this committee. Shareholding Employees can organize an Employee Shareholding Association (ESA) to own a block of shares in the company. While some companies have initiatives, Employee Stock Option Plans are not contemplated in the legal frameworks in most of the countries of the region.

Similarly, bondholders are a traditional example of stakeholders, and they are granted explicit legal rights. They are usually allowed to form a bondholders’ association to be represented legally at the company’s general assembly meetings but do not have any voting power. The association acts on their behalf and makes recommendations for submission to the meeting or to the board of directors.

The organization of stakeholders who can insure that environmental aspects are well preserved by companies are somewhat recognized in the region. Yet, such an arrangement is not fully developed, as is the case in European countries. In addition, shareholder associations and consumer protection groups are organizations which need due attention by MENA securities markets.

Performance-enhancing mechanisms for stakeholder participation are established in the region. As indicated, some companies have share ownership programs for their employees and executives. Companies are also allowed to buy their stocks (Treasury Stocks), and they are not allowed to keep these stocks for more than one year. The company can resell these stocks or reduce its capital. Such transaction will need an approval of the general assembly.

Stakeholders in the region have legal access to relevant information and they have the right to inspect the financial statements and to send a representative to the general assembly meeting.

Role of Banking System as Stakeholder

The corporate system in the region relies heavily on the banking system for financing. Companies are dependent on banks as a constant source of capital despite the relatively high cost involved.

As a source of capital, banks either lend money to corporates through their lending system and as a result, either become stakeholders in the companies or invest in the stocks issued by these companies and thus become shareholders. In either case, banks can play an active role in advocating corporate governance and implementation of related measures. As stakeholders or shareholders, they have the right to demand the observation of standards by the companies they finance. At the current stage of modernization of the banking sector, which includes the increased participation of foreign banks in domestic investments, it will soon be imperative for companies that are not on the Exchange to provide accurate and detailed financial statements on their performance as well as internal operating environment.

Banks as corporation can set the example for the implementation of corporate governance by being a disciplined institution and supervised by a powerful regulatory body “the Central Bank”

IV. Financial and non-financial Disclosure and Transparency

1. Disclosure of material information

Listed companies on MENA's stock exchanges are legally⁴⁴ required to disclose its financial, non-financial and operational performance on continuous and regular quarterly, semi-annual and annual basis⁴⁵. Mandatory information includes balance sheets, income and cash flow statements, directors' reports, changes in stockholder equity and board composition, as well as the external auditor report. Compliance with these requirements is monitored and enforced by the capital market regulating agencies as well as the stock exchanges. Non-compliance with these legal requirements is subject to controversial sanctions. The governing rules in most markets require de-listing of the underlying company from the stock exchange on the assumption that shareholders, as a result, will hold the Board accountable and can fire him/her accordingly. No markets impose fines, in the minds of most market participants should occur.

While the enforcement of disclosure rules is exercised on companies, it is indirectly compiling for the profession of accounting and auditing. The rules and regulations require that financial statements be prepared and audited based on international standards or internationally acceptable standards. These arrangements could be the least required but not at all sufficient to insure full

⁴⁴ By virtue of the capital market laws and listing rules.

⁴⁵ These rules are applicable in Egypt, Jordan, and Morocco. In Lebanon, it is only submitted annually.

adherence to disclosure principles and to insure the high quality of information. The reason is that accounting and auditing professions in almost all countries should be properly organized to be fully responsible for the development and enforcement of best practices in this field. Until then, capital market rules will continue to govern issues of disclosure.

In addition to the regular disclosure, companies are required to make immediate disclosure of all material events⁴⁶ that may affect business and/or its earnings. In addition to publishing into daily newspapers, MENA stock exchanges facilitate the dissemination of this information to investors through their automated trading systems. Some stock exchanges started to impose financial sanctions on listed companies as part of the listing rules in case of noncompliance.

While disclosure is a legal requirement and in general, companies do adhere to the rule, the question remains whether these legalities insure high information quality and whether investors are keen to use the information for better investment decisions. Improving the quality of information is a challenge in the region, which consequently suffers from poor risk assessment strategies. Experience of securities markets indicate that the use of disclosed information is the concern of intermediaries who provide advisory service to their clients. In the MENA region minority investors, particularly institutions, seek professional services. The majority, who are mainly individual and usually mono-investment speculators, act on their own inclination.

Insider information and trading is a serious problem, although with varying degree, in all markets in the region. This is mainly due to a lack of awareness among the corporate sector and the lack of functioning mechanisms to detect and deter insider information. In some markets, poor surveillance by the stock exchange and the regulating agency and the absence of technical capabilities are a good reason for insider information to become a phenomenon.

2. External audit

Similarly, external auditing is a legal requirement in all MENA countries. Financial statements, whether annually or otherwise, should be audited. The power of appointing and removing auditors is vested with the general assembly of shareholders of the company, which also sets their remuneration. In Jordan

⁴⁶ Material changes denote any events that have a tangible effect on the company's activity or in its financial position that may affect trading the company's shares at the stock exchange.

and Egypt, the auditor must not be a founder, board member, an employee or otherwise associated with company or board. There is no legal restriction for an auditor to be a shareholder of the company audited. The auditor may not become a board member or employee of the company within three years of contract termination. The auditor is required to examine all documents, data, and other information necessary to follow international auditing standards. The auditor is liable for misrepresentation and errors. He/she should compensate the company or shareholders for any resulting loss.⁴⁷

Most stock exchanges in the region, through listing rules, require listed companies to institute an audit committee. The committee is mainly in charge of examining and reviewing the company's internal control procedures, the accounting policies and the internal audit. They are also responsible for ensuring that the management responds to the recommendations of the auditor and comply with the related governing rules.

The role of the accounting and auditing profession is key to the application of corporate governance principles with regard to disclosure and transparency and is key to a stronger legal environment within the corporate sector. None of the countries in the region managed to establish a supervisory body that would ensure auditor independence and sound and fair practices. At present, supervision is thin and scattered among many agencies without formal mechanisms of coordination and consistency.

3. Major share ownership and voting rights

Many of the MENA's capital markets recognize the concept of ownership nominee names. Laws, rules and regulations provide a clear base for governance of beneficial ownership and legal owners. This has been prompted by the urgent need to facilitate ownership transfer, to insure active participation in the voting process and to establish a credible settlement system with proper risk management tools. The central depository mechanisms, which are now established in all markets of the four countries, keep an updated shareholder data base as beneficial ownership, is disclosed to the system on a confidential basis through the registered owners.

Experience in the region indicates that such a system of registration has been instrumental in solving many problems associated with voting rights. Central depositories make available an updated shareholder list to the general

⁴⁷ As the case is in Jordan and Egypt under the Company Law.

assembly of the company. Furthermore, investors have the right to access the shareholders data base to get information on a company's ownership structure⁴⁸.

4. Disclosures relating to directors, key executives, and their remuneration

It is common practice for the company statutes to determine what level of disclosure relating to the board should be disclosed to shareholders at the assembly meeting. The disclosure of the names of directors and their remuneration is not a legal requirement in all MENA markets. While in Jordan the names of directors and their remuneration are published in the annual report, disclosure of such information is not required in Egypt and Morocco. Changing this practice requires a change of culture and strict enforcement of disclosure rules. Trading of company directors and managers for their own account should follow disclosure rules and usually has to be approved by the board of directors. However, there is still a long way to go for the MENA markets to improve current practices and implement standards in this regard.

5. Other disclosures

In Jordan, Egypt and Morocco, rules require bond issues to be rated by licensed domestic or international rating agency. This rating should be updated annually.

V. The Responsibilities of the Board

The board structure of companies in the MENA region is dominated by the commonly known "unitary" structure that includes executive and non-executive board members. However, the Moroccan model is similar to the German dual-board structure in which a supervisory board includes non-executive members monitoring the management board, including executive members. The board's responsibilities have been explicitly addressed in all the rules and regulations that govern the companies - listed or not. In general, corporate management has not exerted the necessary efforts to introduce and implement modern management techniques in board structure. The line of responsibility of the board and senior management is not clear and thus the corporate progress is hindered.

⁴⁸ In Egypt, listed companies are required to disclose their ownership structure of five percent and more.

Neither the board's structure nor regulations are issues of concern. What is more important is to guarantee the independence of the board and to ensure the professionalism of board members. In some cases, the existence of a number of non-executive board members is considered sufficient to exercise independent judgment and avoid conflict of interest (in Jordan a minimum of three members are non-executive). Experience indicates that despite the existence of non-executive members, their role in this regard is not practiced. In many cases, the controlling shareholders are in position to choose all board members. Consequently, the assigned persons are either inexperienced in the field of activity of the company or in financial matters, or are in close relation with executive board members or the Chairman, and may feel obligated to act in the interest of the controlling shareholders.

After the recent international corporate crises, experts in the matured markets recommended the separation between the Chief Executive Officer (CEO) and the duties of the Chairman. While this recommendation may be acceptable, it would be difficult to have it adapted in the MENA region, as the majority of companies are family-owned. It is not easy to convince an owner of a company who invested money to step aside and allow others to manage his money. In Lebanon, separation might not be applicable since, according to the commercial code, the chair of the board of directors shall execute the duties of the general manager unless he appointed one to act on his behalf⁴⁹.

It has been commonly recognized by the corporate sector in the region that it is important to have a clear, enforceable definition of an independent non-executive director to guarantee the independence of the board. In addition, rules and regulation should be supported by a code of ethics that would help instituting moral commitments on the part of management. This should be rewarded by implementing a scheme of incentives.

Regional Cooperation

In recognition of the needs to integrate their capital markets, countries in the region members of the Union of Arab Stock Exchanges and Regulatory Authorities (UASERA) have agreed to establish a frame of cooperation between their jurisdictions with a view to promote regional investment opportunities. In order to achieve this objective, the agreement includes that authorities in each

⁴⁹ Code of Commerce (Art. 153). Contrary to this, the Code of Corporate Governance in Oman (Article No. 3) stipulates that the role of CEO/General Manager and chair shall not be combined.

jurisdiction will strive to remove all barriers to market entry either for investors or for service providers. Entry standards for service provision will be established and corporate governance principles are to be enforced.

Preparatory steps have been envisaged to insure that members of the agreement will prepare their markets by implementing reform programs and conducting training in order to increase national capacities and upgrade capabilities to reach an appropriate level which commensurate to the international principles and objectives as well as the best practices of corporate governance.

Features of the Agreement

- The Establishment of the Arab Securities Market (ASM) as a separate and independent entity not related to present stock exchanges and regulatory authorities within the region.
- ASM will be under the supervision of the Union of Arab Stock Exchanges and will have the same headquarters.
- The Arab Securities Market (ASM) will aim to:
 - Enlarge the cycle of trading of the securities issued by Arab companies in the region through investment promotion efforts.
 - Increase public awareness of Arab investors and paving the way to new horizons.
 - Make full use of Arab investments potentialities within the region, which will in turn have a positive effect on the people and living standards in the region.
 - Provide protection and guarantee to the operations between listed companies.
 - Encourage foreign investment in Arab companies.
 - Improve and expand the role of the intermediaries at the regional level with the aim of reaching the international level of performance.
- A Supreme Council will be established with a supervisory and regulatory capacity over the regional ASM. The Council will be composed of three chairs of capital market authorities members of the Union (countries will be chosen according to alphabetical order) and two experts. The chair of the Council will be elected by the board.

- The Council has the right to nullify any decision taken by the board of directors of AMS within a period that does not exceed two weeks.

Listing of Securities

- Companies will be listed upon request on the ASM according to the conditions set by the board of directors.
- The board will approve the listing of eligible companies based on a thorough assessment of their adherence to corporate governance principles, the soundness of the financial position of the company, their adherence to disclosure standards, and dividends distributed in the last two years. The board may consult with the Stock Exchange where the company was initially listed.
- The board of ASM will grant licensing to the financial intermediaries based on entry standards.

Securities Trading

- The board of directors will set the rules and regulations governing trading of listed securities, settlement of transactions, and market surveillance.
- Listed companies on the ASM will be required to submit periodical and annual financial data fifteen days before issuance date. Management of the ASM may examine the information before its dissemination. Management also has the right to demand more information if needed.
- The Management has the authority to suspend operations on the ASM or disqualify intermediaries in case of any law violation.

Arbitration

- Disputes will be settled and resolved by arbitration. An Arbitration Body will be established for this purpose. The arbitration decisions will be considered final and binding for all parties.

Criteria of Eligibility

The idea of the regional securities market is to help improve the quality of the traded financial tools and performance of issuers by insuring their readiness to fully adhere to and implement corporate governance principles and to set the example of best market practices. This is the criteria of eligibility that listed companies must be ready to comply. In addition, market intermediaries are also required, if they so wish to be licensed as regional entities, to meet such a criteria of similar eligibility. It is expected that this market will act as a center of excellence in this area and help encourage other companies to follow suit in terms of implementing corporate governance principles.

Forward outlook

To pursue cooperation in the field of corporate governance , Egypt has proposed to establish an Institute of Directors in Egypt and the region as well, to act as a center of excellence for the creation of a cadre of qualified human resources to manage corporations at different levels. The purpose is to sensitize corporate managers to the application of governance standards in order to meet the eligibility criteria of the regional securities market. In addition, the institute should develop plans to create awareness among business groups and stakeholders, public utilities, and agencies.

Recommendations

Regional financial markets have a long way to go before they can effectively contribute to economic growth and provide relatively cheaper financing. Yet, their role in pursuing corporate governance is indispensable. Exposing companies to new and modern practices is best achieved through capital markets where many of the current impediments can be practically removed. Through capital markets, companies can enlarge their shareholding base by going public, reducing ownership concentration, and building up better risk strategies, as their structure would allow a clearer delineation of management responsibilities. Corporate structure under capital market rules enables proper employment of modern management techniques. In addition, small sized companies can best satisfy their capital requirements for expansion purposes through the market at reasonable cost. Finally, capital markets reduce dependency on banks as the sole source of financing. Bank financing should be used to satisfy short-term financial requirements and not medium and long-term requirements.

Based on the review of the state of corporate governance principles implementation, it is recommended that the review the OECD Corporate Governance principles addresses the following:

Implementation and costs: markets in the region are in early stages of development. Corporate governance principles should be a vehicle for markets to grow rather than an impediment, costly to adhere to. Rules should allow for incentives to companies that adhere to corporate governance standards.

Addressing family owned companies: since family companies are the dominant characteristic in regional markets, it is recommended that corporate governance principles address this issue and be geared to suit this type of companies. Principles should not be an obstacle for the establishment and development of family companies as they represent the backbone of several economies in Asia, Africa, Europe, Latin America, and to some extent North America. However, there should be clear and enforceable principles that protect minority shareholders.

Bankruptcy and exit strategy: with exception of few countries in the region⁵⁰, bankruptcy procedures and exit strategy pose a problem for stakeholders and shareholders. Thus, it is recommended that the principles address this issue in depth.

Separation of ownership and control: governance systems in the MENA region are insider systems, that are characterized by majority or concentrated ownership. In these systems, there is no separation of ownership and control. Complete separation between ownership and control might not be realistic and might hinder further development of the family business environment. Thus, it is recommended that the principles should consider dilution of major shareholders voting rights to the extent that provides a room for minority shareholders and other stakeholders' rights.

Owner's wealth and company's financial position: it is recommended to address the issue of separating owners' wealth from the companies' financial position and extracting private benefits from the company such as extending credit to major shareholders.

⁵⁰ Jordan and Lebanon adopted bankruptcy regulations to protect stakeholders.

Board of directors: a number of reports and codes of corporate governance⁵¹ have addressed this issue extensively. Regardless of the board structure model (unitary or two-tier), the principles should address the issue of board independence. There should be a unified clear definition of the non-executive director⁵² and the criteria for ensuring independence. Minorities should have the right to appoint representatives to the board for better governance.

Accounting and auditing practices: it is recommended that the principles address the issue of differences in adopted accounting standards across the countries. Thus, unification of accounting standards is crucial for better disclosure and transparency. In addition, principles should promote monitoring the practices of accountants and auditors by an independent oversight board. Accounting and auditing practices should be supervised so as to confirm independence, sound and fair practices.

Internal Audit Committees: few markets in the region require the formation of an independent audit committee as a condition to be listed in their exchange⁵³. It is recommended that the principles explicitly state the need for internal audit committees and to be composed only of independent non-executive directors.

Governance Culture: introducing corporate governance as part of the culture of the country will constitute a good and practical solution for the problem of ownership-management mix and it will allow for separate ownership from management, which is in the best interest of the company. Authorities in securities markets, whether government or private business, should provide training opportunities for companies' management and staff as well as other parties with a view to introducing new management techniques and risk assessment methods and strategies.

Strict Bank Supervision: the introduction of a two-tiered approach to the corporate structure of family owned companies, particularly banks, whereby a board of commissioners representing the minority would supervise the board to ensure transparent dealings.

⁵¹Example, Cadbury report in 1992 and Higgs report in 2002 from UK, Winter report in 2002 from EC, and Bouton report in 2002 from France.

⁵² Definition among countries differs according to their regulations, example the case of US versus some European countries.

⁵³ The amended Capital Market Law in Jordan and the new Listing and Delisting Rules in Egypt stated this condition explicitly.

Stages of Development: there should be principles of corporate governance applicable to firms at every stage of their development and growth, from homegrown business to multinational corporations.

Ethics and Incentives: means should be developed for the establishment and enforcement of a code of ethics regarding the moral aspect of companies' operations. Operators need to believe in morals and should be helped for this purpose by relevant training and education. The civil society could be the moral qualifier in this respect with the support of an incentive system and self-regulation framework.

Appendix A **Recommendations from the Lebanese Delegation**

upon attendance of the
Middle East and North African Corporate Governance Regional Working Group

*The Lebanese delegation that attended the Middle East and North Africa Corporate Governance - Regional working group, held in Cairo, Egypt, on September 7, 2003 has issued this common statement that includes its comments on the report entitled **Corporate Governance for Morocco, Egypt, Lebanon and Jordan** and its recommendations for any work to be done on Corporate Governance in the region.*

Comments on the Report: "Corporate Governance for Morocco, Egypt, Lebanon and Jordan"

The Lebanese Delegation believes that several issues of high relevance to corporate governance in the MENA region in general are underestimated and in particular in the countries under review. The Delegation, thus, would like the report to highlight the following issues:

- Public governance and corporate governance have to be dealt with jointly and are of equal importance. Not only do many enterprises in the region are still state-owned but also public governance has direct repercussions on corporate governance. In addition, many recently published reports such as the Arab Human Development report and the World Bank's Governance Report in the MENA Region show very clearly that the region is lagging far behind other developing regions in respect to sound governance.
- Being the predominant forms of companies in the region, Small and Medium Enterprises (SMEs) and Family Owned Enterprises (FOEs) have to be more emphasized, and dealt with separately from larger corporations.
- It is very important to highlight the lack of information on the corporate sector in general, due to the small number of listed companies. Furthermore, information is also hardly accurate in the case of listed companies. Although the report does mention disclosure, it does not sufficiently explore how such disclosure could be encouraged. In the regional meeting, a suggestion was given to establish Companies Houses

that would list and collect information and statistics about non-listed companies.

- Concerning the securities and equities markets, the Delegation notes that most countries in the region do not have securities laws defining bonds, options, derivatives, or rights. Therefore legal reform should be seen as a priority in the region. In addition, even in cases where there are Central Securities Depositories (CSDs), where shares about all listed companies are declared by their owners (such as the case in Lebanon), such information should be electronic and accessible for more transparency.
- The role of the banking sector has not been given enough significance in the report. The ability of banks to monitor clients and the regulations issued by the Central Bank can positively affect corporate governance.

Good Corporate Governance in MENA countries

Recommendations & Proposals

The Lebanese delegation highlighted the importance of a general change in attitudes to uphold the values of transparent and accountable public and corporate governance. Due to the weak overall governance, the weak protection of minority shareholder rights, the still developing legal framework and the inadequacies of the judicial system, sound corporate governance practices are highly relevant for the region.

- It should be therefore seen as a priority to:
 - Introduce concrete judicial reforms
 - Amend laws to protect investors and minority shareholders
 - Modernize and reform insolvency and bankruptcy laws
 - Introduce comprehensive capital market laws
 - Enact a freedom of information act: Right to Know and Right to Tell
- The private sector should introduce the following changes:
 - Establish a separation between board and management
 - Standardize accounting and auditing practices

The Lebanese delegation believes that families/entrepreneurs should contribute to the development and well functioning of financial markets, and that the banking and financial sector is of crucial importance to enforce sound corporate governance. In the banking sector, developing central credit

organizations to report on sources and uses of credit (bank, non-bank & supplier credit) can improve credit information. Increased and improved credit information leads to lower borrowing costs, improves access to credit, develops a credit rating system, improves 'good standing', encourages investment, and facilitates access to export markets.

Core principles for sound corporate governance and monitoring mechanisms should be adapted and/or created:

- The Twelve Financial Soundness Codes and Standards should be adopted and their implementation monitored.
- The Cadbury Report principles for SMEs and FOEs should be adopted;
- OECD Corporate Governance principles should be adopted
- Rewards for good corporate governance should be created

Regional Corporate Governance Cooperation: Elements of an Action Plan

To represent the voice of the region effectively at the Paris meeting, the Lebanese Delegation recommends the following action plan for regional corporate governance cooperation:

The regional group should establish a Corporate Governance-Working Group for the MENA region whose objectives would include improving both corporate governance and the investment climate for the region. A website should be established on corporate governance for the countries of the region to enhance networking potential and the dissemination of knowledge on the issue. Further capacity building could be created by setting up and developing an institute of directors.

The Lebanese Delegation came to the conclusion that a regional dialogue on corporate governance is essential, and that the number of participating countries and organizations must be expanded. As the process should be demand driven, it calls to attract and involve other stakeholders, especially investors and the media.

It recommends building on the substantial economic, financial, banking and other reforms undertaken by some countries to reinforce this reform agenda, and focusing on the development of capital markets.

Guidelines for Transparency and Corporate Governance in Lebanon

The Lebanese Delegation suggests that a Code of corporate governance be adopted by countries in the region, and presents a proposal for a draft of such Code based on the Cadbury Report:

1. Minority shareholder protection

- Protect the rights of minority shareholders:
 - Right to vote on important matters
 - Right to buy back shares
 - Right to formally present an issue to the board of directors
- Treat foreign shareholders equally with domestic shareholders: non-discrimination principle

2. Responsibilities of the Board of Directors

- A majority of board members should be independent from management
- Boards should establish various subcommittees
- All material information should be publicly disclosed (transparency)
- Develop an investor relations program that fully informs all shareholders on corporate activities

3. Accounting and auditing

- Firms should conform to accounting and auditing practices and standards i.e. comply with IAS or U.S. GAAP.
- Audit committee should have a majority of independent directors, who should be able to read and understand fundamental financial statements
- All communications between the committee and external auditors should be without the presence of the company's management.

4. Transparency of Ownership and Control

- Transparency on who controls a company
- Disclosure of who has significant ownership

- Firms should disclose accurate, adequate, and timely information so as to allow investors to make informed decisions about acquisitions, ownership obligations and rights, and the sales of shares
- Establish ‘Companies House’ that would centralize information on companies

5. Regulatory Environment

- Credible and transparent regulatory environment
- Regulatory environment must not be perceived to be under control or influence any particular interest group
- Regulators should be independent from industry and from political parties

The Lebanese Delegation submits these recommendations to the Global Corporate Governance Forum (GCGF), the Organization of Economic Cooperation and Development (OECD), working groups on corporate governance in other MENA countries so as to address them in future working group conferences. It is also important to note that other countries of the region should be brought into this project.

APPENDIX B***Focus Group Discussion***

in collaboration with
Egyptian Ministry of Foreign Trade
Egyptian Center for Economic Studies
Confederation of Moroccan Employers (CGEM)
Private Sector Task Force on Corporate Governance in Lebanon,
(Lebanese Transparency Association, Secretariat)
Jordanian Forum for Economic Development

SUMMARY OF KEY FINDINGS

The Global Corporate Governance Forum recently partnered with the Center for International Private Enterprise (CIPE) to launch a region-wide initiative to assess the state of corporate governance in the Middle East & North Africa (MENA). Meetings in Lebanon, Morocco, and Jordan were attended by representatives from both the private and public sector, including corporate governance practitioners, auditors, and regulatory authorities. The meetings served as a forum to discuss challenges and trends in corporate governance and to field recommendations on implementing corporate governance in MENA. The transcripts drawn from these nation-wide meetings from provide a candid view of the state of corporate governance in MENA. The resulting recommendations from today's Regional Forum on Corporate Governance workshop will be presented in Paris during the November 2003 revision of the OECD Corporate Governance Principles.

It is urgent for the MENA region to surmount or remove existing barriers to implementing corporate governance standards in order for companies to be able to fully access the global market. Often the corporate governance standards promoted by developed economies are not appropriate for the needs of the emerging nations, and MENA is no exception. MENA is a diverse region that faces unique challenges in implementing corporate governance standards. As the debate on corporate governance expands into MENA, Arab businesspeople have stipulated that corporate governance standards be tailored to address the needs of the region.

At the Lebanon meeting, Maged Shawky, the Senior Advisor to the Ministry of Foreign Trade of Egypt and board member of the Cairo-Alexandria Stock Exchange, indicated that corporate governance has been promoted at different levels in the countries of the Middle East & North Africa. In Lebanon,

the banking sector is powerful and well developed and has been the avenue for corporate governance promotion. In Egypt, the focus of corporate governance has been on the capital market, due to its relative strength. As Maged Shawky stated, “In Jordan, the stock market is not highly developed, its main strength lies in the bi-lateral trade agreements and international investments it has attracted. Therefore Jordan has found it expedient to initiate corporate governance implementation within the domain of international investments.” Ra’fat Halaseh of the ABC Bank of Jordan suggested that one of the major obstacles to corporate governance implementation in Jordan is the lack of attention being paid to this important issue. Halaseh indicated that the banks in Jordan are the only ones who seem to be addressing corporate governance and that the private sector is not taking it seriously. The outdated business culture is being preserved at the cost of investment and growth in the Jordanian economy. Halaseh stated that the Jordanian way of conducting business relies too heavily on relationships; “People often know one another” and the rationale for investing in a company becomes, “We know this person and his business is well and is doing great.” This personal arrangement leaves little space for investments based on financial information on corporate performance and professional capabilities in a company.

Family Firms

The relationship-driven decision-making in businesses is consistent with the nature of the firm in MENA. Most of the private companies in the region are family owned businesses. This characteristic creates a gloomy economic outlook for the region when we consider that in MENA less than 5 % of family companies survive until the fourth generation. Corporate governance can create an internal structure to ensure the survival of the company into successive generations. The consensus at all three country-specific meetings was that in order to be effective in MENA, corporate governance standards need to encourage family-dominated firms to adopt modern business management techniques, including the delegation of responsibility based on merit and not bloodline and normalization of family member’s control of the corporate board to ensure that all board members contribute equally to the decision-making process of the company.

At the Lebanon meeting, Wajih El Bizri, Vice President of the Association of Lebanese Industrialists and President of the Lebanese Economic Forum, cited the closed-nature of family firms as the main barrier to corporate governance implementation. Often owner-managers lack the independence and objectivity needed to monitor the company’s activities and are often resistant to

adhere to corporate governance principles. He recommended that family firms take advantage of outside expertise in the form of consultants and auditors to assist them in the transition to a modern management style. This need for openness was echoed at the Jordan meeting by Fawaz Sha'lan, CEO of Medicare, who stated, "corporate governance is the key to separating ownership from management." Owners will only feel secure in delegating the management of their enterprise if the managers are professional and observe corporate governance standards. When corporate governance is observed, owners have the luxury of leaving the responsibility of the day-to-day management of their company to employees. Sha'lan stated, "Introducing corporate governance as part of the culture of the country will constitute the good and practical solution for this problem and it will become possible to separate ownership from management, which is absolutely in the interest of the company."

At all three meetings, the participants highlighted the challenge of reducing family influence over board decisions. To address minority shareholders' rights, the participants recommended addressing the pyramid system of management in family firms, in which family members, who are often the majority shareholders, impose their decisions on the rest of the board, in turn sidelining the minority shareholder and diluting the effectiveness of the board to make an independent decision. An even-handed approach, as recommended by Tony Frem, President of the INDEVCO Group, at the Lebanon meeting, would require that outsiders be on the board of family firms. He further recommended that the corporate governance standards created for MENA recognize the importance of maintaining some family members on the board, but no longer allow them to dominate the decision-making process.

At the Jordan meeting, Ghassan Nuqul of the Nuqul Group recommended the creation of a corporate governance statute to regulate family access to company finances in family firms, specifically in family-owned banks. Nuqul stated, "often a person in a family company can withdraw money from the company at any time he wishes. Family financial matters should be separated from the personal financial matters and this should be done in accordance with a clear and specific mechanism and discipline." Nuqul suggests that along with a corporate governance statute to protect the finances, a non-relative should be placed in charge of the company's finances in order to avoid unfair dealings. Participants recommended a two-tiered approach to the corporate structure of family owned banks, whereby a board of commissioners representing minority shareholders would supervise the board of directors to ensure transparent dealings.

Small and Medium Sized Enterprises

Mohammed Sa'eed Hammami, Managing Director of the Jordan Loan Guarantee Corporation, highlighted another characteristic to be considered: "corporate governance in the case of the small- and medium-sized enterprises." Most companies in MENA are small- or medium-sized enterprises. The corporate governance standards promoted in MENA must be applicable to small companies that do not have the same institutional capacity as the larger firms. Hammami recommended that the starting point for the application of corporate governance in SMEs should be at the level of financial disclosure. He stated, "What is required is capacity building, i.e. training the small private sector [firms] to become good reporters when they draft business plans or when setting up a data system for the statement of accounts." Participants at the Jordan meeting recommended that there should be principles of corporate governance applicable to firms at every stage of their growth, from a homegrown business to a multinational corporation.

Legal Environment

All companies in MENA are subject to the actions of legal institutions, regardless of their size or ownership structure. There are two arenas of challenges in the legal environment in MENA: scope and enforcement. The scope of legal framework varies between overly oppressive and controlling to overly lax and prime for abuse. Enforcement, meanwhile, is consistently spotty; according to the participants, the judiciary in the countries of MENA is not sufficiently developed to field the complaints of businessmen and to persecute violators of corporate governance standards. Ra'fat Halaseh, Deputy General Manager of the ABC Bank in Jordan, cited the challenge of the enforcement of laws governing banks, the Bourse, and private companies in Jordan. He stated, "All of these laws have articles which are supposed to guarantee corporate governance in the enterprises, although the mechanism of implementation in these enterprises is not clear." Often investigations of corporate misdeeds are shrouded in secrecy and rulings are dragged out for years. According to participants at the Morocco meeting, the market authorities lack "not only the will but also the legal power to carry out such an investigation."

At the Lebanon meeting, Mouwaffak El Yafi, Secretary General of the Arab Federation of Public Accountants and the President of the Lebanese Association of Public Accountants, raised the issue of legal challenges to corporate governance in MENA. Citing the outdated Lebanese Commercial Law, El Yafi recommended that vast changes be made to the legal environment

to ensure that corporate governance standards can be applied and upheld through institutional support. This includes the creation of new--and the enabling of existing--regulatory bodies to ensure a firm's compliance with corporate governance standards both within public institutions and private firms, including insurance companies and financial institutions. Judiciaries in MENA must have a set path of implementation to guarantee the enforcement of corporate law. In Jordan, participants recommended the creation of a system of "fast track settlements in financial market related disputes" and "education and training for all related parties including academics, economic press, judges, lawyers, board members, and executive managers" on the legal implications of corporate governance.

Accountants and Auditors

Several of the participants at the Jordan meeting cited accountants and auditors as the key to a stronger legal environment within the corporate structure. Within the framework of disclosure, participants at the Jordan meeting challenged the current auditor-director relationship. The level of independence of auditing committees is often unclear when auditors serve as consultants. The problem of conflict of interest in auditing bodies is rife in companies in MENA. Participants at the Jordan meeting recommended, "accounting and auditing practices should be supervised so as to confirm independence and sound and fair practices." According to Salem Khazaleh of the Department of the Comptroller General of Companies at the Jordanian Ministry of Industry and Trade, the focus of corporate governance in Jordan should be to, "prepare and activate the accounting environment and enable the accounts auditor to perform his legal and professional role. This can be done by sponsoring the international accounting and auditing rules, standards, and principles, as these represent the rules of disclosure, transparency, and the correct information." Ra'fat Halaseh stated a "need for independence of the internal auditor from the general manager so that the internal auditor can work with independent professionalism and perform his role." At the Lebanon meeting, Mowafak Al Yafi, President of the Lebanese Association of Certified Accountants, recommended rotating auditors so that there is no opportunity for the auditor to develop a long term, non-transparent relationship with a company. The vigilant and professional contribution of auditors and accountants can mend the challenges faced by the state of financial information in MENA.

Financial Reporting and Disclosure

Disclosure lies at the center of nearly all corporate governance statutes and codes. Participants at all three meetings identified disclosure as one of the biggest challenges facing the implementation of corporate governance in MENA. Not only is the information untimely, it is often poor quality and contributes very little to the strategic portfolio presented to potential investors. The participants at the Morocco meeting indicated that most shareholders are unable to decipher information presented in financial statements and annual reports because of poor quality. This problem exists despite the existence of statutes rendering the falsification of company information a criminal offense. Participants at the Morocco meeting recommend, “tackling the question of transparency of documents that are submitted to shareholders.” In addition, there is a challenge of “equality of information” in Morocco; not all shareholders are given the same amount of information on the company’s performance.

At the Jordan meeting, Ra’fat Halaseh expanded on the implications of corporate disclosure to illustrate the problems posed by insider trading in Jordanian companies. Halaseh stated that there are no functioning mechanisms to stop board members from benefiting from share trading based on insider information. This problem highlights a conflict of interest and is detrimental to corporations. According to Jalil Tarif, Executive Manager of the Amman Stock Exchange, the Securities Law of Jordan prohibits insider trading in the following statute: “Insiders, including members of the board of directors as well as executive managers and employees, shall not use any insider or confidential information to attain material or moral gains whether for their own benefit or for other and may not divulge any such information to any person other than their respective authority or the courts.” The provision against insider trading exists, but enforcement is still spotty.

Another challenge within the realm of disclosure and financial reporting is the problem of risk assessment. Financial information is of poor quality, and consequently the financial analysis based on this information is of poor quality. The ability to develop a risk assessment strategy is paralyzed by the lack of disclosure. As stated by Ghassan Nuqul at the Jordan meeting, “it is noteworthy that 99.9% of companies in Jordan have no risk assessment strategy.” Successful firms are not statist entities, and without a solid risk assessment strategy, it is difficult to modernize and expand the company. Participants at the Jordan meeting recommended that each company form a risk management department in order to encourage healthy growth of the company.

Board Member Responsibility

Many firms in the Arab world have not implemented modern management techniques in the corporate board structure. Without checks and balances, the delineation of responsibility is unclear and in turn burdens the firm's advancement. According to Bassam Asfour, the relationship between the board of directors, the senior management, and others in the corporate structure should be defined by a corporate governance code in order to ensure a professional operating environment. Corporate governance codes should be implemented and personalized for each company. The uniform necessity of the codes, according to Asfour, is to protect shareholders rights, to oversee management, to require transparency and disclosure, and the guarantee of independent board members.

At the Morocco meeting, a participant mentioned that in many companies, "general assemblies are held to validate administrative procedures," and, in fact, do not steer the direction of the company's progress. Participants noted that often the invitation to serve on a corporate board is seen as a grant and not a responsibility. Also, the corporate structure in Morocco does not universally provide for the separation of the roles of board members from the roles of management. The lack of professionalism in corporate boards extends to other countries in MENA. Na'im Khoury of the SABA Auditing Group cited the challenges posed by non-professional board members, stating that board members "should have knowledge, sufficient time, and should show interest in viewing and examining conditions of the company."

One of the recommendations set forth at the Morocco meeting was to enable the minority shareholder to participate in the decision making process and understand their rights: "there is a lack of interest of shareholders because they do not understand the usefulness of their presence; there is no shareholder culture." In Jordan, participants recommended diluting the major shareholder voting rights "to the extent that provides room for minority shareholders and stakeholders rights" as a means to increasing the role of minority shareholders in the corporate decision making process. The participants at the Moroccan meeting recommended forming a shareholders club that is committed to the principles of corporate governance and upholding their rights within the corporate structure. As mentioned by one participant, "this might drive companies to have a more structured and organized communication policy." Enhanced communication could lead to enhanced quality of financial reports. Information is the enabling factor to involve shareholders in decision making in a company.

Shareholders rights are the opposite extreme of another equally paralyzing challenge within companies: conflict of interest of board members. At the Morocco meeting, participants acknowledged that statutes exist to prevent individuals from serving on company board in which they have the opportunity to personally benefit, however “there remain problems at the level of practice.” Khaled Al Wazani, Head of the Economic Department of the Hashemite Royal Court, mentioned a dire need for professionalism in the public shareholding companies: “The members of the Board of Directors, which the government appoints to the public shareholding companies as representatives do not always possess the required experience to carry out their duties as members of the Board.” The lack of professionalism in board members creates a problem in the chain of responsibility because it is difficult if not impossible to prosecute a government appointed board member for corporate misdeeds. In the Arab world, corporate governance statutes need to address the presence of government-appointed board members in public holding companies. Al Wazani recommends increasing the number of private sector figures on the boards of public companies in order to improve their efficiency and interject new standards of professionalism. Additionally, professional executive committees should be formed to create a pool of capable and professional board members.

Ethics and Incentives

Participants at the Jordan meeting stated that statutes on the roles and responsibilities of board members must be accompanied by a sincere commitment to the moral aspect of company operations. During the Jordan meeting, Hani Hourani, Director General of the Al Urdun Al Jadid Research center, expanded on the challenge posed by businessmen intent on outmaneuvering corporate governance standards. The legal framework in which corporate governance standards are regulated must be strident enough to slow the constant outmaneuvering. The question of the moral implication of corporate governance emerges from within this challenge.

The moral qualifier, according to Ra’fat Halaseh, is civil society. He stated, “The civil societies can make companies comply with moral commitments rather than legal commitments.” At the Lebanese meeting, Armand Fares, President of the Lebanese Businessmen Association and President of the Lebanese Pharmaceutical Importers Association, challenged the assumption that regulations alone would stimulate the implementation of corporate governance. He cited the value of self-regulation and suggested that if regulations were imposed from the government without the consensus of the private sector, corporations might devise more ways to get around the new

corporate governance standard. Instead, practitioners must first be convinced of the value of corporate governance. A certain amount of voluntary effort on behalf of companies is necessary to make this a lasting initiative. Fares mentioned that strides have been made in Lebanon towards self regulation; business associations have penned a number of ethics and standards of conduct codes for employees and managers. Fares recommends that the voluntary and customized approach to corporate governance be nurtured in private firms as an alternative to enforcing the adoption of foreign standards of regulation.

At the Moroccan meeting, participants explored the possibility of publicly publishing the names of firms in compliance with corporate governance as an incentive. As mentioned by a participant, “when this is done, a kind of pressure is applied. It is the prestige of belonging to a group of transparent people. This is much better than coercion.” A similar initiative is already underway in Morocco. The Conseil Déontologique des Valeurs Mobilières (CDVM) acknowledges listed companies who respect fully the rules of transparency in market interactions. These companies are a benchmark for all other companies. At the Lebanon meeting, Nasser El Saidi, Vice Governor of the Central Bank of Lebanon, recommended expanding the recognition given to companies in compliance with corporate governance into an international mark of excellence. He suggested that an internationally recognized organization like the World Bank could list the names of well-governed companies. This free advertisement is just one economic incentive to implementing corporate governance.

Securing Capital and Investment

At both the Lebanon and the Jordan meeting, Maged Shawky Sourial drew attention to the important role of banks as suppliers of capital. Companies are aware that banks are a constant source of capital and, within this realm, companies are dependent on banks to provide money. This dependency creates an opportunity within the realm of corporate governance implementation. Banks have the right to demand the observation of standards from their borrowers. As stated by Ra’fat Halaseh at the Jordan meeting, “Jordanian companies should prepare themselves for what is coming because these companies will discover soon that when offering loans, the banking system will give substantive importance to the institutional life of the company, with corporate governance the only means that can guarantee the presence of a legal environment.” In the current stage of modernization of the banking sector, which includes the increased participation of foreign banks in local investments, it will soon be imperative for unlisted companies in MENA to provide accurate and detailed

financial statements on their performance as well as internal operating environment.

Banks in Jordan have already begun using the corporate governance standard of disclosure as a qualifying mark in accepting and rejecting loan applicants. According to Eman Al Damen, Head of the Credit Department at the Cairo Amman Bank, the majority of the companies that approach the Amman branch of the bank for financing do not provide sufficient disclosure of financial information. The principle of disclosure is paramount in banks' selection of their clients. As mentioned by Ghassan Nuqul at the Jordan meeting, good corporate governance in a company can mean better loan terms because "governance is a comfortable indicator to the banks." Nuqul recommended the establishment of a task force to explore and promote banks' impact on corporate governance implementation in potential borrowers.

Corporate governance is not only a qualifier for bank loans but also a qualifying factor for recipients of foreign direct investment and for companies entering capital markets. In Jordan, according to Jalil Tarif, listed companies on the Amman Stock Exchange must submit quarterly reports and detailed auditors reports. The reports are reviewed quarterly by external auditors. According to Ra'fat Halaseh of the ABC Bank, "the Jordanian Securities Commission has updated the laws governing its functions. In the last two years, the Commission has been engaged in a clear and productive activity in the field of regulating and controlling the process of trading in securities and disclosure of companies." In the case of the Beirut Stock Exchange, the Bourse's legal advisor, Shadi Salameh stated that firms which do not comply with international auditing standards and financial disclosure requirements are de-listed and subject to a legal investigation. All listed companies must submit documentation to the Beirut Stock Exchange in-house auditing committee. There is room to expand the qualifications of listed companies to include other corporate governance standards. He recommends creating a monitoring committee within the Beirut Stock Exchange to gauge corporate governance among the listed companies.

The Beirut Stock Exchange was founded in 1920. Despite its early beginnings and its current cross-listing status with the Cairo Alexandria Stock Exchange and the Kuwaiti Bourse, only 12 Lebanese companies are listed and trading is sluggish. At the Jordan meeting, Bassam Asfour stressed the importance of incentives from financial institutions in the promotion of corporate governance. He stated, "We should encourage them to show that their successes are strong enough to withstand disclosure and transparent behavior, and we should also encourage them to go public so that their successful

experiences can benefit potential investors and provide them with expansion and further growth at low cost.” Participants at the Morocco meeting noted the benefits of going public. One participant stated, “If we are quoted in the stock market, we have the possibility to diversify the sources of financing and reduce the costs of financing, then this is a change we must embrace.” Additionally, many investors recognize that listing a company implies a degree of transparency and possibly a lower risk of investment. With only around 50 companies currently listed on the Casablanca Stock Exchange there is room for more companies to go public.

At the Lebanon meeting, Nasser El Saidi mentioned ways in which listing companies naturally expedites the company’s adoption of corporate governance standards. Saidi recommended that companies let 25% of the firms’ capital to go public to “democratize the company.” With one quarter of the firm under the control of minority shareholders, the principles of corporate governance become more important, especially to the minority shareholders who can push for implementation. Saidi also stated, “the [stock] market is able to impose discipline,” through its independence as a capital markets authority. However the challenges of enforcement still faces the Beirut Stock Exchange. The problem of enforcement of capital market statutes extends to Morocco and Lebanon, as voiced by the participants.

Conclusion

Despite the formidable challenges, the stock markets, the banks and many companies in MENA are on the path to modernization. Clear divisions between departments within the stock exchanges, public adherence to international auditing standards, financial disclosure requirements, and efforts to create a binding legal framework for corporate disputes have demonstrated the important role that capital markets play in the region. During his presentation at the Jordan meeting, Bassam J, Asfour, Chairman of the Jordanian Securities Commission, stated, “Jordan’s economy is becoming more and more interdependent on the regional and the world economy. Companies find themselves competing in a global environment and as such must be able to attract low cost capital whether from local, regional, or international sources.” This statement is equally true for all of the Arab countries. Corporate governance has emerged on the agenda as one of the most important elements of conducting business. It is rightly seen as essential to attract investment, to access capital, and to develop risk management and competitiveness. Corporate Governance implementation is the key to the Middle East’s & North Africa’s continued participation in the world economy.

