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**Does Saudi Corporate Governance attain International Standards
using the UK Best Practice as an Exemplar**

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

By
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2018

Declaration

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

Hussam Al Ahmary

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Abbreviations Used

UK CA 2006	United Kingdom Companies Act 2006
UK CGC	United Kingdom Corporate Governance Code
CL 2015	Saudi Companies Law 2015
CL 1965	Saudi Companies Law 1965
CML 2003	Capital Market Law
CGR 2006	Saudi Corporate Governance Regulations 2006
CGR 2017	Saudi Corporate Governance Regulations 2017
CRSD	Committee for the Resolution of Securities Disputes
ACRSC	Appeal Committee for the Resolution of Securities Disputes
UK	United Kingdom
OECD	Organisation for Economic Co-Operation and Development

Abstract

The concept of corporate governance has been recognised as one of the most important legal, business and financial management concepts in recent times. Corporate governance is a tool that aims to apply principles such as fairness between shareholders, punishing and preventing wrongdoing, helping society and encouraging full disclosure of company information. This will help to reinforce the stability in the financial market, restore the confidence of investors and attract new and foreign investment.

The primary objective of this research is to determine whether the Saudi Arabia corporate governance framework is in line with international standards and to examine if there are any need and willingness for reform. The motivation for selecting the United Kingdom as a benchmark for comparison was inspired by its reputation in upholding high corporate governance standards. The research seeks to outline possible recommendations to add to the Saudi corporate governance regulation, so it can achieve the highest possible standards of corporate governance. A starting point would be the analysis of the UK Companies Act and the UK Corporate Governance Code to determine what can be learned from the experience in the UK to help advance the situation in Saudi Arabia. The research will focus on several key issues, namely, directors' duties, current boardroom practices and gender diversity in Saudi corporate boards. The research will also take into account the possibility of implementing any suggested reforms in adherence to Sharia principles.

The research found that the Saudi corporate governance reflects certain elements of good international corporate governance standards. However, the research revealed major shortcoming in Saudi directors' duties and gender diversity and that these need reform to attain international standards. Taken together, the research findings suggest that Saudi Arabia will benefit from adopting some of the best practices from the UK to reinforce its attractiveness to foreign investment.

Acknowledgements

All praise be to Allah.

I would like to thank my family for their continuous support and encouragement throughout the whole of this journey, always. I would also like to thank Professor Christopher Ryan for his confidence and inspiration, unyielding reassurance and guidance throughout this thesis.

Chapter One

Introduction

Corporate governance aims at optimising and rationalising investment of its capabilities and resources by creating a business environment based on responsibility, control, commitment and transparency. Whether in defining the company's objectives and strategic business plans, or in defining the rights and obligations of each of its entities, and in managing its relationship with stakeholders. This environment interacts with the system of national legislation within which the companies operate and integrate to achieve their objectives effectively and impartially.

The collapse of “role-model” entities, such as Enron Corporation in the USA, the Polly Peck and Barings Bank in the UK and the financial crises experienced in the 1990s in Latin America, Russia and East Asia have thrust the importance of corporate governance into the limelight.¹ These failures were attributed to the lack of transparency, disclosure of the financial accounting data and the weak regulation of the financial markets.² It was then that countries started to notice the need for optimal corporate governance regulations. These regulations have been the most important tool in eliminating or at least mitigating the inherent flaws in the system and regain the confidence and trust of investors.

In the case of Saudi Arabia, it was the collapse of the Saudi financial market in 2006 that prompted Saudi Arabia to realise the importance of corporate governance. The financial crisis highlighted the inherent flaws in financial reporting, transparency, accountability and disclosure.³ The Saudi regulation introduced in 2006 the country's first corporate governance regulations (CGR 2006) to ensure the protection of the securities market and its investors. The CGR 2006 was viewed as the most important legal, financial and administrative regulations in the country at that time.⁴

¹ Ahmad, S. and Omar, R. (2016). Basic corporate governance models: a systematic review. *International Journal of Law and Management*, 58(1), p.77.

² Alotaibi, M. (2015). The importance of corporate governance in Saudi Arabia economy. *Journal of WEI Business and Economics*, 4(1), pp.14-16.

³ Bahrawe, S., Haron, H. and Hasan, A. (2016). Corporate Governance and Auditor Independence in Saudi Arabia: Literature Review and Proposed Conceptual Framework. *International Business Research*, 9(11), p.4.

⁴ *Ibid.*

This research was conducted at a time of change in Saudi Arabia. Saudi Arabia is at the beginning of a National Transformation Programme (Vision 2030) that aims to diversify its oil-dependent economy and to attract foreign investment to the country. Additionally, the publication of the new Companies law in 2015 and the Corporate Governance Regulation in 2017 are some of the changes that reflect the desire of the Saudi government to attain international standards.

1.1 Research significance

To support corporate governance on a worldwide scale, it is imperative to develop a set of principles of corporate governance which serves the dual goal of avoidance of risk and ensuring the benefits of all stakeholder groups. These groups include shareholders, employees, customers, lenders, environment and local communities and against mismanagement.⁵ Corporate governance provisions have outlined the importance of the link between shareholders' and other stakeholder groups, the board of directors and top management.⁶ Aguilera et al⁷ argued that developed and less developed countries have been split into two groups regarding their opinions on corporate governance. Some follow the Anglo-American shareholders' model, whilst others in less developed countries tend to follow the Continental European and Japanese stakeholders' model.⁸

Corporate governance is a tool that can ensure principles such as fairness between shareholders, punishing and preventing wrongdoing, helping society and encourages full disclosure of company information. Additionally, effective provisions of corporate governance are not only necessary for local corporations but also for attracting foreign investment to ensure a strong economy and the quality of a country's' institutions of governance.⁹ Thus the effectiveness of corporate governance is significant when it comes to attracting foreign investors and ensuring

⁵ Monks, R. and Minow, N. (2011). *Corporate governance*. Chichester, West Sussex, U.K.: John Wiley & Sons, p.2.

⁶ Solomon, J. and Solomon, A. (2004). *Corporate governance and accountability*. Chichester: Wiley, p.3

⁷ Aguilera, R., Williams, C., Conley, J. and Rupp, D. (2006). Corporate Governance and Social Responsibility: a comparative analysis of the UK and the US. *Corporate Governance: An International Review*, 14(3), p.147.

⁸ *Ibid.*

⁹ El Khudery, M. (2005) *Corporate Governance*, Arabic edition, Arab Nile Group, Egypt., p. 10.

the development of the country. This view is best expressed by Charles Oman,¹⁰ whereby he states that:

“Corporate governance matters not only because the health of a country’s corporate sector matters for the country’s entire economy but because the quality of a country’s institutions of governance matters greatly for national development. The ability to move from heavy relationship based on predominantly rules-based institutions of corporate as well as public governance is central to the success of the long-term development process in all countries.”¹¹

Moreover, in this day and age, it is hard to disregard the effect that globalisation has on individual economies and the financial market. This effect was felt by Saudi Arabia and several other countries. O’Sullivan¹² explained that the process of globalisation and the global integration of financial markets have arguably put pressure and encouraged the national systems of corporate governance to converge.

An important factor that enhances the significance of the research is Saudi Arabia’s recent implementation of the National Transformation Plan.¹³ Vision 2030 is a major turning point in the history of Saudi Arabia that aims to have a significant impact in terms of economic diversification, privatisation programme, increasing the role of the private sector and attracting direct foreign investment.¹⁴

Furthermore, the publication of a new Saudi Company Law in 2015 (CL 2015) and the Corporate Governance Regulation 2017 that superseded the outdated Company Law issued 1965 and Corporate Governance Regulation 2006 had the intentions of meeting the modern-day needs of the company sector and to establish a motivating environment where companies can thrive and in order to increase their contribution to the Saudi economy. This research is intended to be one of the earliest to examine the recent legal developments in Saudi, specifically

¹⁰ Buiter, W., Fries, S. and Oman, C. (2004). Corporate Governance in Developing, Transition and Emerging-Market Economies. *OECD Development*, 10(1), p.8.

¹¹ *Ibid.*

¹² O’Sullivan, M. (2000). Corporate Governance and Globalization. *Annals of the American Academy of Political and Social Science*, 570(1), p.154

¹³ Vision2030.gov.sa. (2018). *vision 2030 Saudi Arabia*. [online] Available at: <https://vision2030.gov.sa> [Accessed 23 Jul. 2016].

¹⁴ *Ibid*

with regards to the board of directors and their duties in light of those in the United Kingdom and international corporate governance standards.

Therefore, the search for the ideal corporate governance system has become an issue that must be addressed in order to achieve the growth of Saudi Arabia's economy and guarantee their market efficiency and viability. This will support the country to receive and improve their incoming investments and enhance its borrowing potential abroad.

1.2 Aims of Research

The aims of this research are (1) to critically assess whether the Saudi Arabian corporate governance meets international standards by using the UK best practices as an exemplar and to examine if there is a need for reform. This will be determined by analysing the Anglo-American and other Continental models to see whether any lessons can be learned; (2) to outline possible recommendations to amend or add to Saudi corporate governance provisions to achieve an international standard of good corporate governance. A starting point for a possible recommendation will be an analysis of the UK Companies Act 2006 and the UK Corporate Governance Code. The research will also aim to investigate the current practices of Saudi corporate governance and the religious and cultural hurdles that may be faced when attempting to introduce changes to try to reform the framework.

The UK enjoys a respectable and prestigious reputation in terms of law development and is considered at the forefront when it comes to laws regarding the operation of companies and the development of corporate governance. The long cumulative experience of the UK has resulted in the enactment Companies Act 2006 which codified directors' duties, grant more rights to shareholders and the administrative process required by companies.¹⁵ Furthermore, the periodic review and continuous development of the UK Corporate Governance makes the UK an ideal benchmark to find some solutions to any insufficiencies apparent in the Saudi context.

The corporate governance model in Saudi Arabia is considered to be much closer to the Anglo-American model. The Saudi model of corporate governance share resemblances to the Anglo-

¹⁵ Legislation.gov.uk. (2018). *Companies Act 2006 - Explanatory Notes*. [online] Available at: <http://www.legislation.gov.uk/ukpga/2006/46/notes> [Accessed 18 Aug. 2016].

American models in the UK as they both adopt a unitary board of directors without any form of employee representation as well as its shareholder-oriented approach. Therefore, using the UK Companies Act 2006 and Corporate Governance Code as exemplar will aid in the attempt for reform in the Saudi context.

1.3 Research questions and problems

The research will seek to assess whether the current framework of corporate governance in Saudi Arabia is in need of reform. The research will examine the Anglo-American and International standards of corporate governance to select what reforms can be introduced and would be more suited for Saudi Arabia. To address the main question, the following sub-questions will be analysed in subsequent chapters.

1. How did the current Saudi corporate governance system develop?
2. How does the current Saudi corporate governance structure operate?
3. Whether the current practices in Saudi Arabia corporate governance attain international corporate governance standards, by reference to the UK, particularly in relation to directors' duties, boardroom practices and gender diversity, or whether it is in need of reform.
4. Whether internalised reform solution based on the principles derived from Shariah law could, on its own, raise the profile and efficacy of the Saudi corporate governance to the standard of any of the models examined? However, several problems were identified whilst working on this thesis, including:
 - a) Evaluating the current practices of the Saudi corporate governance system and whether there will be a real passion to reform;
 - b) How feasible will it be for Saudi corporate governance systems to incorporate any of the reforms that may be suggested and still be in line with Islamic Law (Sharia Law); and
 - c) The scarcity of literature on Saudi corporate governance systems.

1.4 Research methodology

The methods used in this research will be both critical analytical and comparative methods. A critical analytical approach will involve reviewing a number of different bodies of literature, laws and regulations as well as providing an overview of the Saudi Arabian corporate governance framework in order to suggest possible reforms. The methodology includes analysing the decisions that were issued by the Capital Market Authority and the Committees for the Resolutions of Securities Disputes regarding the themes of corporate governance of Saudi Arabia. It would be necessary to pay particular attention to the regulations of Saudi Arabia, with specific attention to the official Capital Market Law and Implementing Regulations.

The second approach will be comparative. This method will be used to achieve the aims of the research. A comparison will be carried out between the Saudi corporate governance preparations and those specified in the United Kingdom as well as OECD corporate governance principles with regards to the development of corporate governance frameworks. The specific aim will be to see what lessons could be learned from the UK model that could benefit the Saudi Arabian framework. One of the possible advantages of a comparative approach is that it identifies specific or novel legal issues that have been encountered in other jurisdictions and how they have been resolved. A comparative approach plays a significant role when transplanting laws and regulations from ‘industrialised nations’. Jonathan Hill¹⁶ states that the main goal of a comparative approach is to improve the scope of laws.

1.5 Literature review on corporate governance

In modern corporations, corporate governance has risen in significance. This was due to the separation of management and ownership. Corporate governance can be viewed from different angles and it appears to have a number of different definitions. Brele and Means and Zingales (1998) have defined corporate governance as:

“allocation of ownership, capital structure, managerial incentive schemes, takeovers, board of directors, pressure from institutional investors, product market competition, labour market competition, organisational structure, etc., can all be thought of as institutions that affect the

¹⁶ Hill, J. (1989). Comparative Law, Law Reform and Legal Theory. *Oxford Journal of Legal Studies*, 9(1), p.102.

process through which quasi-rents are distributed’’¹⁷. Whereas Garvey and Swan¹⁸ state that “governance determines how the firm’s top decision makers (executives) actually administer such contracts’’.¹⁹

Furthermore, the Organisation for Economic Cooperation in 1998 released a document unifying the code on corporate governance. The definition was "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance.”²⁰ The OECD, whose members include the UK, USA, Germany, France and Canada asserts that “Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring’’²¹

The definition provided in the Cadbury Report is one of the most used definitions of corporate governance. Sir Adrian Cadbury, the head of the committee on the financial aspects of corporate governance in the UK, stated “Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require

¹⁷ Berle, A. and Means, G. (1932). *The modern corporation and private property*. 2nd ed. Transaction Publishers, p.4.

¹⁸ Garvey, G. and Swan, P. (1994). The economics of corporate governance: Beyond the Marshallian firm. *Journal of Corporate Finance*, 1(2), pp.139-174.

¹⁹ *Ibid* p.139.

²⁰ the OECD Principles of Corporate Governance. (1999). *Organisation for Economic Co-Operation and Development*, p.6.

²¹ the OECD Principles of Corporate Governance. (2004). *Organisation for Economic Co-Operation and Development*, p.11.

accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.’²²

The focus of the Cadbury Report was to introduce the principle of ‘comply or explain’. The Report was not intended to be obligatory in law. This means that companies and their governing bodies should apply the recommendations of the report or explain why they do not implement the recommendation. Pettet et al²³ commented that:

“The Cadbury Report was not a report which produced a long list of recommended changes to the law and which thereby postponed the resultant hoped-for improvements until some remote future date after the legislature had acted on the recommendations. The Cadbury report took effect swiftly and without reliance on the law. Sometime after the report was issued by the London Stock Exchange added force to the recommendations of the report by amending the Listing Rules so as to require listed companies to make a statement about their level of compliance with the Cadbury Code of Best Practice and give reasons for non-compliance’²⁴.

Following the Cadbury Report came the Greenbury Report in 1995 which focused on the director’s remuneration and the procedure for remuneration committees. ²⁵This report paid attention to the compensation packages for the executive, non-executive and independent board.²⁶

An advanced definition was made by Shleifer and Vishny²⁷ where they focused more on the provision of finance, considering the protection of outside investors against the expropriation of their financial resources by the companies. They stated that “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. How do they make sure that managers do not steal the capital they supply or invest it in bad projects? How do suppliers of finance control managers?”²⁸

²² Cadbury,A. (1992) *Report of the Committee on the Financial Aspects of Corporate Governance*, Gee Publishing, London,p.9.

²³ Pettet, B., Lowry, J. and Reisberg, A. (2009). *Pettet's Company Law: Company and Capital Markets Law*. 3rd ed. New York: Pearson Education Ltd,pp.193-194.

²⁴ *Ibid.*

²⁵ Greenbury, R. (1995). *Directors' remuneration: report of a study group chaired*. London: Gee Publishing,p.9.

²⁶ *Ibid* p.9.

²⁷ Shleifer, A. and Vishny, R. (1997). A Survey of Corporate Governance. *The Journal of Finance*, 52(2), pp.737-783

²⁸ *Ibid.*

The Turbull Report was published in 2003 and it focused amongst other things, on the internal controls and risk management system. It asserted that the board was fully responsible for making sure that the internal control policy should be put in place and required corporations to report on the controls and risk management system. In addition, The Higgs Committee in 2003 made a number of recommendations relating to the roles non-executive directors and that corporations must produce annual financial reports with the number of the board meetings held and the self-evaluation of the performance of the board. This task must be completed at least once a year.²⁹

Moreover, The Smith Report was also published in 2003, and it was established to scrutinise the internal audit committee role and the methods used to ensure that financial reporting and internal controls should be in the interest of the shareholders.³⁰ A Combined Code was published in 2008 and it consolidated all the past committee reports and produced a common corporate system for the UK listed or quoted joint stock companies. A number of areas were covered in the combined code, such as the link between shareholders and institutional shareholders.³¹ It also required that at least a third of any board members to be non-executive or at least half board to be independent and that no power should be held by one or two members. For example, the Chairman of the board and the CEO should not be the same person.³²

Plessis (2009) defined corporate governance as “The process of regulating and overseeing corporate conduct and of balancing the interests of all internal stakeholders and other parties....who can be affected by the corporation’s conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation”.³³ This definition was viewed as a method of “checks and balances” and ensuring the interests of all corporate participants as well as all concerned stakeholders. Corporate governance has been the subject of extensive research in the UK. For example

²⁹ Higgs, D. (2003). Review of the Role and Effectiveness of Non-Executive Directors. *The Stationery Office*, p.21.

³⁰ Smith, R. (2003). Audit Committees Combined Code Guidance. *the Financial Reporting Council*, pp.3-17.

³¹ The Combined Code on Corporate Governance, (2006). *Financial Reporting Council*, p.5.

³² *Ibid* p. 8.

³³ Plessis, J. (2009). Corporate Law and Corporate Governance Lessons from the Past: Ebbs and Flows, but Far from “The End of History” Part1. *Company lawyer*, 30(2), p.44.

Demirage 1998³⁴, Ezzamel and Willmott 1993³⁵ and Vinten 2001.³⁶ In 2000 Vinten³⁷ compared corporate governance practices between the UK and the US. In 1994 Charkham³⁸ compared corporate governance practices in 5 countries: UK, USA, Japan, France and Germany and he found significant differences in each jurisdiction. This will be discussed later as the research progresses. However, research carried out to investigate corporate governance in developing countries is quite limited and even more so in Saudi Arabia. Al-Motairy examined the corporate governance practices in Saudi Arabia and he faced a number of obstacles in terms of the availability of resources.³⁹ He analysed the regulation of business practices and focus on Saudi Company Law, Capital Market Law and foreign investment law. He pointed out that there is an urgent need to review these regulations to bring them in line with those in more developed countries. Another study was carried out by Oyelere and Mohamed⁴⁰ in 2008 on the current corporate governance practices in the neighbouring country of Oman. The study investigated how corporate governance is being communicated to Stakeholders and recommended tightening the regulations and communication of the Omani stock market in order to be in line with international standards and developments.⁴¹

The Centre for International Private Enterprise institution, CIPE, carried out research in 2003 examining four Middle Eastern countries namely: Egypt, Lebanon, Morocco and Jordan. It analysed corporate governance practices in those countries and concluded that there are several disparities. It pointed out that each country adopted a different approach depending on the complexity of their financial market. It set out several recommendations to improve corporate governance practices in these Islamic states.⁴²

³⁴ Demirage, I. (1998) *Short termism, financial systems, and corporate governance, in corporate governance, accountability, pressures to perform; an international study*, JAI Press, pp. 7-24.

³⁵ Ezzamel, M. and Willmott, H. (1993). Corporate Governance and Financial Accountability: Recent Reforms in the UK Public Sector. *Accounting, Auditing & Accountability Journal*, 6(3), pp. 109-132.

³⁶ Vinten, G. (2001). Corporate Governance and the Sons of Cadury. *Corporate Governance: The international journal of business in society*, 1(4), pp.4-8.

³⁷ Vinten, G. (2000). Corporate governance: the need to know. *Industrial and Commercial Training*, 32(5), pp.173-178.

³⁸ Charkham, J. (1994) *Keeping Good Company: A Study of Corporate Governance in Five Countries*, Oxford Press, Oxford.

³⁹ Al-Motairy, O. (2003) Implementing corporate governance in Saudi Arabia, *Arab Journal of Administrative Sciences*, 10(3), pp. 281-305

⁴⁰ Mohamed, E., Oyelere, P. and Al-Busaidi, M. (2005) A survey of internet financial reporting in Oman. *International Journal of Emerging Markets*, 4(1), p.9.

⁴¹ *Ibid.*

⁴² The Centre for International Private Enterprise (CIPE). 2003. Regional corporate governance: Recommendation corporate governance. Working group of Middle East and North Africa, <http://www.cipe-arabia.org/search.aspx> Last Accessed 22 December 2016.

Therefore, it is evident that the middle east as a whole needs better corporate governance in order to add more fairness, transparency and act as a form of “checks and balances”, which will strengthen investors’ confidence in their financial markets and in particular the Saudi Arabian market.

1.7 Comparative Law and Legal Transplantation

This section is going to discuss corporate governance in relation to listed companies in Saudi Arabia. The Saudi Arabia stock market operates in a manner which aims at maximizing value and receiving more liquidity. This is done by targeting foreign investors investments in the country. Consequently, interpreting other worldwide successful experiences and assessing the compatibility of Saudi Legislation with other prosperous global regimes in relation to this manner, will influence the development and improvement of corporate governance and the stock market of Saudi Arabia.

To achieve the prime merits of comparative law, it is essential that the nature of law and sources of legal development are understood. This allows for a fuller insight into the different facts which are considered to shape legal rules. In addition, it affects legal reform in a positive way, as it improves the academic and practical fields in this field.⁴³

Individuals may be divided into advocates or resistors of state legal change using international and transnational law. Regardless of their position, it is essential that the factors and implications which may complement or hinder those legal changes are recognised. In addition, it is ‘important to consider the dynamic interaction between transnational law and its opportunities, limits and impacts in light of their particular contexts and local institutions and national law’⁴⁴

⁴³Watson, A. (1974). *Legal transplants: An Approach to Comparative Law* (1st ed.) Edinburgh: Scottish Academic Press, at 16,17.

⁴⁴ Gregory, S. (2012). Transnational Legal Process and State Change. *Law and Social Inquiry: Journal of the American Bar Foundation*, 37, at 45. Available at SSRN: <http://ssrn.com/abstract=1901952>, accessed on 20/3/2016.

Moreover, comparative law provides essential benefits to those concerned with legal reform. It allows them to have a decision on the methods of borrowing from other systems. In addition to this, advocates of legal change will be able to evaluate the accuracy and gravity of foreign solutions as well as deciding the extent to which they require modifications.⁴⁵ Therefore, for the people concerned with law reform to get the optimum of comparative law, it is crucial that they are able to distinguish and isolate the reasons for success in a society. It is essential that they take into consideration the circumstances which hamper or aid legal development in the reviewed societies.⁴⁶

1.7.1 The Concept of ‘Legal Transplantation’

It is regarded the legal transfers played and continue to play an important role in the development of legal systems around the world.⁴⁷ Alan Watson created the term ‘legal transplant’ in the 1970s. He defined it as “the moving of a rule or a system of law from one country to another or from one people to another”.⁴⁸

In particular, Watson insists that legislation is regarded as “the fruit of human experience” just like technology which is created and developed in a specific region, and then spread out to the rest of the world based on its relevant value and need to those areas.⁴⁹ Therefore, it is concluded that less developed and advanced countries are those who are more likely to adopt foreign legal rules. This statement is supported by historical evidence two of which relate to Germany in the fifth century and the Wild West.⁵⁰ Furthermore, Transnational legal rules play a role in assisting legislators in perceiving and shaping the most relevant enactments and institutional arrangements which are unique to each country. This guarantees an accurate application and enforcement of the laws enacted. Hence Comparative law and legal

⁴⁵Watson, A. (1974). *Legal transplants: An Approach to Comparative Law* (1st ed.). Edinburgh: Scottish Academic Press, p. 16.

⁴⁶ *Ibid.*

⁴⁷ Gillespie, J. (2006). *Transplanting Commercial Law Reform: Developing a 'rule of Law' in Vietnam*. Aldershot: Ashgate Publishing, Ltd., at 3.

⁴⁸ Watson, A. (1974). *Legal transplants: An Approach to Comparative Law* (1st ed.). Edinburgh: Scottish Academic Press, p. 21.

⁴⁹ *Ibid.*, p 95, 100.

⁵⁰ *Ibid.*, p, 99.

transplantation are crucial in developing societies, by benefitting from successful experiences of other states in relation to legal norms, processes and institutional organisations. ⁵¹

1.7.2 Causes and Forms of Legal Transplantation

Valderrama proposes the main aspects that certify laws for legal transplant: "(i) authority, (ii) prestige and imposition, (iii) chance and necessity, (iv) expected efficacy of the law, and (v) political, economic and reputational incentives from the countries and third parties".⁵²

Moreover, the methods of legal transplant can be divided, into two major forms externally imposed and internally voluntary which will be discussed below.⁵³

First, externally imposed transplants are compulsory. They come to effect with colonization and military expansion. It is considered as the main form which superpowers used to legally transplant into an ideal number of host developing countries. ⁵⁴ It is falsely inferred that compulsory transplantation ends with the end of the colonial era. However, this is not the case, it is argued that legal transplant was used as a weapon in the 'Cold War' between the USSR and the United States.⁵⁵ Moreover, it is insisted that forced legal transfers continue to exist through certain agreements and international legal harmonization projects. ⁵⁶

Second, voluntary legal transplants are ones which are regarded as positive legal transfer. This is the method which is adapted today and plays a great role in legal transfers that are governed by internationalisation and globalisation. It is the most logical form, especially in relation to commercial and economic sectors. These two fields have an increasing demand for

⁵¹ Gregory, S. (2012). Transnational Legal Process and State Change. *Law and Social Inquiry: Journal of the American Bar Foundation*, 37, p.15. Available at SSRN: <http://ssrn.com/abstract=1901952>, [accessed on 20/6/2018.]

⁵² Valderrama, I. (2004). Legal Transplants and Comparative Law. *International Law Journal*, 1(2), p.265. Available at SSRN: <http://ssrn.com/abstract=2017940>, accessed on [20/6/2018]

⁵³ Berkowitz, D., Pistor, K., and Richard, J. (2003). Economic Development, Legality, and the Transplant Effect. *European Economic Review*, 47(1), p. 174.

⁵⁴ Gillespie, J. (2006). *Transplanting Commercial Law Reform: Developing a 'rule of Law' in Vietnam*. Aldershot: Ashgate Publishing, Ltd., p. 3.

⁵⁵ *Ibid.*

⁵⁶ *Ibid.*

this method because of the presence of international trade and investments in addition to ‘global economic integration and the standardization of global models.’⁵⁷

Furthermore, transferring legal norms in a voluntary manner is accomplished through specific individuals and institutions. These include business representatives, public bodies, independent activists, and professionals.⁵⁸ Importantly, these individuals are supported by ‘transnational organisations and networks, as well as international treaties and global, multilateral, regional and bilateral norms that are approved by their country’.⁵⁹

1.7.3 Standards for Legal Borrowing

It is crucial to point out that legal transplant may not be separated from its cultural, political, social and economic contexts. Moreover, it is not a simple remove and adds process. It may be beneficial to a certain area but does not have the same performance when applied elsewhere. The final consumers should be analysed before adopting a foreign rule. Consequently, it is essential that Law Makers are able to distinguish and become familiar with legal borrowing, and its effectiveness in relation to the targeted local legal culture. This consideration will allow for the rules to be legitimate, enforceable and effective in relation to the development that is needed.⁶⁰

This can be accomplished by considering the legal environment in the recipient country. Valderma points out that "the transplantation process may vary based on social, legal economic, fiscal, financial and technical circumstances prevailing in each country’s “legal culture” and legal system".⁶¹ What works for one society, may be disastrous for another. Therefore, failure to consider these important factors before the transplantation takes place may result in a negative effect.⁶²

⁵⁷ Spamann, H. (2009). Contemporary Legal Transplants: Legal Families and the Diffusion of (Corporate) Law. *Brigham Young University Law Review*, (6), at 1876. Available at SSRN: <http://ssrn.com/abstract=1411704>, [accessed on 20/3/2017]

⁵⁸ Gregory, S. (2012). Transnational Legal Process and State Change. *Law and Social Inquiry: Journal of the American Bar Foundation*, 37, at 11. Available at SSRN: <http://ssrn.com/abstract=1901952>, accessed on 20/3/2018.

⁵⁹ *Ibid*

⁶⁰ Berkowitz, D., Pistor, K., and Richard, J. (2003). Economic Development, Legality, and the Transplant Effect. *European Economic Review*, 47(1), p. 192.

⁶¹ Valderrama, I. (2004). Legal transplants and Comparative Law. *International Law Journal*, 1(2), at 274. Available at SSRN: <http://ssrn.com/abstract=2017940>, [accessed on 20/3/2018]

⁶² *Ibid*, p. 272- 273.

Moreover, another factor which must be addressed before legal transplantation takes place is enforceability. The process of enforcing law involves a number of participants. Some of which are judges, lawyers, legal academics and corporate legal officers. Hence, it is argued that the imposition of newly adapted foreign legal rules is based on the extent of cooperation between these legal actors. The effectiveness of improving the quality of national laws lies in the cooperation of these actors, and their ability to overlook their agendas and interests when it comes to lawmaking.⁶³ This is not easily achieved, and examples of this are seen in corrupt governments.

1.7.4 Legal Transplants in Saudi Arabia

It must be noted that Saudi Arabia is a territory which has never been occupied by a foreign country. Therefore, it has not experienced an imposition of foreign laws. Saudi Arabia has a unique legislation which relies on Islamic law. This form of law applies to a number of spheres but is most specific to personal status law and the civil judicial system. Also, Saudi Arabia is a country which is currently growing fast and is creating strong connections with powerful international organisations and countries. These facts inspired Saudi Arabian-Law Makers to become more open in relation to borrowing and transferring legislation from other countries. Furthermore, Saudi Arabia is currently transferring laws that were seen in the past as ‘too liberal’ and in opposition to social norms. Consequently, The Country has identified the need for development and global expansion. Hence, after taking into consideration the needs of their people it has developed its commercial, banking, economic and company law sectors, through the voluntary adaption of transnational legal rules.

Moreover, the explanatory note of the initial Saudi Law of Companies 1965 provides an illustration of this. It points out, that alongside the rapid growth of trade projects came to a great amount of companies. Therefore, a lack of appropriate regulations which deal with unique needs and complications faced from this growth was felt. National laws were insufficient at the time; hence it was essential that rules were borrowed from other successful

⁶³ Watson, A. (1974). *Legal transplants: An Approach to Comparative Law* (1st ed.). Edinburgh: Scottish Academic Press, p. 99.

countries which have more experience in these matters.⁶⁴ Another example of Saudi Arabia transmitting foreign law is seen in Saudi Commercial Law 1931. This law was derived from the Ottoman Trade Act and The French commercial code.⁶⁵

Therefore, it is essential that countries like Saudi Arabia consider the factors addressed above. A mere process of cloning successful experiences of other countries may not result in the aimed purpose. It may actually create further obstacles for the corporate sector. Ideally, a balance between useful experiences of legislation in other countries and the national legislative framework should be made. This important consideration of the overall socio-economic effects of the proposed legislative framework will help in achieving the targeted aim of developing national laws through other successful experiences.

1.8 Conclusion

In order for one to effectively review and consider the corporate governance system in Saudi Arabia, it is essential to address the internal corporate structure of a company. The board of directors play a crucial role in governing the internal matters of a company. Due to the fact that a company is a separate legal person but not an animate, it is the directors who take the role of the mind and body. They make the corporate institution that represents shareholders and coordinates their interaction. In addition, directors are usually empowered to exercise powers of the company. which allow them to manage the business. Therefore, analysing the composition, roles and key interactions of the board is essential to an effective review of the corporate governance legislation.

In order for the Saudi to develop and meet global standards of global governance, it is essential that its legislation is compared and measured against global experience in this context; English law. This could be achieved by having those concerned with legal reform assess the nature of law and the sources of legal development. Consequently, the authenticity

⁶⁴ See the official website of the Bureau of Experts at the Council of Ministers, the explanatory note of the law of companies is available at: <https://www.boe.gov.sa/printsystem.aspx?lang=1&systemid=236&versionid=48>, accessed on [8/9/2018]

⁶⁵ *Ibid.*

and validity of foreign solutions should be evaluated. This will allow for the extent of required modification to be concluded.

Chapter Two
Definitions and theories of corporate governance

2.1 Introduction

This chapter critically reviews the available literature on corporate governance, with two specific objectives: to define corporate governance from the perspectives of various scholars and organisations, then to review writings on the related theories of corporate governance so that these theories may be compared. The chapter will also examine the principles of Sharia and corporate governance

2.2 Definitions of corporate governance

Diverse meanings have been assigned to the term ‘corporate governance’ by the very many scholars in the field, whose angles of enquiry into the establishment and operation of companies are so varied that their perspectives on corporate governance must necessarily vary accordingly.⁶⁶ One definition of corporate governance is that of a mechanism for limiting the risk that the owners of a firm, its shareholders, are subject to.⁶⁷ Alternatively, it can be defined as the body of principles, such as its financial strategy, that controls the organisation’s practices.⁶⁸ A broader and more detailed definition states that corporate governance is “‘a set of processes, customs, policies, laws and institutions’” which determine how the enterprise is “‘directed, administered or controlled’”, in order either directly or indirectly to affect the way that it behaves towards its stakeholders.⁶⁹ The Cadbury Committee offers the simple phrase ‘the system by which companies are directed and controlled’,⁷⁰ on which it elaborates a Follows: “Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the

⁶⁶ Turnbull, S. (1997). Corporate Governance: Its scope, concerns and theories. *Corporate Governance*, 5(4), pp.184-185.

⁶⁷ Schneider, A. and Georg Scherer, A. (2013). Corporate Governance in a Risk Society. *Journal of Business Ethics*, 126(The 2), pp.310–320.

⁶⁸ Al-Suhaibani, M. and Naifar, N. (2013). Islamic Corporate Governance: Risk-Sharing and Islamic Preferred Shares. *Journal of Business Ethics*, 124(4), pp.623-632.

⁶⁹ Dignam, A. and Lowry, J. (2018). *Company law, Core Text Series*. 10th ed. UK: Oxford University Press, pp.350-370.

⁷⁰ Cadbury, A. (1992) *Report of the Committee on the Financial Aspects of Corporate Governance*, Gee Publishing, London. p.2.5.

stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.”⁷¹

Corporate governance, in the words of Donaldson, is “the structure whereby managers at the organisational apex are controlled through the board of directors, its associated structures, executive incentive, and other schemes of monitoring and bonding”.⁷² It can also be seen as representing the relationships among diverse interest groups, namely the shareholders, whether controlling or minority, the board, the management and indeed all other stakeholders, as the OECD Principles of Corporate Governance explain:

“Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.”⁷³

The Principles further define good corporate governance as providing directors and managers with the appropriate incentives so that the objectives which they pursue are sure to serve the company’s interests, which by definition are those of its shareholders, while also ensuring that monitoring is effectively conducted. These principles are not binding, however, is intended as guide comprising a set of objectives and recommendations for implementation, to which policymakers should refer and which they should then adapt to suit the legal, social, cultural and economic context in which particular regulations are to operate. A functional definition of corporate governance is that when it is done well, it makes corporate structures and operations more transparent while protecting the dealings among stakeholders, managers and governments from undue political interference.⁷⁴

Some scholars distinguish between narrow and broad definitions of corporate governance, the former being limited in scope to shareholders’ protection, management control and other

⁷¹ Cadbury, A. (1992) *Report of the Committee on the Financial Aspects of Corporate Governance*, Gee Publishing, London, pp.2.5.

⁷² Donaldson, L. (1990). The Ethereal Hand: Organizational Economics and Management Theory. *The Academy of Management Review*, 15(3), p.375.

⁷³ the OECD Principles of Corporate Governance. (1999). *Organisation for Economic Co-Operation and Development*, p.6.

⁷⁴ Working Group 5 ‘Hawkamah Institute for Corporate Governance: Task Force on Corporate Governance of State-Owned Enterprises’.

aspects of the agency problem.⁷⁵ Corporate governance thus defined is concerned with the separation of ownership and control and the conflicts of interest between shareholders and managers that arise as a consequence in large corporations.⁷⁶ Its purpose is to guarantee the rights of shareholders and to balance their interests with those of the management.⁷⁷

The contrasting broad definitions of corporate governance reflect the concerns of stakeholders' theory,⁷⁸ according to which its correct focus is the regulation of relationships that the enterprise has not only with shareholders but also with many other stakeholder groups in the corporation and beyond it in society at large, including employees, customers, bondholders, creditors, suppliers and the general public.⁷⁹ Corporate governance is seen from this perspective as a set of laws, regulations and practices governing the relationships among owners, managers and stakeholders of all kinds.⁸⁰ Shleifer and Vishny defend this view of corporate governance as ensuring

“fairness, transparency, accountability, sustainable financial performance, increased shareholder confidence, access to external finance and foreign investment, fair treatment of the stakeholders in a company, maximisation of shareholders' value and the enhanced reputation of a company, nation and economy.”⁸¹

⁷⁵ Olayiwola, W. (2010). Practice and Standard of Corporate Governance in the Nigerian Banking Industry. *International Journal of Economics and Finance*, 2(4), p.176.

⁷⁶ Tricker, R. and Tricker, B. (2015). *Corporate governance : principles, policies, and practices*. 3rd ed. Oxford, United Kingdom: Oxford University Press, p.28.

⁷⁷ Majeed, H., Johansson, E. and Nasim, Q. (2009). *International Corporate Governance Comparison: Pakistan and Sweden*. Lund University.

⁷⁸ Lin, P., Li, B. and Bu, D. (2015). The relationship between corporate governance and community engagement: Evidence from the Australian mining companies. *Resources Policy*, 43, pp.28-30

⁷⁹ Tirole, J. (2001). Corporate Governance. *Econometrica*, 69(1), pp.1-5.

⁸⁰ Becht, M., Bolton, P. and Röell, A. (2002). Corporate Governance and Control. *ECGI Working Paper Series in Finance*. P.19[online] Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=343461

⁸¹ Shleifer, A. and Vishny, R. (1997). A Survey of Corporate Governance. *The Journal of Finance*, 52(2), pp.737-783.

This broader definition of corporate governance necessitates the incorporation of a definition of ‘stakeholder’, which for Freeman denotes ‘any group or individual who can affect or is affected by the achievement of the organisation’s objectives’.⁸² To regulate the relationships that the corporation has with its various stakeholders, the corporate governance mechanism must effectively monitor the policies and actions of the executive management.

The diversity in the definitions above reflects the multiplicity of ways in which corporate governance is conceived. Al Zahrani attributes this variety to the different countries concerned, to the functional contexts, to policies on trade, commerce and business, and to the scholars and practitioners involved.

This thesis takes as working definitions those offered by the Cadbury Report⁸³ and the OECD Principles,⁸⁴ as cited above because they are very widely accepted by corporate governance scholars and practitioners alike. The Cadbury Report was well received at home and abroad when published in the UK in 1992, being admired as the first comprehensive set of widely applicable corporate governance standards and guidelines on shareholders’ rights, directors’ duties and responsibilities and the functioning of board subcommittees. The OECD Principles of Corporate Governance were first issued in 1999 and have since been globally recognised as setting the standard for first-rate corporate governance. They are concerned with upholding shareholders’ rights, including those of minority shareholders, with the need for disclosure and transparency, by treating all stakeholders equitably and with ensuring that the directors fulfil their duties. Indeed, the World Bank has a procedure in place that encourages the transparent gathering of country information in relation to corporate governance practices. Thus, information gathered is used to develop corporate governance regulations and practices in each country by improving work plans, academic conferences and the levels of practical support required by each country.

⁸² Freeman, R. E. (2010) *Strategic Management: A Stakeholder Approach*. Cambridge: Cambridge University Press, p.46. and Arora, P. and Dharwadkar, R. (2011). Corporate Governance and Corporate Social Responsibility (CSR): The Moderating Roles of Attainment Discrepancy and Organization Slack. *Corporate Governance: An International Review*, 19(2), pp.136-152.

⁸³ Cadbury, A. (1992) *Report of the Committee on the Financial Aspects of Corporate Governance*, Gee Publishing, London, p.2.5.

⁸⁴ Oecd.org. (2004). *OECD Principles of Corporate Governance*, p3. [online] Available at: <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf> [Accessed 23 May 2016].

2.3 Corporate Governance Theories

The study of corporate governance is of interest to scholars in disciplines as diverse as economics, finance, law, management, politics and organisational behaviour,⁸⁵ so no single theory can be relied on comprehensively by those who seek to analyse and interpret the practices and behaviour associated with the concept.⁸⁶ It is particularly germane to seek alternatives to agency theory as a theoretical framework for such studies.⁸⁷ The following subsections critically review in turn a number of theoretical stances which have been prominent in economics, law, finance and organisational behaviour studies of corporate governance. The theories in question are agency theory, stakeholder theory, resource dependence theory, the myopic market model and corporate governance from a Sharia perspective.

2.3.1 Agency Theory

Agency theory, which takes a shareholder-oriented approach, is arguably the most dominant model of corporate governance. It arose as a fundamental response to the problems potentially associated with the mutually inimical interests of the owners and controllers of businesses.⁸⁸ Shareholders, for example, might be rightly concerned that the company's managers would use its funds to serve their own interests, instead of maximizing the value of the company and that of the shares. From this perspective, corporate governance is a necessary set of controls to ensure that managers exercise their fiduciary duties properly. Agency theory puts the interests of employees (including managers) below those of the shareholders, whose benefit should be the company's principal concern.⁸⁹ The shareholders own the company, so their interests are paramount, while those of the employees are secondary or indeed insignificant, as indeed is any perceived moral responsibility of the managers or directors to act in anyone else's

⁸⁵ Bebchuk, L. and Weisbach, M. (2010). The State of Corporate Governance Research. *The Review of Financial Studies*, 23(3), pp.939-996.

⁸⁶ Sharma, N. (2013). Theoretical Framework for Corporate Disclosure Research. *Asian Journal of Finance & Accounting*, 5(1), pp.183-196.

⁸⁷ Judge, W., Zattoni, A. and Douglas, T. (2013). Developing Corporate Governance Theory through Qualitative Research. *Corporate Governance: An International Review*, 21(2), pp.119-122.

⁸⁸ Schneider, A. and Georg Scherer, A. (2013). Corporate Governance in a Risk Society. *Journal of Business Ethics*, 126(The 2), pp.310-320.

⁸⁹ Kim, D. and Kim, D. (2014). The impact of corporate governance on employment relations in South Korea: the shareholder versus stakeholder perspectives. *The International Journal of Human Resource Management*, 26(3), pp.338-360.

interest.⁹⁰ This implies that it is virtually inevitable that the interests of employees, customers, suppliers and any other stakeholders in the wider community will be poorly served or even seriously damaged.⁹¹ It is particularly in the US, the UK, Australia, Canada and other common law jurisdictions that corporate governance mechanisms originally developed to benefit shareholders rather than anyone else. Under this model, corporate governance serves to guarantee the achievement of whatever objectives the owners have chosen to set.⁹² Agency theory assumes that shareholders and managers are unlikely to share common interests and that they will behave opportunistically in their own conflicting interests.⁹³ The governments of the 1980s in the USA and UK promoted the shareholder approach to corporate governance, a regime under which many corporations strove to maximise shareholder value. The US stock market and the economy thrived at this time, persuading companies in Germany, Japan, France, and other major economies to adopt this approach.⁹⁴

Agency theory is particularly concerned with principal-agent conflicts, which are generated by the separation of ownership and management.⁹⁵ These may result in managers (who act as agents of the owners) serving their own interests while neglecting those of the owners (the principals); alternatively, they may create information asymmetry, with consequent agency costs to the corporation.⁹⁶ Berle and Means, in a well-known study, offer a key account of the contractual principal-agent relationship, explaining that the ownership of enterprises became separated from their control in countries whose industrial activity and markets were expanding.⁹⁷ Shareholders may well expect managers to make decisions and perform their functions in the best interests of the owners themselves, but this does not necessarily happen,

⁹⁰ Thomsen, S. and Conyon, M. (2012). *Corporate Governance: Mechanisms and Systems*. UK: McGraw Hill Higher Education, pp.338-360.

⁹¹ Kim, D. and Kim, D. (2014). The impact of corporate governance on employment relations in South Korea: the shareholder versus stakeholder perspectives. *The International Journal of Human Resource Management*, 26(3), pp.338-360.

⁹² Mulili, B. and Wong, P. (2011). Corporate Governance Practices in Developing Countries: The Case for Kenya. *International Journal of Business Administration*, 2(1), pp.14-27.

⁹³ Chambers, N., Harvey, G., Mannion, R., Bond, J. and Marshall, J. (2013). Towards a framework for enhancing the performance of NHS boards: a synthesis of the evidence about board governance, board effectiveness and board development. *Health Services and Delivery Research*, 1(6), p.3.

⁹⁴ Lazonick, W. and O'Sullivan, M. (2000). Maximizing shareholder value: a new ideology for corporate governance. *Economy and Society*, 29(1), pp.13-35.

⁹⁵ Mustapha, M. and Che Ahmad, A. (2011). Agency theory and managerial ownership: evidence from Malaysia. *Managerial Auditing Journal*, 26(5), pp.419-436.

⁹⁶ Uğurlu, M. (2000). Agency costs and corporate control devices in the Turkish manufacturing industry. *Journal of Economic Studies*, 27(6), pp.566-599 and Farrer, J. and Ramsay, I. (1998). Director Share Ownership and Corporate Performance - Evidence from Australia. *Corporate Governance: An International Review*, 6(4), pp.233-248.

⁹⁷ Mizruchi, M. (2004). Berle and Means revisited: The governance and power of large U.S. corporations. *Theory and Society*, 33(5), p.591.

because the managers will be motivated to maximise their own salaries and remunerations, rather than boosting corporate cash flow and profits.⁹⁸

One way to address the agency conflict arising from the separation of ownership and control is to invoke the convergence of interest model,⁹⁹ which predicts that agency cost will be zero when the owners of the company manage it themselves.¹⁰⁰ This ideal condition can be approximated by incentivising managers to partake of the shareholders' risk, such as by offering them stock options as remuneration or tying their bonuses to the performance of the firm.¹⁰¹ Devices of this kind will also align to a greater or lesser extent the interests of the internal and external stakeholders. In Malaysia, Mustapha and Ahmad analysed data from 235 companies in various sectors and found that as predicted by agency theory, managerial ownership was inversely related to total monitoring costs.¹⁰² Their findings challenge an earlier study, in which Deutsch found that the composition of the board, in particular, the proportion of outside directors, appeared to have little effect on critical decisions in matters such as executive compensation and risk control, involving the potential for conflict between the interests of shareholders and of managers.¹⁰³

It follows from agency theory that reducing the number of executive directors may make the board more independent,¹⁰⁴ which in turn would help shareholders to hold the directors to account.¹⁰⁵ It also follows that establishing good corporate governance in respect of board structure and composition will limit monitoring and bonding costs, thus improving governance practices, voluntary disclosure and financial performance.¹⁰⁶ The application of agency theory

⁹⁸ *Ibid.*

⁹⁹ Jensen, M. and Meckling, W. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 3(4), pp.305-360.

¹⁰⁰ J Farrer, J. and Ramsay, I. (1998). Director Share Ownership and Corporate Performance - Evidence from Australia. *An International Review: Corporate Governance*, 6(4), pp.233-248.

¹⁰¹ Thomsen, S. and Conyon, M. (2012). *Corporate Governance: Mechanisms and Systems*. UK: McGraw Hill Higher Education, pp.173-175.

¹⁰² M Mustapha, M. and Che Ahmad, A. (2011). Agency theory and managerial ownership: evidence from Malaysia. *Managerial Auditing Journal*, 26(5), pp.419-436.

¹⁰³ Deutsch, Y. (2005). The Impact of Board Composition on Firms' Critical Decisions: A Meta-Analytic Review. *Journal of Management*, 31(3), pp.424-444.

¹⁰⁴ Al-Janadi, Y., Rahman, R. and Omar, N. (2013). Corporate Governance Mechanisms and Voluntary Disclosure in Saudi Arabia. *Research Journal of Finance and Accounting*, 4(4), pp.25-35.

¹⁰⁵ Bebchuk, L. and Weisbach, M. (2010). The State of Corporate Governance Research. *The Review of Financial Studies*, 23(3), pp.939-961.

¹⁰⁶ Siddiqui, M., Razaq, N. and Malik, F. (2018). Internal Corporate Governance Mechanisms and Agency Cost: Evidence from Large KSE Listed Firms. *European Journal of Business and Management*, 5(23), pp.103-109.

also entails the establishment of board subcommittees to oversee the firm's audit, nomination and remuneration functions and to monitor these vital areas of managerial activity.¹⁰⁷

An evident weakness of agency theory and the subject of much criticism has been that it is heavily concerned with shareholders, which it treats as the sole claimants while paying little attention to stakeholders of multiple other kinds, thus failing to represent the crucial relationships among them that actually exist within and beyond the firm.¹⁰⁸ Satisfying such stakeholders is essential for corporations to achieve their commercial objectives in the complex and competitive modern global environment, a consideration which has become ever more evident.¹⁰⁹ This has prompted Schneider and Scherer to argue that agency theory ignores the risks attendant on the dynamic nature of the said environment, failing to deal adequately with the consequent threats to the legitimacy of commercial enterprises.¹¹⁰ The following subsection therefore, examines a widely discussed alternative to agency theory, namely stakeholder theory.

2.3.2 Stakeholder theory

Stakeholder theory, which may be seen as fundamentally challenging agency theory, emerged as a response to the claim that the exclusive concern of agency theory with the interests of shareholders does not in practice serve the ends of either corporate performance or accountability.¹¹¹ Critics saw increasingly clear that far from simply producing goods or services, companies must be seen as comprising a set of different but intertwined systems, each one demanding the application of consideration and strategy.¹¹² This theory was developed by Freeman and supported by Blair.¹¹³ The former defines stakeholders as 'any group or individual who can affect, or is affected by, the achievement of a firm's purpose'.¹¹⁴ This covers employees, customers, suppliers, creditors, society at large and even the firm's competitors. Stakeholder theory thus involves social responsibility and is concerned with the

¹⁰⁷ Allegrini, M. and Greco, G. (2013). Corporate boards, audit committees and voluntary disclosure: evidence from Italian Listed Companies. *Journal of Management & Governance*, 17(1), pp.187-216.

¹⁰⁸ *Ibid.*

¹⁰⁹ Robertson, C., Diyab, A. and Al-Kahtani, A. (2013). A cross-national analysis of perceptions of corporate governance principles. *International Business Review*, 22(1), pp.315-325.

¹¹⁰ Schneider, A. and Georg Scherer, A. (2013). Corporate Governance in a Risk Society. *Journal of Business Ethics*, 126(The 2), pp.310–320.

¹¹¹ *Ibid.*

¹¹² Pande, S. and Ansari, V. (2014). A Theoretical Framework for Corporate Governance. *Indian Journal of Corporate Governance*, 7(1), pp.56-72.

¹¹³ Freeman, R. E. (2010) *Strategic Management: A Stakeholder Approach*. Cambridge: Cambridge University Press, p.46. And Blair, M. (1995). Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century. *Brookings Institution*, 39(1), pp.62-64.

¹¹⁴ *Ibid.*

interests not just of shareholders but of all these other parties.¹¹⁵ It holds that the company must facilitate democratic participation in corporate decision-making and should seek to maximise social wealth,¹¹⁶ not merely the benefit of shareholders, which is the objective of management according to agency theory.¹¹⁷

Stakeholder theory holds that the genesis of corporate governance problems is the too-narrow definition of corporate objectives in terms of shareholder value, so they should be much more broadly expressed to include the interests of all stakeholder groups as enumerated above, going so far as to embrace a responsibility to society at large. Indeed, an essential component of stakeholder theory is the recognition of corporate social responsibility (CSR) and of all stakeholders' interests, even to the detriment of the profitability of the company. Researchers have found that in France, Germany and other civil law jurisdictions, corporate governance frameworks have developed with just such a focus on balancing the interests of all stakeholders.¹¹⁸

It follows from the above distinction in focus that sources of profitability are perceived very differently under the two models. Agency theory considers all non-shareholders merely to serve the ends of profitability, whereas stakeholder theory also views the interests of many non-shareholders as ends in themselves.¹¹⁹ A parallel fundamental distinction concerns the corporation's objective, which for agency theory is the maximisation of shareholder value, while stakeholder theory takes it to be serving commercially a wider set of societal interests.

When Kim and Kim studied 214 Korean firms, contrasting the effects on employment relations of the stakeholder and shareholder perspectives on corporate governance, they found support for stakeholder theory.¹²⁰ According to their results, an orientation of corporate governance policies and practice towards the interests of multiple stakeholders, rather than shareholders only, was associated with higher spending on education and training, longer average employee tenure, a favourable climate of industrial relations and fewer strikes. The authors conclude that

¹¹⁵ Kim, D. and Kim, D. (2014). The impact of corporate governance on employment relations in South Korea: the shareholder versus stakeholder perspectives. *The International Journal of Human Resource Management*, 26(3), pp.338-360.

¹¹⁶ P Gomez, P. and Korine, H. (2010). *Entrepreneurs and democracy*. Cambridge: Cambridge University Press, pp.44-46.

¹¹⁷ Blair, M. and Roe, M. (1999). *Employees and corporate governance*. Washington, D.C: Brookings Institution Press, pp.69-70.

¹¹⁸ Mulili, B. and Wong, P. (2011). Corporate Governance Practices in Developing Countries: The Case for Kenya. *International Journal of Business Administration*, 2(1), pp.14-27.

¹¹⁹ *Ibid.*

¹²⁰ Kim, D. and Kim, D. (2014). The impact of corporate governance on employment relations in South Korea: the shareholder versus stakeholder perspectives. *The International Journal of Human Resource Management*, 26(3), pp.338-360.

a stakeholder-orientated corporate governance policy benefits employees and improves labour relations by comparison with a shareholder-orientated approach.

Chan et al in a study analysis of the annual reports of 222 listed companies found that those providing more CSR information were larger, more highly leveraged and in more high-profile industries, as well as having higher corporate governance ratings.¹²¹ An earlier study of media companies found a positive association between a stakeholder orientation and performance:

“Stakeholder-oriented governance mechanisms, including reduced institutional ownership, increased insider ownership, enlarged board representativeness, increased board interlocks, a fixed compensation for CEOs and directors, and certain takeover controls like dual class shares and poison pills, were positively associated with media firms’ performance.”¹²²

Werder addresses the exercising of opportunism, arguing that this is not limited to the management of a company since all of its stakeholders are likely at some time to be in a position to behave opportunistically; conversely, every stakeholder is at risk of being the object of some other stakeholder’s opportunism.¹²³

Kansal and Joshi also took a stakeholder approach to their survey of shareholders and brokers regarding their perceptions of Indian firms’ CSR initiatives. Respondents in both groups of stakeholders expressed the view that investor confidence was stronger in CSR-oriented companies, boosting their stock prices and enhancing both corporate goodwill and their reputation.¹²⁴ The researchers conclude that CSR initiatives were being implemented by Indian companies, whose stakeholders had a strong interest in these policies.¹²⁵ Ayuso et al. similarly found evidence of a positive association between CSR responsibility on the board and indicators for dealing with primary and secondary stakeholders.¹²⁶ They also studied how stakeholder engagement affected financial performance and found that it improved the profitability of firms in the United Kingdom, Canada and South Africa, while for those in the

¹²¹ Chan, M., Watson, J. and Woodliff, D. (2013). Corporate Governance Quality and CSR Disclosures. *Journal of Business Ethics*, 125(1), pp.59-73..

¹²² Guosong, S. (2009). *Toward a stakeholder model of corporate governance: Evidence from U.S. media companies’*. University of Alabama Libraries,p.2.

¹²³ v. Werder, A. (2011). Corporate Governance and Stakeholder Opportunism. *Organization Science*, 22(5), pp.1345-1358.

¹²⁴ Kansal, M. and Joshi, M. (2014). Perceptions of Investors and Stockbrokers on Corporate Social Responsibility: A Stakeholder Perspective from India. *Knowledge and Process Management*, 21(3), pp.167-176.and Calabrese, A. and Costa, R. (2014). Guest Editorial for the Special Issue “Measuring Corporate Social Responsibility (CSR): The Central Role of Stakeholders”. *Knowledge and Process Management*, 21(3), pp.149-150.

¹²⁵ *Ibid.*

¹²⁶ Ayuso, S., Ariño, M., García-Castro, R. and Rodriguez, M. (2014). Maximizing Stakeholders' Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance. *Business & Society*, 53(3), pp.414-439.

United States, Australia and Hong Kong, it was board responsibility for CSR which was positively associated with financial performance.¹²⁷ On the other hand, when Hillman et al. surveyed 250 firms and more than 3000 directors, they found that organisational performance was unrelated to the presence of stakeholder directors on the board.¹²⁸ Chambers et al. report two other major criticisms:

“Despite the fact that stakeholder governance models are deeply embedded in some countries in Europe, notably Germany, and in Japan, and that claims for these countries’ industrial and social success are often based on this model, the empirical evidence for stakeholder theory is weak. The theory is further criticised for encouraging risk-averse, inoffensive but bland and lowest common denominator decision-making”.¹²⁹

While stakeholder theory does emphasise the importance of CSR, it does not show how the decision-makers in a firm should or indeed could adjudicate among the varied and conflicting interests of the stakeholder groups. Furthermore, managing the diverse and unclear expectations of stakeholders might prompt trade-offs among stakeholder interests which is highly complex and that managers can only really effectively focus on the simple bottom line.¹³⁰

2.3.3 Resource dependence theory

Resource dependence theory (RDT) is a strategic contingency theory with origins in sociology and economics,¹³¹ which is concerned with the distribution of corporate power and which sees board members as a human capital resource whose main role is to use their skills, powers and knowledge to give the enterprise’s managers the best possible advice.¹³² Pfeffer and Salancik identify four benefits that the directors can bring to the firm, being advice, legitimacy and access to information and to resources.¹³³ Neville elaborates on this last element, noting that “boards, and especially outside board members, can bridge the gap between the firm and its environment and serve as a mechanism for attracting resources and thereby add to the value

¹²⁷ *Ibid.*

¹²⁸ Hillman, A., Keim, G. and Luce, R. (2001). Board Composition and Stakeholder Performance: Do Stakeholder Directors Make a Difference?. *Business & Society*, 40(3), pp.295-314.

¹²⁹ Chambers N, H. (2013). *Towards a framework for enhancing the performance of NHS boards*. Southampton: NIHR Journals Library, p.22.

¹³⁰ J. Argenti, ‘Stakeholders: the case against Long Range Planning’ 30 (1997) 442–5.

¹³¹ Chambers N, H. (2013). *Towards a framework for enhancing the performance of NHS boards*. Southampton: NIHR Journals Library, p.22.

¹³² Pfeffer, J. (1972). Size and Composition of Corporate Boards of Directors: The Organization and its Environment. *Administrative Science Quarterly*, 17(2), p.218-228.

¹³³ Pfeffer, J. and Salancik, G. (2003). *External Control of Organizations*. Palo Alto: Stanford University Press, pp.164-167.

creation of the firm”.¹³⁴ The resource-based view illuminates the positive contribution to strategy and thence to performance jointly provided by the directors’ experience and expertise, i.e. their human and relational capital, and the quality of top management.¹³⁵

The overall concern of resource dependence theory is with ways of minimising the uncertainty emanating from the external environment and dependence on other organisations.¹³⁶ Adding to this, Hillman, Withers and Collins, found evidence of a general acceptance that companies can both influence and be influenced by their environment.¹³⁷ It has also been argued that RDT will be valid and insightful so long as there is a part for power to play in the life of organisations.¹³⁸ Drees and Heugens recently conducted a meta-analysis of 157 tests of RDT which supported its main contentions:

“Organisations respond to resource dependencies by forming inter-organizational arrangements like interlocks, alliances, joint ventures, in-sourcing arrangements, and mergers and acquisitions. In turn, these arrangements make them more autonomous and more legitimate”.¹³⁹

However, the narrow focus of RDT on external factors, might diminish the role of the board in determining the future of the enterprise by determining strategy and by overseeing the functioning of internal management and the performance of managers.¹⁴⁰

2.3.4 The myopic market model

In common with agency theory, the myopic market model suggests that the firm exists solely to serve its shareholders’ interests, but it differs insofar as it rejects the ‘competitive myopia’ of agency theory,¹⁴¹ which its supporters see as resulting from an obsession with short-term market value as measured by returns, profits and stock prices, and from a reliance on measures of performance affected by inefficient market forces.¹⁴² The myopic market model holds that

¹³⁴ Neville, M. (2011). The role of boards in small and medium sized firms. *Corporate Governance: The international journal of business in society*, 11(5), pp.528.

¹³⁵ Bordean, O. (2012). A multi-theory approach of the strategic role of boards’ *Studies in Business and Economics*. *Studies in Business and Economics*, 7(2), pp. 43-51.

¹³⁶ *Ibid.*

¹³⁷ Hillman, A., Withers, M. and Collins, B. (2009). Resource Dependence Theory: A Review. *Journal of Management*, 35(6), pp.1404-1427.

¹³⁸ Davis, G. and Cobb, J. (2010). ‘Resource dependence theory: Past and future’ *Stanford's organization theory renaissance, 1970-2000*. Bingley: Emerald. Volume 28 pp.21 - 42

¹³⁹ J Drees, J. and Heugens, P. (2013). Synthesizing and Extending Resource Dependence Theory. *Journal of Management*, 39(6), pp.1666-1698.

¹⁴⁰ Hodgkinson, G. and Sparrow, P. (2002). The competent organization: a psychological analysis of the strategic management process. *Open University Press*, p.412.

¹⁴¹ Hayes, R. and Abernathy, W. (1980). Managing Our Way to Economic Decline. *Harvard Business Review*, pp.67-77.

¹⁴² *Ibid.*

corporate governance fails when the existing institutional arrangements encourage management to pursue short-term performance, rather than seeking to maximise shareholder wealth and the company's competitiveness over the long term.¹⁴³ It contends that corporate governance should be reformed to produce an environment that encourages and enables the sharing by managers and shareholders (especially large and institutional ones) of long-term performance horizons.¹⁴⁴ It also makes the following recommendations for the improvement of corporate governance: (a) shareholders' loyalty and voice should be strengthened, (b) shareholders' exit should be reduced, (c) 'relationship investing' should be encouraged, to lock financial institutions into long-term positions, while the takeover process and voting rights for short-term shareholders should be restricted, and (d) employees, suppliers and others having long-term relationships with the enterprise should be empowered.¹⁴⁵

2.3.5 Some comparisons

This subsection considers some of the differences and similarities among the various theories and models of corporate governance, beginning with their contrasting assumptions regarding the associated problems and their solutions. Agency theory sees corporate governance failures as caused by the separation of ownership and management functions; to address this agency conflict, it recommends more robust incentive systems and less restricted markets. Stakeholder theory, by contrast, locates the root of poor corporate governance in a failure to fully engage stakeholders, which should be resolved by broadening the corporate objectives so that they address wider societal interests rather than the crude creation of economic value for shareholders. Finally, the myopic market model blames corporate governance failures on the inefficiency of market forces and holds that the remedies are to strengthen shareholders' loyalty and voice, reduce their propensity to exit and encourage relationship investing.

Whatever these general and specific distinctions among the various corporate governance theories, there is some sharing of assumptions. Thus, agency theory shares with the myopic market model the assumption that maximising shareholders' wealth should be the principal goal of the enterprise, while the stakeholder and stewardship theories both take account of a wider set of stakeholders in setting and pursuing corporate objectives

¹⁴³ Blair, M. (1995). Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century. *Brookings Institution*, 39(1), pp.62-64.

¹⁴⁴ Letza, S., Sun, X. and Kirkbride, J. (2004). Shareholding Versus Stakeholding: a critical review of corporate governance. *Corporate Governance*, 12(3), pp.242-262.

¹⁴⁵ Keasey, K., Thompson, S. and Wright, M. (1997). *Corporate Governance: Economic and Financial Issues*. 1st ed. Oxford University Press, pp.6-7.

2.4 Corporate Governance and Sharia principles

There has been observed a heightened interest in corporate governance from the Islamic perspective, which scholars have studied in order to assess the effectiveness of religious means of addressing human corruption and misconduct. Such transgressions are seen as the main factors behind corporate scandals affecting national and international markets.¹⁴⁶

This interest has arisen due to the recent rapid expansion of the economy of Islamic countries in recent times, by some estimates it has researched a size of over 4 trillion dollars.¹⁴⁷ It is estimated that only 19% of trade is conducted amongst Islamic countries and 79% of their trade is conducted with non-Islamic countries.¹⁴⁸ Therefore, it can be argued that to neglect the influence of Islam as a religion on the lives of Muslims would alienate large percentage of potential investors, partners, and customers and create obstacles in the understanding of the cultural environment in which these companies operate, which is highly significant given how diverse the global markets are today.¹⁴⁹

Muslim thinkers have thus adopted Islam as the basis for delimiting corporate governance practices,¹⁵⁰ with the aim that new legislation will comply with the needs of Saudi Arabia's contemporary Islamic society. Abdul Rahman states that not only Islamic financial institutions but even global corporations would benefit if the principles and values of Islam were incorporated into habitual business practice.¹⁵¹

It is acknowledged that corporate governance, whether from an Islamic or Western outlook, covers important tasks, thus aligning with the goals of both corporations and market participants. It is considered that because the Islamic perspective incorporates Islamic objectives for which there are no direct equivalents in Western corporate governance it would include values additional to those of corporate governance practices.¹⁵²

¹⁴⁶ El-Gamal, M. (2005) *Islamic Bank Corporate Governance and Regulations: A Call for Mutualization*. Unpublished, p. 9

¹⁴⁷ Rethel, L. (2018). *Corporate Islam, Global Capitalism and the Performance of Economic Moralities*. *New Political Economy*, [online] p.1. Available at: <https://www.tandfonline.com/doi/full/10.1080/13563467.2018.1446925>. [accessed on 23/2/2016]

¹⁴⁸ *Ibid.*

¹⁴⁹ Lilian Miles and Simon Goulding, 2010 'Corporate Governance in Western (Anglo-American) and Islamic Communities: Prospects for Convergence', *Journal of Business Law*, 2010, p.2.

¹⁵⁰ *Ibid*, p.33.

¹⁵¹ AbdulRahman, A. (1998). Issues in corporate accountability and governance: An Islamic perspective. *American Journal of Islamic Social Sciences*, 15(1), p.62.

¹⁵² Hasan, Z. (2008). *Corporate governance from the Western and the Islamic perspective*. [online] A paper presented at the Annual London Conference on Money, Economy and Management, p. 4. Available at: <https://zulkiflihasan.files.wordpress.com/2008/06/microsoft-word-london-conference.pdf> [Accessed 6 May 2017].

The aims of corporate governance from the Islamic perception are to improve corporate legal regimes by imposing Islamic objectives and values on the day-to-day business and corporate transactions to encourage Muslims, whether individuals or corporations, to conduct themselves in accordance with Islamic principles.

Islamic values are not inconsistent or inimical to global principles of corporate governance and code of practice established over the last decades. While these corporate governance and codes have, in the main, focused on profit maximisation and economic efficiency, their aim has been to ensure that corporations act in accordance with appropriate ethical standards and to benefit the society. Islamic values are significantly determined by the principles and objectives of Sharia, which are directed toward the regulation of human behaviour and the assurance of public welfare. Muslims must extend the general application of these values to all areas of their lives, including their financial activities. More particularly, Islamic values can counteract negative human traits such as greed and selfishness which might otherwise lead to irregularities and corruption in financial and business affairs.¹⁵³ For instance, Hassan and Salleh rightly note that human beings are involved in managing the business of the company in pursuit of the principal goal of “maximising the wealth of its owners. The codes of upholding trust, maintaining integrity, exercising transparency and accountability would remain [unfulfilled] if the issues of man, his values, ethics and moral conduct are not tackled in the first instance.”¹⁵⁴

Furthermore, critics of the Anglo-American model highlight the issues that are inherent in principal-agent relationships. However, the Islamic corporation may wish to adopt a novel way of governance or a modified vision of the stakeholder centred approach as an alternative. The Islamic model of governance will be on the principles of consultation (Shura) in which all stakeholders have a shared goal of Tawheed (the oneness of Allah).¹⁵⁵

In the Islamic context, the protection of stakeholder’s interests goes beyond profit maximisation and requires a certain element of ethic and the Islamic principle of Tawheed. Tawheed is the foundation of the Islamic faith as such it would be the basis for the Islamic corporate governance framework. Allah states in the Holy Quran: “Men who celebrate the praises of Allah standing, sitting, and lying down on their sides, and contemplate the wonders of creation in the heavens and the earth, (with the thought): "Our Lord! Not for naught Hast Thou created all this! Glory to Thee! Give us Salvation from the penalty of the Fire”¹⁵⁶

¹⁵³ *Ibid.*

¹⁵⁴ *Ibid.* p.4

¹⁵⁵ *Ibid.*

¹⁵⁶ Holy Quarn, Sura 3, Ayah 191.

This provides that the fundamental principle of governance in which Allah has created everything on the earth for a purpose and he has placed humans as the viceregents. Therefore, Allah monitors every aspect of human activity and he is aware and knowing of everything at all times. Allah states: “O my son! If it be (anything) equal to the weight of a grain of mustard seed, and though it be in a rock, or in the heavens or on the earth, Allah will bring it forth. Verily, Allah is Subtle, Well-Aware”.¹⁵⁷ This provides that all of mankind is answerable to Allah, which affirms that Tawheed is the foundation of Islamic corporate governance. The principle of Tawheed derives two important concepts; viceregency and justice. In the context of corporate governance, the stakeholder as viceregents of Allah has a fiduciary duty to maintain the principle of distributive justice through the Shura process.¹⁵⁸ It was noted by Charpra that the practice of Shura is considered as an obligation rather than an option.¹⁵⁹ The process of Shura would ensure a wide participation of stakeholders either through representatives or directly.

This process of corporate governance is based on two key elements; Sharia boards and the Shura participants i.e. all the stakeholders. The Sharia board would consist of Islamic jurists (Faqeeh) who play a crucial role to advise and supervise the operation so as ensure that all the activities carried out by the corporation adhere to Sharia principles. In addition, the shareholders will play an active role as participants and stakeholders in the decision-making process by considering the interests of all direct and indirect stakeholders without solely focusing on profit maximisation.

Furthermore, Islamic constellation of values include a number of significant ethical principles which can be seen as applicable to corporate governance from the Islamic perspective. The second of these principles is Islamic accountability, represented by the Arabic term ‘hesab’, which denotes God’s full accountability towards humans, who in turn have liabilities towards God. In The Quran Allah asks:

“Did you think that I had created you in play [without any purpose], and that you would not be brought back to me?”¹⁶⁰

The Islamic tradition can be seen as anticipating Islamic accountability, in the sense that Muslims in the early Islamic empire initially practised something approximating the modern

¹⁵⁷ Holy Quarn, Sura 31, Ayah 16.

¹⁵⁸ Hafeez, M. (2013). An Analysis of Corporate Governance in Islamic and Western Perspectives. *International Journal of Business*, 2(3), p.102.

¹⁵⁹ Chapra, M. (2018). Islam and the Economic Challenge. *Journal of Islamic Studies*, 5(1), p.234.

¹⁶⁰ Holy Qur’an, Sura 23, Ayah 115.

conception of accountability. Pilgrimage was said to be an occasion when employees and those who manage the affairs of the caliphate can be called by the Caliph himself and by the public at large to account for their part in the affairs of the empire.¹⁶¹

The principle of Islamic accountability applies to corporate governance to the extent that it requires Muslims to be aware that they will be accountable to God for all of their actions, including their financial and commercial conduct, until the day of judgement. This means that each company executive is accountable to the board of directors and the shareholders as fiduciary; that the directors, as fiduciaries, are in turn accountable to the shareholders; the auditors are independently answerable to all shareholders; that the majority shareholders are accountable to the minority shareholders; and that the company itself is accountable to the government and society as a whole.¹⁶² Thus, Islamic accountability incorporates the principle of accountability as stated by the OECD:

“The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.”¹⁶³

The third essential Islamic value is that of justice (Adalah), which promises the equitable circulation of wealth and forbids segregation and monopoly. Its Quranic source is this:

“O you who believe, stand out firmly for justice, as witnesses to Allah, even though it be against yourselves, or your parents, or your kin, be he rich or poor, Allah is a better protector to both [than you]. So, follow not the lusts [of your hearts], lest you avoid justice; and if you distort your witness or refuse to give it, verily, Allah is ever well-acquainted with what you do.”¹⁶⁴

It can thus be stated that Islamic justice is an important element of corporate governance from an Islamic perspective, which corporations must apply when considering their shareholders’ needs, to ensure that they avoid unfairness in their business dealings.

In regard to the Islamic framework of corporate governance, board members and top executives should respect the value of truthfulness in all of their business dealings, with respect to

¹⁶¹ Abbas Al Akkad (2008). Omar Genius, Arabic edition. Beirut: Modern Library,p.46.

¹⁶² Hasan, Z. (2009). Corporate Governance : Western and Islamic Perspectives. *International Review of Business Research Papers*, 3(1), pp.285-287.

¹⁶³ Oecd.org. (2004). *OECD Principles of Corporate Governance*,p.58. [online] Available at: <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf> [Accessed 9 Jun. 2016].

¹⁶⁴ Holy Qur’an, Sura 4, Ayah 135.

information, policies, transactions and the annual financial statement issued by the board, so that all corporate stakeholders have accurate facts on which to base the taking of reasoned decisions.

The fourth and crucial Islamic value is sincerity of intention (*Ikhlas al niyyah*), referring to a distinction made in the Islamic view of individual morality between intentional and non-intentional acts. The obligation to act with sincerity is signalled in the Prophet Muhammad's Sunnah as follows:

“The [reward of] deeds depends upon the intentions and every person will get the reward according to what he has intended. So, whoever emigrated for the sake of Allah and his apostle, then his emigration will be considered to be for Allah and his apostle, and whoever emigrated for the sake of worldly gain or for a woman to marry, then his emigration will be considered to be for what he emigrated for.”¹⁶⁵

Fifthly, the Islamic value of consultation (*Shura*) is a central value and in simple terms, means conducting mutual consultations to achieve a general consensus. The concept of *Shura* can be found in the Holy Quran. Allah states that:

“Those who respond to the Lord, and establish regular prayer, who (conduct) their affairs by mutual consultation; who spend out of what We bestow on them for sustenance.”¹⁶⁶ This would require consulting with representatives in the formulation of policies and when taking decisions. As decisions were reached with due deliberation after taking into account the views and concerns of the affected parties this tends to underpin aspects of justice and equality. Thus, prevent the unjust act by one person or a group of individuals of alienating and overriding the rights of others. As Islamic corporate governance is rooted in the values of fairness and justice it is required that upon taking a decision that individual must uphold an ethical standard and ensure the participation of those who the decision will affect. Therefore, the inherent openness and transparency in the process of *Shura* in dealings with members, shareholders and stakeholders raise the effectiveness of corporate governance.¹⁶⁷

Finally, the concept of trustworthiness (*Amanah*) is a necessary value and the concept is found in the Holy Quran. Allah narrates:

¹⁶⁵ Sahih al-Bukhari, Book of Oaths and Vows, Book 83, Hadith 66.

¹⁶⁶ Holy Quran, Sura 42, Ayah 38.

¹⁶⁷ Sulphrey, M. M., 2015. Corporate governance in Islam vis-à-vis the modern corporate world. *Malaysian Accounting Review*, 14(1), 86.

“O ye who believe! Betray not the trust of Allah and the Messenger, nor misappropriate knowingly things entrusted to you.”¹⁶⁸ And “O ye who believe! When you deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing. Let a scribe write down faithfully as between the parties: let not the scribe refuse to write: as Allah has taught him; so let him write. Let him who incurs the liability dictate, but let him fear Allah his Lord and not diminish aught of what he owes”.¹⁶⁹

The concept of trustworthiness is a highly regarded virtue in Islam that every individual is required to conduct themselves ethically whether in an organisation or in their personal life. It is argued that when moral norms are not reflected in legislation or when these laws are not implemented effectively by individuals and businesses it could lead highly unethical and morally objectionable behaviour such as fraud and dishonesty. Examples of this can be seen when mighty corporations such as Enron and Lehman Brothers crumbled.¹⁷⁰

The effectiveness of a religious theory can be assessed in terms of its ability to promote desirable corporate governance practices. In other words, recognising a connection between corporate governance from the Islamic perspective on one hand and the various references in sacred texts to the Islamic objective of wealth and the Islamic constellation of values on the other. Researchers have debated whether the Islamic interpretation of corporate governance competes with the models accepted in the West, such as the Anglo-American shareholders’ model and the Continental European stakeholders’ model of corporate governance. There are two fundamental distinctions between these models and the Islamic one. First, the ethical basis of Western business morality is largely a set of derived secular values. Secondly, the fundamental beliefs and values of Western corporate governance theories tend to emphasise individual self-interest, although there is an inclination towards amending some principles in favour of the interests of society.

Nonetheless, critics among corporate governance academics have often questioned why corporations which operate in the Islamic world find this model so attractive. Hasan observes that many Islamic corporations have approved and adopted the Anglo-American shareholder

¹⁶⁸ Holy Quran, Sura 8, Ayah 27.

¹⁶⁹ Holy Quran, Sura 2, Ayah 282.

¹⁷⁰ Sulphery, M. (2015). Corporate governance in Islam vis-à-vis the modern corporate world. *Malaysian Accounting Review*, 14(1), p.87

model, as in its core it promotes the maximization of the shareholder wealth.¹⁷¹ A study conducted by Lim P.K on Malaysian corporate governance reforms found that the overwhelming majority of Malaysian corporations preferred to adopt the Anglo-American model. This significant as Malaysia is considered the leading countries in Islamic finance.¹⁷²

Miles and Goulding identify the desire to contribute to global command and occupations as a driver of the adoption of the Anglo-American model by the Islamic world's capital markets and corporations.¹⁷³ In the meantime, most Islamic countries are found to fall short of the full implementation of global corporate governance principles, for a number of reasons. First, the Islamic world is affected by many conflicts in multiple domains: legal, social, economic and political.

Islamic countries must cope with high levels of illiteracy, fraudulent governing elites, radicalisation and the failings of human rights, including the rights of women. Undoubtedly, these factors affect the attractiveness of Islamic countries as destinations for open foreign investment in relation to the general conduct of business and the implementation of the best corporate governance practices.¹⁷⁴ Although one cannot ignore the poor records on corruption in Islamic countries, one must nevertheless accept that corporate governance from the Islamic perspective may provide an ethical and value-led framework. Indeed, many commentators who support the Islamic perspective argue that significant Islamic values stand in effective challenge to corporate governance principles since past international financial collapses had resulted from a lack of morality in the actions of auditing and accounting firms.¹⁷⁵

2.5 The most common model of corporate governance used worldwide

The perpetual financial crises that have led to the collapse of major corporations in many countries in the past few decades have highlighted the need to implement a strong corporate governance model. Notwithstanding these crises, the search and implementation a good corporate governance practice have surged in recent years. This is due to the development of capital markets and the need to minimise barriers between international capital markets as

¹⁷¹ Hasan, Z. (2008). *Corporate governance from the Western and the Islamic perspective*. [online] A paper presented at the Annual London Conference on Money, Economy and Management, p. 4. Available at: <https://zulkiflihasan.files.wordpress.com/2008/06/microsoft-word-london-conference.pdf> [Accessed 6 May 2017].

¹⁷² Liew, P. (2007). Corporate Governance Reforms in Malaysia: the key leading players' perspectives. *Corporate Governance: An International Review*, 15(5), pp.724-740.

¹⁷³ Miles, L. and Goulding, S. (2009). Corporate Governance in western (Anglo American) and Islamic communities: prospects for convergence?. *Journal of Business Law*, p.2.

¹⁷⁴ *Ibid.*

¹⁷⁵ Wilson, R. (2005). Islam and business. *Thunderbird International Business Review*, 48(1), pp.69-73.

well as increasing investors' confidence to enter such markets. It can be noted that there is a global consensus about the importance of certain core principles of corporate governance. This can be seen in the well-known set of principles that were introduced by the Organisation for the Economic Co-operation and Development.

However, there are several corporate governance systems that have been established in different economic and legal environments. These systems were also subject to various political and cultural contexts. Therefore, it can be said corporate governance models depend on a number of factors such as the development of the capital market, the ownership structure, the legal and economic systems adopted by each state. Moreover, the difference in "corporate governance systems around the world stem from the differences in the nature of legal obligations that managers have to the financiers, as well as in the differences in how courts interpret and enforce these obligations".¹⁷⁶ These factors play a significant role in the formation and practice of corporate governance systems. The following section will address two of the most known models of corporate governance, namely, the Anglo-American and the Continental European Model.

2.5.1 The Anglo-American model

The Anglo-American model of corporate governance is the model used in the United Kingdom (UK) and the United States of America (US). The Anglo-American model has been built on a common law system that tended to be more focused on Shareholders and the protection of their rights and interest. Moreover, the ownership structure on these countries tends to be more dispersed with a large number of outside investors. This is in contrast with civil law countries in which ownership structure is tended to be more concentrated.¹⁷⁷

The Anglo-American model of corporate governance has three main features. It is Shareholder-focused, outsider dominated and market-oriented.¹⁷⁸ This model rests its premise that market for capital, managerial labour and the corporate control delivers effective controls on managerial discretion. This system of corporate governance assumes that due to the

¹⁷⁶ Shleifer, A. and Vishny, R. (1997). A Survey of Corporate Governance. *The Journal of Finance*, 52(2), p.750.

¹⁷⁷ Mallin, C. (2013). *Corporate Governance*. 4th ed. Oxford: Oxford University Press, p.227.

¹⁷⁸ Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States. (2002). *European Commission, Final report and Annexes*, [online] p.33. Available at: ['shttp://www.ecgi.org/codes/documents/comparative_study_eu_i_to_v_en.pdf](http://www.ecgi.org/codes/documents/comparative_study_eu_i_to_v_en.pdf) [Accessed 8 Dec. 2017].

advanced nature of capital markets and the legal infrastructure, there is no conflict between the separation of ownership and control and the protection of minority shareholders.¹⁷⁹ Furthermore, capital markets should adhere to a strict set of regulation to ensure the integrity of disclosed information and prevents insider trading with a framework based on the fiduciary relationship between the shareholder and the managers motivated by profit.¹⁸⁰

The most distinctive feature of the Anglo-American model is the structure of corporate ownership in which ownership is not concentrated but widely dispersed, such as the case in the US, whereby more than 50% of shares are held by individuals.¹⁸¹ Although the UK belongs to the Anglo-American system of corporate governance and shares many of the stated features above, the UK system differs in some aspects specifically in the protection of stakeholders. It has been argued the some of these divergences was a result of the UK membership at that time with the European Union and its member states.

The following section will highlight some differences between the UK and US systems of corporate governance. Unlike the case in the UK, the US system is based on rules whereas the UK is based on principles, such as “comply or explain” principle which gives listed companies the chance to report on the level of compliance with the UK corporate governance code and explain, in the case of non-compliance, the reasons for not doing so. This can might be viewed as giving companies the chance to not comply with certain principles if they can explain their reason. The code also gives the shareholders a pivotal role in the appointment of directors and voting on their remuneration, as well as replacing CEO and the chairman.¹⁸² Unlike the system in the UK, the US system permits the CEO to accumulate the considerable level of power and permits them to chair and sit on any subcommittees. Furthermore, in the US, the CEO is permitted to combine the role of CEO and chairman. In the UK the share ownership structure is more concentrated in the hands of institutional investors which gives them more power and allows them to play a greater role in corporate governance. in contrast to the case in the US. There’s also several disparities in financial reporting, the accountability of auditors. As a result, the UK legislation regarding corporate governance is much closer to its European neighbours than the US.

¹⁷⁹ Cernat, L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or Still the Century of Diversity?. *Journal of European Public Policy*, 11(1), pp.150-152.

¹⁸⁰ *Ibid.* p.150

¹⁸¹ *Ibid.* p.151.

¹⁸² Mullineux, A. (2010). Is There an Anglo-American Corporate Governance Model? *International Economics and Economic Policy*, 7(4), pp.437- 443

2.5.2 The continental European model.

The corporate governance system in continental European countries was built on civil law and is considered quite distinct from the Anglo-American system of the corporate governance these continental European countries tend to be more focused on certain stakeholder groups offering their interests and rights wider legal protection than to shareholders.¹⁸³ In other words, the stakeholder theory is the underlying principle in the continental European system. In this system, particularly in Germany, companies raise most of their finance through banks therefore as banks have a significant role in financing venture capitalists and often have a close long-term relationship with those corporations and often granting bank representatives a seat on the supervisory board. In contrast to the one-tier structure found in the Anglo-American model, continental European countries opted for two-tier board: the board of directors and the supervisory board. The two-tier system can be found in all German and Austrian companies over a certain size and is also popular in the Netherlands, Poland, Denmark and Switzerland. The main features of this model can be described as being bank focused, insider-dominated and stakeholder oriented.¹⁸⁴ Moreover, in this system banks and other dominant ownerships might be able to get their representatives a seat on the supervisory board, thus exercising a degree of control.¹⁸⁵ For instance over 50% of share ownership in Germany belongs in the hands of banks and insurance companies, therefore, strong relationships, long-term commitments and business interdependencies are established.¹⁸⁶ The continental European model highlights and promotes the labour related aspects and employee involvement and participation, it also allows them to contribute to the strategic management decision.¹⁸⁷ Examples of this can be seen in Germany, Austria and Denmark whereby employees of companies of a certain size have the right to elect their representatives on the supervisory board. This gives the labour sector much greater influence in the European model when compared to the limited role of trade unions in the Anglo-American model.

¹⁸³ *Ibid*, p.441.

¹⁸⁴ Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States. (2002). *European Commission, Final report and Annexes*, [online] p.32. Available at: http://www.ecgi.org/codes/documents/comparative_study_eu_i_to_v_en.pdf [Accessed 8 Dec. 2017].

¹⁸⁵ Dignam, A., and Galanis, M. (2008). Corporate Governance and the Importance of Macroeconomic Context. *Oxford Journal of Legal Studies*, 28(2), pp. 202.

¹⁸⁶ Cernat, L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or still the century of diversity? *Journal of European Public Policy*, 11(1), p.150.

¹⁸⁷ Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States. (2002). *European Commission, Final report and Annexes*, [online] p.32. Available at: http://www.ecgi.org/codes/documents/comparative_study_eu_i_to_v_en.pdf [Accessed 8 Dec. 2017].

2.5.3 Theory and model of corporate governance adopted in Saudi Arabia.

It is evident that Saudi Arabian legislation seeks to adopt rules and standards to ensure adherence of listed companies with the best governance practices in order to ensure the protection of shareholders and stakeholders rights.¹⁸⁸ The Saudi Arabian corporate governance system is considered to be much closer to the Anglo-American model of corporate governance and more in line with its general theory which aims to generate a fair return to shareholders. Saudi legislation and corporate governance regulations adopt similar features in which it adopts a unitary board of directors and does not permit the establishment of a two-tier model. Furthermore, the Saudi corporate governance system is not bank orientated nor does it support any other long-term ownership. Similar to the Anglo-American model Saudi corporations are not legally required to provide any form of employee participation in the management decision-making process nor does it support any form of employee representation. Saudi legislation contains certain articles that aim to protect the rights and interest of stakeholder's groups, the rights and interest of minority shareholders and sets limitation in the powers of the CEO.¹⁸⁹ For instance, the Saudi company's law prevents chairman from combining any other roles in the company.¹⁹⁰ Moreover, Saudi government dominates most financial, business and labour sectors this also extends to the Saudi stock market where the ownership structure of several large listed companies has been occupied by state concentrated ownership, therefore, this environment increases the role and control of the state over the corporate sector.

Notwithstanding the similarities that the Saudi governance system shares with either model, it is contended that no system of corporate governance can exist in isolation from the consequences of the company's action on the various groups of stakeholders. Consequently, certain features of the continental European system may be beneficial in reforming corporate governance in Saudi Arabia. Features such as the engagement and participation of employees on certain matters as well as facilitating some methods for employee representation. This would be beneficial as there is no form of protection by trade unions or civil institutions in Saudi Arabia. It is concluded that there is no perfect model of corporate governance and certainly no model should be imitated blindly. Each system of governance explored has its merits and must be viewed in the light of local and legal settings, the characteristics of the capital market and the ownership structure.¹⁹¹

¹⁸⁸ Saudi Arabia Corporate governance regulations 2017. Article 2A.

¹⁸⁹ This will be further discussed in chapter 7 .

¹⁹⁰ Saudi Arabia Companies Law 2015, Article 81.

¹⁹¹ Mallin, C. (2013). *Corporate Governance*. 4th ed. Oxford: Oxford University Press, p.22.

2.6 Conclusion

This chapter began by reviewing various definitions of corporate governance, reflecting a wide variety of backgrounds, experiences, policies and standards among the scholars and countries concerned. Next, the chapter reviewed five specific theories and models of corporate governance, namely agency theory, stakeholder theory, resource dependence theory, the myopic market model and corporate governance and Sharia principles.

This chapter explored the various definitions and theories in corporate governance. This chapter had two specific objectives: Firstly, to define corporate governance from the perspective of various scholars to extend our understanding of the concept. Secondly, to review the literature on the related theories of corporate governance so these theories so that these theories may be compared. The chapter also aimed to shed light on an alternative theory, namely; the theory of corporate governance from the Sharia perspective. The review of the theories is also intended to serve to re-evaluate in the Saudi context in the following chapter.

The first section noted that the term ‘corporate governance’ has been defined by numerous scholars in the field. Some scholars distinguish between narrow and broad definitions of corporate governance, where the former limited the scope of the definition to shareholder’s protection and management control and other aspects of the agency problem. The broader definitions tend to reflect the concerns of the stakeholder theory, where it focuses more on the regulation of the relationship of the company has not only with its shareholders but also with other stakeholder groups, including employees, customers, creditors, suppliers and the general public. The author decided to take as working definition those offered by Sir Adrian Cadbury in his well-known report and the OECD principle, as they are widely accepted by scholars and practitioners alike. The theories of corporate governance were considered in the next section, namely agency theory, stakeholder theory, resource dependency theory, the myopic market theory and the theory of corporate governance from Sharia. The agency theory was shown to be the most dominant model of corporate governance. The approach of the agency theory was shown to be more shareholder-orientated. The rise of the agency theory was in response to the problems associated with the mutually inimical interest of the owners on one hand, and the management on the other hand. From this perspective, corporate governance is seen as a necessary tool of control to ensure that the management does not negate from their fiduciary duty. The agency theory puts the interest of the shareholders paramount to the interest of other

group, including the management. Therefore, it was inevitable that the interest of the employees, customers, suppliers and any other stakeholder in the wider community will be poorly served. It was shown that it was particular in the UK, US and other common law jurisdictions that corporate governance mechanisms were developed to serve the interest of the shareholder rather than any other party. Principle-agent conflicts are the primary concern of agency theory which are generated by the separation of ownership and management. Therefore, aligning the interest of the management with the interest of the shareholder by linking bonuses and remuneration to the performance of the company was an attempt to mitigate the principle-agent conflict. The application of the agency theory entails the reduction of the number of executive directors in the board and increasing the number of independent directors who help shareholders to hold directors to account. The application of agency theory also entails the establishment of board subcommittees to oversee the company's audit, nomination and remuneration functions.

Stakeholder theory was investigated in the next section. It was shown that the emergence of the stakeholder theory fundamentally challenges the principles of agency theory. Stakeholder theory advocates respond to the claims of the agency theory and point out that the exclusive concern with the interest of shareholder does not, in practice, enhance accountability or the performance of the company. It posited that the company's role goes beyond from simply offering services or producing goods, but involves social responsibility and the interest of other groups beyond shareholders.

Stakeholder theory proposes that directors should act in the interest of all stakeholder including customers, creditors suppliers, employees and society as a whole. the stakeholder governance model was largely implemented in continental Europe and other civil law jurisdictions. An essential component of stakeholder theory was viewed in the recognition of CRS. The fundamental distinction was noted between agency theory and stakeholder; where agency theory advocates that the company's objective is the maximisation of shareholder value, stakeholder theory takes it to be serving commercially a wider societal interest. The next section examined the resource dependency theory and the myopic market model. Resource dependence theory (RTD) was described as a strategic contingency theory which is concerned with the distribution of corporate power and which sees board members as a human capital resource whose main role is to use their skills, powers and knowledge to give the enterprise's managers the best possible advice. In common with agency theory, the myopic market model suggests that the firm exists solely to serve its shareholders' interests, but it differs insofar as

it rejects the 'competitive myopia' of agency theory. The myopic market model holds that corporate governance fails when the existing institutional arrangements encourage management to pursue short-term performance, rather than seeking to maximise shareholder wealth and the company's competitiveness over the long term. The next sections aimed to explore an alternative religious theory, corporate governance from sharia perspective. Islamic values of Tawheed, accountability, justice, sincerity and other values were investigated in order to ascertain to what extent the Sharia principles could moderate and enhance corporate governance principles and practices.

Chapter Three
The Background and The Legal Structure of Saudi Arabia

3.1 Introduction

This chapter will provide general background information on Saudi Arabia and its legal structure. The ‘constitutional law’ of Saudi Arabia will be examined. The chapter will end with a review of the current court system in Saudi Arabia. These facts will aid in understanding and clarifying several key matters which are crucial to the upcoming chapters.

3.2 Background information of Saudi Arabia

Saudi Arabia commands significant religious status amongst other Islamic countries as it is the birthplace of Islam where the two holiest cities of Islam, Makkah and Al- Medina are located. More than 2 billion Muslims directing their daily prayers towards Makkah. The second holiest city is Al- Medina which houses the Mosque and grave of Prophet Mohammed peace be upon him (PBUH).

The importance of the religion of Islam in Saudi Arabia is evident, and it has an extensive impact on all aspects of daily life in Saudi Arabia. The Basic Law of Governance 1992, affirms the central role of the religion, whereby it provides that “ the State shall protect where it the Islamic creed, apply its Shari’a, encourage the good and prohibits the evil, and carry out the duty of calling for God.”¹⁹² Menoret noted that “Islam is inseparable from Saudi consciousness and national pride, not only because Saudi Arabia houses the holy places of Makkah and Medina but also because it was the centre of the first indigenous Arab-Muslim resistance to foreign domination. Even for the youngest Saudis, therefore, Islam is the key to their self-perception and their affirmation of national sentiments”.¹⁹³

3.3 Saudi Arabia legal structure

An understanding of corporate governance in Saudi Arabia depends critically on understanding the legal system and its underlying structure. As explained above, Saudi Arabia is an Islamic

¹⁹² Saudi Arabia Basic Law of Governance, 1992, Article 23.

¹⁹³ Ménoret, P. (2005). *The Saudi enigma*. 1st ed. London: Zed Books, p.100.

country that derives its legal system from Sharia and its sources. Other valid sources of law include statute, custom and regulations if they do not conflict with Sharia. Sharia, which regulates all aspects of life and commerce, is derived from five primary sources: the Quran, the Sunnah, ijma, qiyas and al-masalih al-mursalah. The Quran and Sunnah are seen to embody divine rulings; they, therefore, form the basis of the other three main sources. Each of the five is now considered briefly, in turn:

The First source of Sharia is the absolute provisions that are found in the text of the Holy Quran. The Quran is the holy book which Muslims believe to have been revealed to the prophet Muhammad (peace be upon him). It contains divine commands that must be followed. The second source of Shariah is the Sunnah, a series of books in which the acts and the correct sayings (Hadiths) of prophet Muhammad (PBUH) that have been attained by reliable narrators and are recognised by the majority if not all of the Islamic scholars. The importance of following the Sunnah of the prophet Muhammed is mentioned frequently in the Quran, Allah states that “He, who obeys the messenger (Muhammed), he indeed obeyed Allah”.¹⁹⁴ The Ijma is considered a secondary source of Islamic law. Ijma is the recorded consensus of Muslim jurists at a certain period on any question of law that has arisen since the death of the prophet Muhammad. Prophet Muhammed (PBUH) was to be a strong advocate of Ijma, and has encouraged Muslims to be when he stated that “My Ummah will never upon an error”.¹⁹⁵ The significance of Ijma is evident in Islam, and even more so in today’s climate where Muslim scholars are expected to handle complex laws and as well as satisfy the needs of Muslim societies.

The Qiyas (analogical deduction) is an additional secondary source of Islamic law which requires taking the ruling in a case set out in either the Quran or the Sunnah and applying it to another case considered analogous because the two cases share the same reasoning.¹⁹⁶ An additional secondary source is Al-masalih al-mursalah which refers to the rulings adopted by the ruler of an Islamic country in the best interest of that country, on a matter which is subject to neither prescription nor prohibition in the Quran or Sunnah. Its exercise must not contradict shariah. Given the flexibility of shariah, several matters in Saudi Arabia are subject to legislation or regulation are based on al-masalih al-mursalah, which allows the adoption of rules which are necessary for public welfare.

¹⁹⁴ Holy Quaran, Sura 59, Ayah 7.

¹⁹⁵ This hadith was narrated by ibn Majah, hadith no. 9107, see Ibn Majah, M. and Ansari, M. (2007). *Sunan ibn-i-Majah*. Riyadh: Darusallam, pp.1993-1996.

¹⁹⁶ Abdar-Rahman, D. (2008). *Shariah: Islamic Law*. London: Publishers Ltd, p.70.

3.3.1 The role of Sharia

The pivotal role Sharia can be seen in numerous articles in different laws in Saudi Arabia. For all legislation enacted in Saudi Arabia, the Basic Law of Governance 1992 stipulates that Sharia is the final point of reference and all laws must be formulated in accordance with the principles of Sharia and must not depart from them.¹⁹⁷ Nevertheless, despite the emphasis on the role of Sharia in the Saudi legislation, there are several rules that do in fact conflict with Sharia, particularly in the banking and insurance sectors.¹⁹⁸

The imposition of these rules can be attributed to the needs of civil society in the modern state, however, these rules have been merely borrowed from transnational law without taking into account the local environment nor attempting to find a local solution.¹⁹⁹ Moreover, the process of passing laws and their codification proved to be a contentious issue in Saudi Arabia and remains the subject of disagreements between Sharia scholars and politicians. The disagreements have even affected the usage of certain terms such as “qanon”, the Arabic term for “law”, and tashri' (legislation) were deliberately evaded in favour of marsom (decree) and nizam (ordinance).²⁰⁰

To gain an understanding of the situation in Saudi Arabia, one must acknowledge that Sharia is not just a body of laws but is a religion with rules that covers all aspects of human life including worship, personal relationships and commercial activities. The Islamic doctrine is an integral part of the Saudi culture, particularly as 100% of Saudi citizens Muslims,²⁰¹ thus there is a strong desire by Saudis to protect and stand by their Islamic beliefs.

As stated earlier, the absolute provisions that are contained in the Holy Quran and the authenticated Hadith of the Prophet Muhammad are the main sources of Sharia. These provisions may include either certain rules or general principles that cover issues such as

¹⁹⁷ Article 46 of Basic Law of Governance 1992, and Article 2 of Law of the Shura Council 1992 in the Kingdom of Saudi Arabia.

¹⁹⁸ Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 734-736.

¹⁹⁹ *Ibid*, p. 735.

²⁰⁰ *Ibid*, p. 734

²⁰¹ See the report of percentage of Muslims in each country, Cia.gov. (2018). *The World Factbook — Central Intelligence Agency*. [online] Available at: <https://www.cia.gov/library/publications/the-world-factbook/fields/2122.html> [Accessed 22 Apr. 2016].

Islamic penalties for specific crimes, divorce settlements, inheritance and dealing in usury (whether paying or receiving interest). There are several general rules and principles in Sharia that regulates what is considered Halal (permissible) or Haram (prohibited). These may be derived from Islamic text, instructions and provisions. For instance, the protection of human rights and the principle of justice and harm etc.

Furthermore, there is a general principle that any action is permissible as long as it does not contradict the objective of Sharia. The principle of *Asol Al-Fiqh* (Islamic jurisprudence) and *Masqsaid Al-Sharia* (the objectives of Sharia) focus in the use of a limited number of Islamic text, whether in the Holy Quran or the Hadith and to regulate novel events and permits adjustments in the law in order to accommodate social change. This enables Sharia to be creative, innovative and flexible to accept good international practices.²⁰² Thus, it can be argued that Sharia is equipped to admit any new rule regardless of its origins as long as it does not Islamic of objectives of justice, human rights and the interests of people.²⁰³ This confirms the acknowledgement of Sharia of the role human and social experiences in developing legislation. It was through this flexible approach Islamic civilisation has played a major role in the regulation of people's affairs and was ready to provide solutions for perceived or existing problems. This benefit was not limited to the Islamic civilisation but also improved non-Islamic civilisations that it has been in contact with. For instance, the noteworthy efforts of Ibn Kaldoon and Ibn Rushd in the fields of sociology and philosophy and Islamic scholars preservation and the interpretation of the work of Aristotle and Socrates.²⁰⁴

3.4 The Basic Law of Governance 1992

The Basic Law of Governance 1992 was issued under the reign of King Fahad AL Saud, the fifth King of Saudi Arabia. In 1992, King Fahad decreed the issuance of four significant laws, specifically: The Basic Law of Governance, the Consultative Council Law, the Law of Regions and finally the Law of the Council of Ministers.²⁰⁵ The Basic Law of Governance is the most significant piece of legislation of the aforementioned laws and is comprised of nine sections with eighty-three articles and encompasses several principles.

²⁰² Kamali, M. (2002). *Principles of Islamic jurisprudence*. 3rd ed. The Islamic Texts Society, pp.7-9.

²⁰³ *Ibid*.

²⁰⁴ Perry, M. (2008). *Western civilization: Ideas, Politics, and Society*. 9th ed. Boston: Wadsworth Cengage Learning, pp.261-262.

²⁰⁵ Basic Law of Governance, Royal Order, No. A-90, dated 1 March 1992. The Consultative Council Law, Royal Order, No. A-91, dated 1 March 1992. The Regional Law, Royal Order, No. A-92, dated 1 March 1992. The Council of Ministers Law, Royal Order, No. A-13, dated 20 August 1993

While it is claimed that there is no constitutional law in Saudi Arabia since the legal structure is based on the Holy Quran and Sunnah (traditions of the Prophet Mohammed PBUP), effectively, the Basic Law of Governance can arguably be considered as the equivalent of the country's constitutional law. This is affirmed by Article 1 of the Basic Law of Governance (BLG 1992), Article 1 states: "The Kingdom of Saudi Arabia is a fully sovereign Arab state. Its religion shall be Islam and its constitution shall be the book of God and the Sunnah (traditions) of his messenger."²⁰⁶ Under the Law of Governance, introduced in 1992, which serves as Saudi Arabia's constitution, the King stands at the head of the political system and has the official title of the 'Custodian of the Two Holy Mosques.' Beneath him, three legislative bodies are authorised to initiate and approve laws: The Council of Ministers, the Consultative Shura Council and Individual ministers.

The first part of the Basic Law of Governance covers the general principles such as the construction and condition of the country, its religion and its official language.²⁰⁷ The second part explains the system of governance and the mechanisms and specifies that only the sons and grandson of the Founder of Saudi Arabia may inherit the throne.²⁰⁸ The third section of the Basic Law of Governance addresses the foundations of the Saudi society emphasising the importance of religion, family and education in the everyday life of every individual to ensure the sound basis of the Saudi society.²⁰⁹

The economic affairs of Saudi Arabia are covered in the fourth section of the Basic Law of Governance, where it maintains that the government owns all natural resources.²¹⁰ The Basic Law of Governance provides that all public agencies shall be continuously supervised financially and administratively.²¹¹ The Basic Law of Governance stressed that the governance of the country must be basic on justice, Sharia and equality in accordance to Sharia Law and maintains that the state must protect human rights and civil liberties in accordance to Sharia law and provide security and civil liberties to all citizens and residents so that no citizen or resident may be detained or imprisoned without any legal justification.²¹² The Basic Law of

²⁰⁶ Basic Law of Governance, 1992, Article 1.

²⁰⁷ Basic Law of Governance 1992, Article, 1, 2, 3 and 4.

²⁰⁸ *Ibid*, Article 5 (b)

²⁰⁹ *Ibid*, Article 9 and 10

²¹⁰ *Ibid*, Article 14.

²¹¹ *Ibid*, Article 80.

²¹² *Ibid*, Article 26 and 36

Governance 1992 also provides that the state must facilitate job opportunity for every able individual and enact laws for their protection.²¹³

3.5 The Saudi court system

The Saudi judicial authority comprises the General Courts (Sharia Court), the Administrative Judicial Body (Board of Grievances) and the quasi-judicial committees. The Sharia court system operates across several types of courts and the Law of Judiciary 2007 provides that the following hierarchal structure for Sharia courts; the Supreme Court, the Court of Appeal and the Courts of the First instance which are: General Courts, Penal Courts, Family Courts, Commercial Courts, and Labour courts.²¹⁴ Each court is different in terms of hierarchical structure, and they have limited jurisdiction on the cases brought before them in accordance with the Law of the Judiciary, the Law of Criminal Procedures and the Law of Procedure before Sharia courts.²¹⁵ The Law of judiciary 2007 provides that the Supreme Judicial Council be responsible for directing Sharia courts and tasked with the supervision of the work of the courts and its judges.²¹⁶

3.5.1 The Board of Grievances

The Board of Grievances also known as Daiwan al Mazalm, was first established in 1955 and was reorganised and restructured in 1982 to serves as an independent administrative, judicial body reporting directly to the King.²¹⁷ Originally the Board of Grievances had limited jurisdiction and could only adjudicate claims against the government and its institutions.²¹⁸ However, with the passage of time, it has inherited wider jurisdiction and began to deal with Commercial disputes.²¹⁹ Indeed, the Board of Grievances was encouraged to handle commercial disputes by the government, for instance, the Royal Decree No. M/63 provided that most commercial disputes including company law dispute to be referred to the Board of Grievances.²²⁰ In 2000, Saudi Arabia began a series of legislative reforms which cultivated in the restructuration of the BOG for the second time since 1955 and the passing of the Law of

²¹³ *Ibid*, Article 28.

²¹⁴ Law of Judiciary 2007 pursuant to Royal Order M/78 dated 1/10/2007, Article 9.

²¹⁵ Faraj, M. (2014). *Toward new corporate governance standards in the Kingdom of Saudi Arabia*. SABIC Chair for IFMS.P.35

²¹⁶ Law of the Judiciary 2007, Article6.

²¹⁷ The Board of Grievances created pursuant to Royal Decree M-51 dated 1982.

²¹⁸ Gould, N. (2009). The Saudi Board of Grievances. *International Quarterly*, (11), p.1.

²¹⁹ *Ibid*.

²²⁰ Royal Decree No. M/51 dated 14/09/1982.

The Board of Grievances in 2007 and restricted its jurisdiction to adjudicate over the following:²²¹

- (a) “Cases relating to rights provided for in civil service, military service and retirement laws for employees of the Government and entities with independent corporate personality or their heirs and their other beneficiaries.
- (b) Cases for revoke of final administrative decisions issued by persons concerned when the appeal is based on grounds of lack of jurisdiction, defect in form or cause, violation of laws and regulations, error in application or interpretation thereof, abuse of power, including disciplinary decisions and decisions issued by quasi-judicial committees and disciplinary boards as well as decisions issued by public benefit associations – and the like – relating to their activities. The administrative authority’s refusal or denial to make a decision required to be made by it in accordance with the laws and regulations shall be deemed an administrative decision.
- (c) Tort cases initiated by the persons concerned against the administrative authority’s decisions or actions.
- (d) Cases related to contracts to which the administrative authority is a party.
- (e) Disciplinary cases filed by the competent authority.
- (f) Other administrative disputes.
- (g) Requests for execution of foreign judgments and arbitral awards.”

This returned the Board back to its roots as an administrative judicial body and transferred the jurisdiction over of commercial disputes to the commercial branch of the Sharia courts. However, it is worthy to note that the commercial branch of the Sharia courts has not been established yet due to the decline of Sharia court judges to adjudicate over certain commercial disputes that they considered to be non-compliant with Sharia law, such as Banking legislation and Insurance contracts. In order to bypass this predicament, the government created the various quasi-judicial committees that to fill in the gaps within the judiciary.

Under the previous Law of Board of Grievances, the Board did not have authority to review decisions of the quasi-judicial committees. However, the 2007 Law grants the Board of Grievance jurisdiction to review decisions imposed by the quasi-judicial committee.²²² The Board of Grievances is not authorised to review any decisions issued by three committees, namely, the Banking Disputes Committee, the Customs Disputes Committee and the

²²¹The Law of the Board of Grievances 2007, Article 13.

²²² The Law of Board of Grievances 2007, Article 13 (b).

Committee for the Resolution of Securities Disputes. The decisions of these committees are deemed final and are not subject to any kind of judicial review.²²³

3.5.2 Quasi-judicial Committees

The Saudi legal system comprises of various quasi-judicial committees that enjoy full judicial powers and adjudicate over several essential issues. The quasi-judicial committees were established to address a wide variety of disputes including administrative, civil, criminal and commercial.²²⁴ The quasi-judicial Committees enjoy full independence from Sharia courts and depend on written rules and regulations rather than specific provisions of Sharia Law.²²⁵ The development of the quasi-judicial committees was seen as an alternative court that deals with the determination of disputes including administrative and commercial that is considered to be beyond the jurisdiction of Sharia courts. Furthermore, there have been concerns over the application of civil law principles on issues which, as it was viewed as non-Islamic. It has been argued that “the expansion of civil jurisdiction would only come at the expense of Sharia courts.”²²⁶ Codification is considered one of the most significant justifications for the creation of these quasi-judicial committees in the Saudi context. In other words, these committees are governed by provisions that have been codified in each relevant field and adjudicated accordingly. The Sharia scholars, who control the judiciary, strongly oppose any suggestion of codification of Sharia rules into a unitary civil code as it is seen to dispossess Sharia from its role in the judiciary.²²⁷

The underlying objective of the for the establishment such committees can be traced back to 1932 when Islamic scholars objected to the creation of commercial courts. This continued to the present day even with the establishment of commercial courts, Sharia judges continuously rejected to enforce certain laws and regulations in cases presented before them. Specifically, Sharia courts decline to enforce laws and regulations governing non-Islamic activities in

²²³ The Explanatory notes of the Law of Board of Grievances state that decision of the quasi-judicial committee is considered final according their established laws and that any decisions by these committees are not subject to judicial review by the Board of Grievance.

²²⁴ Al-Jarbou, A. (2011). *Audicial Review of Administrative Actions Under the Saudi Law*. Riyadh, p.113.

²²⁵ *Ibid.*

²²⁶ Al-Ghamdi, M. (2012). The Dispute Resolution Review: Saudi Arabia. *Law Business Research*, p.665.

²²⁷ Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4),pp, 733.

banking and insurance agreements.²²⁸ The necessity to fill in the gaps in the judiciary promoted the Saudi government to establish by Royal Decree numerous quasi-judicial committee, including the Labour Disputes Committee, the Banking Dispute Committee, the Committee for the Resolution of Securities Disputes and the Customs Disputes Committee. Notwithstanding, these committees are established by Royal Decree, they ultimately belong to a specific ministry rather than to the judiciary. Therefore, the minister has broad authority over the committee and can, at his discretion, appoint the member of the committee, dismiss them and can even dissolve the committee.²²⁹ Arguably, the exercise of such control can affect the decisions and the independence of the members of these committees. There are currently over one hundred quasi-judicial committees in Saudi Arabia, a large number of these committees can be viewed as having a negative influence on the independence of the judiciary.²³⁰ The committee is empowered by the royal decree to adjudicate over certain matters, including securities dispute. However, they are not granted the necessary protection and independence afforded to judges. The independence of the judiciary is considered an essential element under the Law of the Judiciary as it is affirmed in the First article that:

“Judges are independent, and in the administration of justice, they shall be subject to no authority other than the provisions of Sharia and laws in force. No one may interfere with the judiciary.”²³¹

The current dilemma in Islamic legislation is not about the incapability of Sharia to admit new rules but rather it is the incapability of Sharia scholars and lawmakers to resolve their conflicts. It is evident that there is a strong correlation between the development of law and the development of civilisation, culture and economy. Advanced countries in these areas were able to introduce and develop laws. As a consequence of the decline of Islamic countries over the past few centuries, the role of Sharia scholars shifted from producing and developing rules to harmonizing western laws with Sharia. Given the strong correlation between law and culture, western laws were met with some pessimism by Sharia scholars as it was seen to have been built on the principles of capitalism that generally aims at maximizing profits. This can be contrasted with the objectives of social welfare and justice inherent in Sharia teachings. This created an atmosphere of reluctance and resistance by the Sharia scholars to adopt any legal rules, particularly when those rules deviate from objectives of Sharia. In the past few centuries, the colonisation by European countries of several Muslim countries impacted the development

²²⁸ *Ibid*, p. 119.

²²⁹ *Ibid*.

²³⁰ Al koly, O. (2013). *No constraints on the work of quasi-judicial committee*. [online] Okaz. Available at: <https://www.okaz.com.sa/article/625036/> [Accessed 20 Sep. 2016].

²³¹ Law of Judiciary 2007, Article 1.

of Islamic civilisation. Faced with the dominance of western nations in the fields of military, industry and economy forced Islamic civilisation to an almost halt, including the provisions derived that may be derived from Sharia. This created resistance by the Sharia scholars to towards any foreign legislation.²³² This is most visible in the context of Saudi Arabia particularly as Saudi Arabia is the birthplace of Islam and contains the two holiest sites of Muslims and considered by many Muslims as the model Islamic country.

Taking all the above-mentioned factors, a visible conflict has arisen between the lawmakers in Saudi Arabia and the Islamic scholar. This conflict has resulted in certain questionable provisions have emerged, which cannot be attributed to Sharia, for instance, the ban of the usage of the term “law”, the ban on women driving and the prohibition of benefiting of many laws western laws even if its compliant with Sharia. This defensive stance was adopted by some Islamic scholars who had hoped that it would preserve the supremacy of Sharia.²³³ Fortunately, the influence of those Islamic scholars has decreased in recent times. This can be seen in the recent lifting of the driving ban on women.²³⁴ To sum up, the relationship between Sharia and law in Saudi Arabia has heavily impacted the legislative and judicial system and has unfortunately negatively impacted the development of the corporate sector at both levels.²³⁵

Therefore, it is suggested that Sharia scholar and the lawmakers work together and cooperate to bring an end to this conflict and ensure that disputes regarding securities, banking and other disputes that have no access to the courts are adequately covered by the relevant judicial authority. This issue may be resolved in two ways. Firstly, the lawmaker should recognise and comply with the provisions of the BLG 1992 which states that all legislation must be formulated in accordance with Sharia principles.²³⁶ This would entail that the lawmakers will not seek to enact any rules or legislation, including those regarding banking, commerce and securities that depart from the principles of Sharia and ban such practices whether national or

²³² Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 733.

²³³ Almbred, M. (2015). The Faculties of Law and the Judgment in Other Than What Allah Revealed. Arabic Edition, available online at <http://saaid.net/book/open.php?cat=&book=14183>. [Accessed on 23/6/2018]

²³⁴ Revesz, R. and Stevenson, C. (2017). *Opinion: Saudi Arabia lifted its ban on women driving because of economic necessity, not women's rights*. [online] The Independent. Available at: <https://www.independent.co.uk/voices/saudi-arabia-women-driving-ban-lifted-reason-economics-finance-rights-equality-a8414426.html> [Accessed 18 May 2018].

²³⁵ These points will be discussed further in chapter 4.

²³⁶ Articles 1, 46, 55 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia. And Article 2 of Law of the Shura Council 1992 in the Kingdom of Saudi Arabia.

international. This will also require foreign entities and investors to adhere to and respect the local rules and culture if they wish to work or invest in Saudi Arabia.

On the other hand, Islamic scholars must be more proactive and be up to date with the current development of the international commercial system. Sharia scholars will need to keep an open mind regarding the supremacy of Sharia law and recognise that the inherent flexibility of Sharia is one of the most significant features which allowed the Sharia system to be creative and innovative in the past when faced with novel events and accepting good international practices. This can be done by encouraging research to find an appropriate solution to meet the current economic and financial needs of the modern world. Nevertheless, it must be noted that this solution is currently in place, at least to some extent, in the Islamic banking sector. In the recent past, the banking sector was extremely removed from the provisions of Sharia, however, nowadays the Islamic banking system is internationally recognised and provides products and services that are compliant with Sharia.

3.6 Conclusion

This chapter provided general background information on the Kingdom of Saudi Arabia. The chapter focused on the legal structure of the country and consider key issues that may affect corporate governance practices in the country. The chapter was intended to highlight some of the more unique features inherent in the country's legal structure. It was noted that Saudi Arabia is considered the birthplace of Islam and contained the two holy cities of Makkah and Al-Medina. In fact, the official title of the King of Saudi Arabia is the 'Custodian of the Two Holy Mosques' demonstrating the relationship between Islam and the country. For that the reason, Saudi Arabia holds a special status among other Islamic nations. Under the Basic Law of Governance, introduced in 1992, which serves as Saudi Arabia's constitution, the king stands at the head of the political system. Beneath him, three legislative bodies are authorised to initiate and approve laws: The Council of Ministers, the Consultative Shura Council and individual ministers. It was emphasised that the Saudi legal system is derived from Sharia, specifically from the two primary sources of Sharia, the Holy Quran and the Sunnah (tradition of the Prophet PBUH). It was mentioned that the Saudi judicial system is comprised of the Sharia court system, the Board of Grievances and the quasi-judicial committees. It was noted that the reason for the establishment of these committees was to fill in the gaps in the judiciary as Sharia courts refuse to enforce laws and regulations governing non-Islamic activities, such as banking and insurance contracts.

Chapter Four
Development of Saudi Corporate Governance

4.1 Introduction

This chapter seeks to provide a description of the development and where appropriate an evaluation of the corporate governance framework in Saudi Arabia. This chapter will seek to answer one of the research question, namely, how did the current system of corporate governance develop. This chapter will provide the necessary information on the regulatory bodies and corporate governance legislation in place before the corporate governance reforms that have recently been pursued in Saudi Arabia. It does so by presenting background information on corporate governance in Saudi Arabia, then examining the external and internal corporate governance frameworks. The remainder of the chapter is organised as follows. The first section presents background information relating to the Saudi corporate governance framework and the second section discusses the corporate governance model within the Saudi corporate context. The third and fourth sections describe the external and internal corporate governance frameworks respectively.

4.2 Background Information

Until the early 1980s, there was no well-developed and formally operated equity market in Saudi Arabia. The stock market was small and regulations were weak, so potential shareholders and investors were poorly protected and not attracted to invest.²³⁷ The Saudi stock market began simple operations in the 1930s with the foundation of the country's first joint stock company, the Arabian Automobiles Company. In the mid-1970s there were still fewer than twenty public companies, but the subsequent oil boom facilitated rapid economic expansion and a sharp increase in the number of major public companies and banks. However, the stock market remained informal until 1985, when the central bank, the Saudi Arabian Monetary Agency (SAMA) was instructed to develop the stock market. SAMA was responsible for regulating and monitoring stock market trading from 1985 until July 2003, when the Capital Market Authority (CMA) took over.²³⁸ The only legislation concerned with mandatory monitoring of the behaviour of corporations and their officers is the Saudi CL 1965, which

²³⁷ Hussainey, K. and Al-Nodel, A. (2008). Corporate governance online reporting by Saudi listed companies. *Research in Accounting in Emerging Economies*, 8, p.39.& AlNodel, A. and Hussainey, K. (2010). Corporate Governance and Financing Decisions by Saudi Companies. *Journal of Modern Accounting and Auditing*, 6(8), p.1.

²³⁸ Samba Financial Group (2009). *The Saudi Stock Market: Structural Issues, Recent Performance and Outlook*, Riyadh, p.4.

specifies the requirements for corporate governance mechanisms in only a limited number of areas concerning the structure of boards of directors and the general assembly of shareholders.²³⁹ Saudi Arabia has been classified as an important emerging economy.²⁴⁰ In 2010, the Saudi stock market represented 44% of total Arab market capitalisation and 25% of the total Arab GDP.²⁴¹ The importance of its emerging economy is marked by Saudi Arabia's membership, since 2008, of the G20.²⁴²

In the 2000s, the regional and international significance of the Saudi economy was not, however, reflected in the number of listed firms and the value of market capitalisation,²⁴³ which led academics, investors and practitioners to call increasingly strongly for stock market and corporate governance reforms.²⁴⁴ Among their proposals were: (i) increasing market capitalisation and the number of listed firms; (ii) enhancing the market for corporate control and other external corporate governance mechanisms. (iii) tightening corporate governance rules to protect shareholders' rights; (iv) improving transparency and disclosure; and (v) allowing foreign investors to participate directly.

At the same time, the World Bank, the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) were among transnational organisations which put pressure on Saudi Arabia and other emerging economies to introduce corporate governance codes as a matter of priority.²⁴⁵

In response, the Saudi government initiated corporate governance reforms in the early 2000s, along with more general economic reforms. The Saudi Arabian General Investment Authority (SAGIA), The Supreme Economic Council and the Saudi Stock Exchange (Tadawul) were among the bodies set up to boost investment and economic growth. Specific corporate

²³⁹ Haniffa, R. and Hudaib, M. (2007). Locating Audit Expectations Gap within a Cultural Context: The Case of Saudi Arabia, *Journal of International Accounting, Auditing and Taxation*, 16(2), pp.179-206.

²⁴⁰ Al-Filali, I. and Gallarotti, G. (2012). Smart Development: Saudi Arabia's Quest for a Knowledge Economy, *International Studies*, 49,(1-2), pp.47-76.

²⁴¹ Hearn, B. Piesse, J. and Strange, R. (2011). The Role of the Stock Market in the Provision of Islamic Development Finance: Evidence from Sudan, *Emerging Markets Review*, 12(4), pp.339

²⁴² Al-Matari, Y., Al-Swidi, A. and Fadzil, F. (2012). Corporate Governance and Performance of Saudi Arabia Listed Companies. *international review of management and marketing*, 4(2),pp..1-30

²⁴³ Al-Filali, I. and Gallarotti, G. (2012). Smart Development: Saudi Arabia's Quest for a Knowledge Economy, *International Studies*, 49(1-2), pp.47-76

²⁴⁴ Alshehri, A. and Solomon, J. 2012. 'The Evolution of Corporate Governance in Saudi Arabia', Conference Paper, British Accounting and Finance Association (BAFA), Brighton, UK.

²⁴⁵ Clarke, T. (2004). Cycles of Crisis and Regulation: the Enduring Agency and Stewardship Problems of Corporate Governance, *Corporate Governance: An International Review*, 12(2) pp.153-161.

governance reforms began in 2003 with the establishment of the CMA which is responsible for the regulation of the Capital Market and overseeing the corporate governance regime. The result has been considerable growth in the number of firms, market capitalisation, liquidity and visibility.²⁴⁶

Share prices on the Saudi stock market rose rapidly in early 2004 and this growth continued until the beginning of 2006 when share prices fell sharply so that the market lost over 55% of its value (over \$480 billion) by the end of that of 2006. This crash exemplified the urgency of corporate governance reforms.²⁴⁷ In November 2006, the CMA in direct response, introduced the Saudi Corporate Governance Regulations (CGR 2006), the main aims being to restore market confidence and to protect investors.²⁴⁸

4.3 External Framework of the Saudi Corporate Governance

The external framework of Saudi corporate governance consists of: (i) the Ministry of Finance, formed in 1932, (ii) SAMA, established in 1952, (iii) the Ministry of Commerce and Industry (MOCI) founded in 1953, (iv) the Public Investment Fund (PIF), created in 1971, (v) the Saudi Organization for Certified Public Accountants (SOCPA), instituted in 1992, (vi) SAGIA, set up in 2000, (vii) Tadawul, opened in 2003 and (viii) the CMA, also established in 2003, (ix) the Committee for the Resolution of Securities Disputes established in 2003. while the internal mechanisms are: (i) the Corporate Governance Regulations, (ii) the listing rules and (iii) Capital Markets Law 2003 and the Saudi Companies Law 1965 (CL 1965). Next, the sections that follow outlines the most important external corporate governance mechanisms, before a detailed discussion of the internal corporate governance framework.

Among the eight bodies listed above as constituting the Saudi external corporate governance framework, the four of the most significant are the MOCI, Tadawul the CMA, and the Committee for the Resolution of Securities Disputes. Each of these four is now discussed in turn, before consideration of some challenges facing the external governance framework.

²⁴⁶ *Ibid*, p.152.

²⁴⁷ Samba Financial Group (2009). *The Saudi Stock Market: Structural Issues, Recent Performance and Outlook*, Riyadh, p.5.

²⁴⁸ Al-Abbas, M. (2009). Corporate Governance and Earning Management: An Empirical Study of the Saudi Market, *Journal of American Academy of Business*, 15(1), pp.301-310 .

4.3.1 Ministry of Commerce and Industry

In 1953, the MOC was established and was tasked with regulating all the activities on the Saudi stock market. The MOC was the sole authority that regulated listed companies and the organisation of the shareholder's general assembly. The MOCI drafted the Companies Law In 1965(CL 1965), which featured a relatively small number of provisions that protected shareholders and even fewer provisions on directors. The MOCI released the Public Disclosure Standard In 1990 in a bid to promote voluntary disclosure and transparency. Until 2003, the MOCI was the sole authority regulating the stock market, however, in the 2006 reforms, many of the MOCI's supervisory powers were transferred to the CMA.

4.3.2 Saudi Stock Exchange

As previously discussed, there were only 14 public companies listed in Saudi Arabia in 1975, in a stock market which had operated informally for over 40 years. Its operations were first formalised in 1985 when SAMA took responsibility for developing the market and regulating trading.²⁴⁹ When this responsibility transferred to the newly created CMA in 2003, it sought to improve the stock market by setting up a formal stock exchange, the Tadawul, as a regulatory body responsible for administering the financial market. The board of directors of the Tadawul is appointed by the Council of Ministers and includes legislators and representatives of licensed Saudi brokerage firms and listed companies.²⁵⁰

4.3.3 Capital Market Authority

The establishment of the CMA in 2003 was a significant advance and has been described as by far the most important reform of corporate governance in Saudi. The CMA reports directly to the Council of Ministers, which strengthens its hand in regulating the stock market and expediting corporate governance reforms. It has formulated a number of rules in relation to corporate governance. Including the Capital Market Law 2003 (CML 2003), Listing Rules

²⁴⁹ Hussainey, K. and Al-Nodel, A. (2008). Corporate governance online reporting by Saudi listed companies. *Research in Accounting in Emerging Economies*, 8, p.39

²⁵⁰ Riyadhvision.com.sa. (2018). *Saudi Stock Exchange (Tadawul) | RiyadhVision*. [online] Available at: <http://www.riyadhvision.com.sa/about-saudia-arabia/economy-global-trade/saudi-stock-exchange-tadawul/> [Accessed 25 Jul. 2017].

2004, the 2005 Merger and Acquisition Regulations and finally the Saudi Corporate Governance Regulations in 2006. (CGR 2006) The CMA's primary responsibilities are: to develop and regulate the Saudi capital market and promote transparency and disclosure in listed companies to increase investors' confidence.²⁵¹ In order to improve the corporate governance practices of Saudi listed firms, the CMA has implemented three major corporate governance initiatives in three main stages.²⁵² The first of these stages were completed with the issuing of the CGR 2006. Stage two is to raise awareness of good corporate governance practices and to reinforce their benefits among listed firms. Stage three of the initiatives sought to enhance the effectiveness of the CGR 2006 by bringing it in line with current international corporate governance standards and practices. In addition to seeking to improve the internal corporate governance mechanisms and regulations, the CMA has also attempted to make the market for corporate control a more active and effective external mechanism of corporate governance.

4.3.3.1 Powers of Inspection and investigation by the CMA

Conducting thorough inspections and investigations into the capital market is one of the most important factors in order to ensure the implementation of any enforcement action. The need for an independent enforcement agency with the appropriate resources and skills to undertake inspection and investigation and bring strong enforcement procedures are some of the most vital mechanisms that deter those who might participate in market manipulation or fraudulent financial activities. Indeed, this was affirmed by the principles of the International Organisation of Securities Commission which states "The regulator should have comprehensive inspection, investigation and surveillance powers."²⁵³

To protect investors and traders from any form of fraud or market manipulation, and to ensure the sound development of the stock market, the CMA has been given absolute power to undertake inspections and conduct all necessary investigations into all listed companies who violate the provisions of the CML 2003 and its implementing regulations.²⁵⁴

²⁵¹ Mergers and acquisitions. (2007). *The Capital Market Authority*, [online] p.53. Available at: <https://cma.org.sa/en/RulesRegulations/Regulations/Documents/Merger%20and%20Acquisition%20Regulation%20s.pdf> [Accessed 23 Jun. 2018].

²⁵² Corporate Governance Country Assessment. (2009). [online] p.9. Available at: <http://documents.worldbank.org/curated/en/838731468106752813/pdf/625770WP0ROSC000Box0361486B0PUBLIC0.pdf> [Accessed 24 Jul. 2018].

²⁵³ International Organization of Securities Commissions. (2010). *Objectives and Principles of Securities Regulation*, [online] p.6. Available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf> [Accessed 25 May 2017].

²⁵⁴ CML 2003, Article 5(c)

Since the establishment of the CMA has declared that its primary enforcement objective is the protection of market investors and members of the public from unsound and unfair practices market practices. According to Article 5 (c), the CMA must “protect citizens and investors in securities from unfair, and unsound practices or practices involving fraud, deceit, cheating and manipulation.”²⁵⁵ To that end, the CMA has established one of the most noteworthy departments, the Investigation Department, to help facilitate its mission. In accordance with Article 5 of the CML 2003, the members of the CMA and its staff designated the board shall have the power to “subpoena witnesses, gather evidence, and require the production of any records, papers, or other documents the authority deems relevant or material to its investigation.”²⁵⁶ The role of the Investigations Department can be summarised as follows;²⁵⁷

- a) Overseeing all investigation processes
- b) Subpoena witnesses for interview
- c) Questioning suspects
- d) Investigating violations reported by outside sources
- e) Investigating electronic violations in securities

In regard to inspection, the CML 2003 has authorised the CMA to inspect records or any other documents, whoever the holder may be, to determine “whether the person concerned has violated, or about to violate the provisions” of the CML 2003, its implementing regulations or listings rules.²⁵⁸ Therefore, as a regulatory body, the CMA has been given full statutory powers to discharge its responsibilities to guarantee the effective enforcement of the provisions of the CML 2003 thus, protecting the stock market from any form of fraudulent activities.

4.3.3.2 The Committee for the Resolution of Securities Disputes

Further to the discussion in chapter two, the Saudi government has established various quasi-judicial committee over the past years as a necessary tool to side-step the rejection of Sharia courts judges from adjudicating over certain commercial and financial matters. Indeed, the establishment of such committee was necessary to deal with issues associated with the rapid development of the Saudi economy including its stock exchange. As an essential step in resolving securities disputes and to maintain the integrity of the Saudi Stock Exchange the

²⁵⁵ *Ibid.*

²⁵⁶ *Ibid*

²⁵⁷ Cma.org.sa. (2018). *Organizational Structure*. [online] Available at: https://cma.org.sa/en/AboutCMA/CMA_Department/Pages/default.aspx [Accessed 23 May 2018].

²⁵⁸ *Ibid* .

committee for the resolution of securities disputes (CRSD) was created by the Capital Market Law 2003.

The CRSD was classified as the court of first instance in relation to any disputes in the securities market.²⁵⁹ Article 25 of the CML 2003 states that the CMA should establish a committee which shall be known as the “Committee for Settlement of Securities Disputes which shall have jurisdiction over disputes covered by the provisions of this Law, its Implementing Regulations, and the regulations, rules and instructions of the Authority and the Capital Market, with respect to public and private rights.”²⁶⁰

According to the CML 2003, the CRSD must comprise of legal advisers who are specialised in the jurisprudence of financial markets with appropriate experience.²⁶¹ The CMA board must appoint the members of the CRSD for a renewable three-year term.²⁶² In order to ensure the independence of the committee while performing its function, the members are prohibited from having any direct or indirect commercial or financial interest and must not have kinship relationship up to the fourth degree with any litigants or complainants in any suit brought before the CRSD.²⁶³ Article 25 (b) provides that the CRSD must consider all cases brought before them within fourteen days from the initial date of filing the lawsuit.²⁶⁴

The primary objective of establishing the CRSD is to address any matters that may arise from the violation of the provisions of the CML 2003. The jurisdiction of the CRSD extends to include dealing with lawsuits, decision and actions taken by the CMA. In addition, the CRSD has the jurisdiction to consider the grievance against the decision of the CMA and Tadawul. In such cases, the CRSD may issue decision indemnifying the aggrieved party and issue reinstatement or take any decision it may consider appropriate to safeguard the rights of the aggrieved party. Moreover, any cases that may arise between traders or investors within the scope of the CML 2003 and its implementing regulations must be referred to the CRSD.²⁶⁵

4.3.3.3 Authorities of the CRSD

The CML 2003 has granted a wide range of powers to the CRSD in order to strengthen its authority on the capital market and provided the committee with all the powers to investigate

²⁵⁹ CML 2003, Article 25

²⁶⁰ *Ibid.*

²⁶¹ *Ibid.*, Article 25 (b)

²⁶² *Ibid.*, Article 25 (b)

²⁶³ *Ibid.*, Article 25 (b)

²⁶⁴ *Ibid.*, Article 25 (b)

²⁶⁵ *Ibid.*, Article 25(c)

and resolve any dispute that may arise in the Market. In accordance with the CML 2003, the CRSD is granted the following authorities:

- a) To investigate and settle disputes.
- b) To subpoena witnesses
- c) To issue the appropriate decisions to resolve lawsuits
- d) To impose sanctions, penalties and custodial sentences²⁶⁶
- e) To order the presentation of documents
- f) To award damages

4.3.3.4 The Appeal Committee for the Resolution of Securities Conflicts (ACRSC)

The ACRSC was established by a royal decree issued by the Council of Ministers.²⁶⁷ The membership of the ACRSC is considerably different from the CRSD, whereby the ACRSC is composed of three members representing the Ministry of Commerce and Industry, the Ministry of Finance and the Bureau of Experts at the Council of Ministers. The members of the ACRSC are appointed for a renewable three-year term by the Council of Ministers. To ensure the right of all litigants, the CML 2003 granted litigants the right to appeal the decision of the CRSD before the appeal panel within a period of 30 days from the date of the notification.²⁶⁸ However, any person wishing to appeal must seek permission from the ACRSC and the committee has the discretion to refuse to review decisions made by the CRSD.²⁶⁹ If the ACRSC grants permission to appeal, then it has the following powers²⁷⁰:

- a) To affirm the decision rendered by the CRSD
- b) To reconsider the complaint or lawsuit, based on established information in the litigation case file with the CRSD
- c) To issue an appropriate decision for the lawsuit or complaint.

Significantly, the CML provides that the decisions of the ACRSC are deemed final.²⁷¹

²⁶⁶ CML 2003, Article 57 (c). The committee may in cases that involve fraud and insider trading punish the violators of Articles 49 and 50 of CML 2003 by imprisonment for a term not exceeding five years.

²⁶⁷ *Ibid*, Article 25 (f).

²⁶⁸ CML 2003, Article 25(f).

²⁶⁹ *Ibid*, Article 25(f).

²⁷⁰ *Ibid*, Article 25 (g).

²⁷¹ *Ibid*. Article 25 (g).

4.4 Difficulties Facing the CMA

It is clear that the nature of the judicial and administrative bodies that exert authority over the board of directors have a noteworthy effect on the performance of the board of directors and its relationships with its members including shareholders and stakeholders and the company as a whole. The CMA is the sole authority that supervises and regulates the conduct of all listed companies. In other words, listed companies in Saudi Arabia are under the jurisdiction of the CMA, not the Ministry of Commerce and Industry nor the commercial court.

Regulatory and supervisory authorities in Saudi Arabia faced some criticism. According to The World Bank's report on the observance of standards and codes relating to corporate governance practices in Saudi Arabia, the CMA faces several challenges and difficulties.²⁷² These include a lack of managerial independence among the regulatory authorities, unnecessary political interference and a shallow market where corporate legislation is weakly implemented and enforced.²⁷³ This subsection briefly discusses some of these challenges to good external governance.

The weakness of the present regime is that the CMA reports directly to the Council of Ministers. It acts as an agency of the government, which directly appoints its board members. Its independence is thus restricted by excessive government interventions that compromise its ability to monitor and regulate corporate practices.²⁷⁴ This governmental influence is illustrated by the fact that foreigners cannot invest directly in the Saudi stock market until 2015,²⁷⁵ and no foreign firms are yet to be listed. In contrast, there is no direct government intervention in the securities markets of Western countries such as the USA and the UK.²⁷⁶ The related problem is that the CMA is not managerially independent from the Saudi government, adding to the likelihood of political interference and making its operations less efficient. This ineffectiveness arises partly because the politicians who intervene may lack the technical knowledge needed to supervise the complex financial architecture of today's market. This

²⁷² R Corporate Governance Country Assessment. (2009). [online] p.20. Available at: <http://documents.worldbank.org/curated/en/838731468106752813/pdf/625770WPOROSC000Box0361486BOPUBLIC0.pdf> [Accessed 24 Jul. 2018].

²⁷³ *Ibid.*

²⁷⁴ Al-Matari, A. Al-Swidi, K. and Fadzil, B. (2012). Corporate Governance and Performance of Saudi Arabia Listed Companies, *British Journal of Arts & Social Sciences*, 9(1), pp.1-30.

²⁷⁵ Parasie, N. (2016). *Saudi Regulator Makes New Moves to Lure Foreign Investors*. [online] The Wall Street Journal. Available at: <https://www.wsj.com/articles/saudi-makes-new-moves-to-lure-foreign-investors-1462277467> [Accessed 11 Jun. 2017].

²⁷⁶ Lipton, M. and Lorsch, J. (1992). A Modest Proposal for Improved Corporate Governance, *Business Lawyer*, 48(1), pp.59-77

weakens the ability of the CMA to implement regulations and enforce them, so compliance with company law tends to be poor, as are transparency, disclosure and various governance practices.²⁷⁷ Legislation protecting investors and shareholders is also too weak to prevent insider dealings and manipulation from disadvantaging minority shareholders,²⁷⁸ as happened notably at the time of the 2006 stock market crash.²⁷⁹

Another significant fact that must be noted is that the financial penalties and fines imposed on violators of the provisions of the law must be deposited into the CMA accounts. This indicates that fines and financial penalties may be used as financial resources of the CMA.²⁸⁰ The CML 2003 also requires the CMA to deduct from its income all current capital expenses as well as any other expenses needed by the CMA and maintain a general reserve that amounts to double the total of all its expenditure and then shall remit the surplus to the Ministry of Finance.²⁸¹

Moreover, the CMA may file a lawsuit against certain infringements of the CML before the CRSD.²⁸² The CMA has the power to determine these infringements as well as being the authority that issued the regulations relating to such infringements. This is demonstrated in Article 57 of the CML which empowers the CMA to file a lawsuit against breaches of Article 49 and 50 of the CML which regulate matters concerning fraud and insider trading. This gives the CMA the power to set the rules that determine the practices and acts that would constitute fraud and insider trading as well as stipulating and defining related terms.²⁸³ In essence, this means that the CMA in these cases plays the role of the lawmaker, claimant, investigator, judge and jury simultaneously.

The CMA has established the CRSD and the ACRSC to address all matters that may arise from any violation of the CML and its implementing regulations and to resolve any dispute that may emerge between traders or investors in the securities market. The role that these committees

²⁷⁷ *Ibid.*

²⁷⁸ La Porta, R., Lopez-De-Silanes, F. Shleifer, A. and Vishny, R. (2002). Investor Protection and Corporate Valuation, *Journal of Finance*, 57(3), pp.1147-1170. Also, Piesse, J. Strange, R. and Toonsi, F. (2012). Is there a Distinctive MENA Model of Corporate Governance?, *Journal of Management & Governance*, 16(4), pp.645-681.

²⁷⁹ Al-Abbas, M. (2009). Corporate Governance and Earning Management: An Empirical Study of the Saudi Market, *Journal of American Academy of Business*, 15(1), pp.309.

²⁸⁰ CML 2003. Article 25 (b)

²⁸¹ *Ibid.* Article 13 and 14.

²⁸² *Ibid.* Article 5(a).

²⁸³ *Ibid.* Articles 25 (c), 49 and 50.

play is fundamental in Saudi's securities market and their efforts to promote confidence of traders and investors in the market. However, a number of concerns have been identified within these two committees.

Firstly, Although the CRSD and ACRSC carry out judicial functions and have authority to do so. However, according to the Saudi law, the members of these committees are not viewed as judges and their verdicts are not deemed judicial, but they consider as administrative decisions.²⁸⁴ Furthermore, the CRSD and ACRSC exercise their judicial duties outside the remits of the courts, which adhere to the strict principles of justice, objectivity in procedures and full judicial independence. As mentioned earlier, the members of CRSD and ACRSC have been appointed from legal consultants with a specialism in the jurisprudence of transactions and proficiency in commercial and securities markets. However, this does not mean that they possess sufficient legal qualifications and independence such as the members of the judiciary.

Secondly, The CML 2003 seems to participate in the weakening of the independence of members of these committees by authorising the CMA to appoint and pay its members' salaries.²⁸⁵ Therefore, a potential conflict of interest may arise seeing that the members of the committees are appointed by a decision of the CMA board, and therefore it is reasonable to assume that the CRSD members will find it particularly difficult to issue any decision that is distinct with the directives of the CMA. Such interference will undoubtedly have a negative impact on the decisions of the committee, as well as raising a potential conflict of interest, thus jeopardising the integrity of the members, the committees and the market. For instance, the members of the ACRSC are representatives of the Ministry of Commerce and Industry, the Ministry of Finance and the Bureau of Experts at the Council of Ministers to receive appeals against the decisions of the CRSD and to issue final decisions on the lawsuits considered before them. According to the 2016 Annual Report produced by the CMA, a total of 241 decisions were issued by the CRSD of which 102 decisions were issued against listed companies and senior executive directors. However, out of the 36 appeals received by the ACRSC, 33 final judgments were issued in favour of the CMA compared to only 3 final judgments were issued against the CMA in cases which were brought by it or against it.²⁸⁶

²⁸⁴ CML 2003. Article 25 (b)

²⁸⁵ Capital Market Law, Article 25 (a)

²⁸⁶ The Capital Market Authority in Saudi Arabia, Annual Report 2016, at p. 105-107.

A noteworthy example was the recent case of Al Mojil Group in 2017 which caused a major debate in the Saudi securities market and highlighted the concerns in this regard when the CRSD handed down severe sanctions that included billions in fines and even prison sentences. In this case, the final resolution handed down a fine of 1.6 billion Riyals (\$427 million) to be deposited in the CMA accounts and imposed a five years prison sentence for the chairmen Mohammed Al Mojil and his son and deputy Adel Al Mojil for irregularities related to the company's initial public offering (IPO). Additional sanctions also included the auditors and several members of the executive management.²⁸⁷ It should be noted that in order to appeal a decision by the CRSD, permission must first be granted by the ACRSC which has the discretion to decline to review the decision by the CRSD, affirm the decision or reconsider the lawsuit. Significantly, decisions by the ACRSC are deemed final with no legal recourse to the Board of Grievance or any other court for that matter.²⁸⁸

The Saudi legislator may find it beneficial to gain from experience from the UK court system in this regard. The High Court in the UK considers several types of securities disputes.²⁸⁹ For instance, The Chancery Division in the High Court is headed by the Chancellor of the High Court and consists of over independent fifteen judges. The Chancery Division contains several specialised courts such as the Commercial Court and the Bankruptcy and Companies Courts. The court deals with a number of areas including disputes arising from the securities market. The Divisions of the High Court is can be found in most major cities across the UK. Certainly, providing access to court is considered a vital requirement for enforcing securities laws and access to a court is considered by the International Organisation of Securities Commissions as one of the mechanisms that must be readily available for any aggrieved party or investor.²⁹⁰

A solution to this current dilemma and the negative consequences caused by the quasi-judicial committee is to transform these committees into authentic courts. Such authentic courts would be divided into two levels; the court of the first instance and an appeals court. This would necessitate the legal system in Saudi Arabia to recognise these committees as part of the

²⁸⁷ The Capital Market Authority. (2018). *The CMA Announcement on The Issuance of a Final Decision by The Committee for the Resolution of Securities Disputes Convicting Violators of the Capital Market Law and Its Implementing Regulations*. [online] Available at: https://cma.org.sa/en/market/news/pages/cma_n_2182.aspx [Accessed 2 Aug. 2018].

²⁸⁸ CML 2003. Article 25 (g)

²⁸⁹ Judiciary.uk. (2018). *Civil justice in England and Wales*. [online] Available at: <https://www.judiciary.uk/about-the-judiciary/the-justice-system/jurisdictions/civil-jurisdiction/> [Accessed 20 Jun. 2017].

²⁹⁰ International Organization of Securities Commissions. (2010). *Objectives and Principles of Securities Regulation*, [online] p.7. Available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf> [Accessed 25 May 2017].

judiciary and afford its members the same power, protection and independence currently afforded to members of the judiciary authority. This would also apply to the process of appointment, tenures and the nature of decisions taken by the members of these committees

Thirdly, the committees are only located in the Saudi capital city, Riyadh. Neither committee has established any regional branches within the 13 provinces of Saudi Arabia. The lack of geographical presence of the two committees could pose a potential problem for investors and could be seen as having a negative effect on the efficiency of these committees in enforcing Capital Market Law. As Spain noted, providing easy access to justice is one of the main requirements for obtaining a unique justice system.²⁹¹ Saudi Arabia is a vast country that makes up the majority of the Arabian Peninsula, and the absence of any regional quasi-judicial committees outside the capital could be seen as a barrier for traders and investors from bringing in their disputes to the CRSD as it would be financially costly and time-consuming. The establishment of regional branches in the main Saudi cities such as Jeddah and Dammam may help boost the investor's confidence and consequently increase investment in the capital market. Despite the CML 2003 permitting the use of all electronic forms of evidence to be admissible, such as computer data, email and telephone recordings, all hearings are required to take place in the capital city, Riyadh. To improve accessibility to these committees, it is essential that the CMA allows for the establishment of regional offices in the main cities of Saudi Arabia.

Finally, the CML 2003 require the CRSD and ACRSC to be comprised of only three members who are solely in charge of resolving all securities disputes brought before them. The fact that the Saudi Capital Market continued its rapid growth over the past decade and became the largest market in the Middle East²⁹² also reflected on the number of disputes brought before the committees.²⁹³ It is evident that the number of members of these committees is not sufficient enough to deal the size of the market and the problems that accompany it, such as, the sheer volume of cases and thus prolonging the litigation process.

²⁹¹ Spain, L. R. (2011) The Opportunities and Challenges of Providing Equal Access to Justice in Rural Communities, *William Mitchell Law Review*, 28, pp 367

²⁹² Information Memorandum for Qualified Foreign Investors. (2018). *Tadawul*, [online] p.7. Available at: <https://www.tadawul.com.sa/wps/wcm/connect/ebdd6030-3683-4a1f-8f37-2ef59d0dd9fc/Information+Memorandum.pdf?MOD=AJPERES> [Accessed 21 Jun. 2017].

²⁹³ Crsd.org.sa. (2018). *the Committee for the Resolution of Securities Disputes*. [online] Available at: <http://www.crsd.org.sa/ar/Pages/default.aspx> [Accessed 23 Jun. 2017].

It can be noted that the above facts and concerns may create an atmosphere of uncertainty about the litigation in the capital markets in Saudi Arabia and might call into question its credibility. Consequently, this may cause an undesirable and negative effect on Saudi companies, the board of directors and foreign investors.

4.5 Internal Corporate Governance framework in Saudi Arabia

4.5.1 The Saudi Corporate Governance Regulations 2006

This subsection reviews details of the provisions of first corporate governance regulations that was implemented in 2006, which was considered to be central at that time to the Saudi listed firms for good corporate practices. The four parts of the CGR 2006 deal respectively with preliminary provisions, with shareholders' rights and the general assembly, with disclosure and transparency and with the board of directors.

The preliminary provisions address definitions and the relationship of the CGR 2006 with other legislation. Article 1 outlined the Regulation's primary purpose which was to regulate corporate governance standards and improve Saudi firms' compliance with the regulations. Article 1b asserted that the CGR 2006 is the principal guide for the governance of all public firms listed on the Saudi stock market. Listed companies were required to explain in their annual reports their failure to implement any of its provisions, thus establishing the extent of their compliance.

Part Two of the Regulation contained provisions regarding the general assembly and shareholders' exercise of their rights and access to information. Article 5a provided that the general assembly must be held within six months after the end of the company's fiscal year and that its date, location and agenda must be announced at least 20 days in advance. The company should also publish an invitation to the meeting on its website and that of the Saudi stock market. Article 5f entitled shareholders to participate in formulating the agenda of the general assembly meeting by requiring the board of directors to discuss any topic proposed by shareholders owning 5% of the company's shares or more.

Article 4b aimed to reduce asymmetric information, stipulating that the board and management should afford shareholders full access to information, updated every six months, enabling them to exercise their rights fully. Additionally, the company should communicate this information regularly, using the most effective means available. Article 5j required the stock exchange to

be informed immediately of the results of the general assembly through the Tadawul website, without any delay, especially if the information is price sensitive, otherwise, the company would incur a penalty. A one-share-one-vote policy is recommended by Article 6b, to ensure full participation by small shareholders in decisions such as board nominations. The CGR 2006 likewise asserted the rights of shareholders to receive dividends; Article 7 required the dividends policy to be discussed at the general assembly.

Part Three of the CGR 2006 mirrored Tadawul's Listing Rules and was concerned with corporate transparency and voluntary disclosure.²⁹⁴ Article 9 stated that the composition of the board should be disclosed in the annual report to ensure the independence of the board of directors. Furthermore, Corporate annual reports should specify whether each board member was an executive director, non-executive directors or independent non-executive directors (NED) as well as a brief description of the jurisdictions and duties of the board. The annual report must have also included a list of all sub-committees, such as the audit, nomination and remuneration committees, naming their chairpersons and members, and giving information about their meetings. According to Article 9e, all compensation and remuneration received by each director and the top five executives, including the CEO and CFO should be disclosed in the annual report.

Article 18 prohibited board members from doing any act in contravention of the company's interests. Furthermore, their legitimate interests in other companies ought to be disclosed; the annual report should name all other listed companies of which a director of the company was also a director. Articles 10 to 16 address five aspects of governance related to the board of directors: its main functions, its responsibilities, its composition, its sub-committees and its meetings.

The principal role of the board is to reduce agency costs and to maximise shareholder value. Its strategic and policymaking functions are threefold: to specify the company's overall strategy; to set its risk management policy and identify areas of risk, and to review and update specific strategies and policies. The board had to also supervise policy implementation and hold managers to account for any failure to meet objectives. Article 10b recommended that each listed company should draft its own corporate governance code, in compliance with the CGR 2006. Article 10e dealt specifically with the board's obligation to monitor the executive

²⁹⁴ Saudi Listing Rules 2004, Article 8.

management and employees, ensuring that their actions meet appropriate standards of ethics and professionalism. The Regulations also stated that each listed company should have a written policy on its relationship with its stakeholders so that their rights are protected.

As to the board's responsibilities, the code considered the most important responsibility was to represent the shareholders' interests. Moreover, it also called on board members to do everything necessary to uphold the well-being of stakeholders, not only the interests of shareholders. The chairman of the board should safeguard equality and promptness of access to information for all directors. Most importantly, non-executive and independent directors should be granted unfettered access to all and any information they need to fulfill their responsibilities. The code assigns ultimate responsibility for running the company to the board, notwithstanding the valid delegation of some powers to subcommittees or third parties (Article 11a). Therefore, Article 11b called for the articles of association to expressly specify directors' responsibilities.

The composition of the board is limited by Article 12 to between three and eleven members, of whom at least one third ought to be independent directors and NEDs should also constitute a majority on any company board. Furthermore, the general assembly appoints members, for no more than three years before reappointment or dismissal, which the general assembly also controlled.

The CGR 2006 recommended that the CEO role be distinct from the chairmanship of the board so that the board can monitor the firm's performance more effectively. In fact, Article 12d recommended prohibited conjoining the position of chairman and any other executive positions in the company. Article 13 required the board to establish whatever sub-committees are needed to serve the company's interests. At a minimum, every listed firm should have audit, nomination and remuneration committees. Each committee needs enough non-executive directors to uphold corporate governance principles and should notify the full board transparently as to its performance, findings and decisions. The board itself is to monitor the activities of all its committees to check on the adequate performance of their duties. Executive board members must be excluded from membership of the audit committee, which should have at least three members, one or more of whom are professionally literate in finance and accountancy. The audit committee has, according to Article 14c, three main functions: to supervise the company's internal audit and review its internal control system, to recommend the appointment and remuneration of an external auditor and to review the auditor's assessment of financial statements. As to the nomination and remuneration committees, Article 15

prescribes the following responsibilities: to ensure all directors' independence annually; to expressly establish company policy on compensating and remunerating board members and top executives; to determine the strengths and weaknesses of the board of directors and to recommend strategies that serve the company's interests.

Lastly, about board meetings, Article 16 of the Regulations requires members to endeavour to attend them all and to fulfil their duties and responsibilities. Furthermore, board meetings should be documented, so that there are records of both voting and deliberations.

4.5.2 Saudi Companies Law 1965 and Corporate Governance

Formal regulation of corporate operations and activities was initiated in Saudi Arabia in 1965 with the introduction of the Companies Law, considerably amended in 1982 and 1985.²⁹⁵ The CL 1965 outlines certain provisions relating to corporate governance, such as the board of directors, disclosure and transparency and the rights of shareholders and general assembly.

The following section will highlight and explains the internal corporate governance mechanisms contained regarding the board of directors. This section covers five main areas: board size, the relationship of the CEO to the chairman, the powers of the board, and the frequency of its meetings.

Article 66 of the CL 1965 states that the company is managed by the board of directors. It stipulates that the articles of association determine the size of the board, which must have at least three members, and that the general assembly of shareholders shall appoint them for a tenure not exceeding three years, but it does not mention the composition of the board. For example, it does not specify how many independent or non-executive directors there must be, nor even if any are required to be appointed to the board; the articles of association constitute the only restraint on deciding board composition. The CL 1965 also regulates the remuneration of directors. Article 74 stipulates that they should be paid a fixed amount, a proportion of the profits, or a combination of these. It also limits the maximum annual compensation to 10% of net profits.²⁹⁶

²⁹⁵ Kantor, J. Roberts, C. and Salter, S. (1995). Financial Reporting Practices in Selected Arab Countries, *International Studies of Management and Organization*, 25(3), pp.33.

²⁹⁶ Companies Law 1965, Article 74 states: "The company's bylaws shall specify the manner of remunerating the members of the board of directors. Such remunerations may consist of a specified salary, a fee for attending

The CL 1965 did not include any requirement to set up board sub-committees, despite their importance to the maintenance of good corporate governance. However, this gap was filled in 1994 by a resolution by the Ministry of Commerce and Industry mandating all listed companies to establish audit committees as a tool to increase transparency in financial statements.²⁹⁷ The resolution specified certain characteristics for the audit committee in terms of composition and structure. The resolution stated that audit committee members should be independent and must not have a direct or indirect interest in the transactions of the company and should not be members of the executive management and should not handle managerial, technical, or consultancy work. Moreover, the resolution stated that members of the committee should hold appropriate qualifications in the financial and accounting field. Finally, in relation to the size of the committee, the resolution indicated that they should not be less than three and should be odd.²⁹⁸

In relation to the chairman, Article 79 of the CL 1965 permitted the roles of chairman and CEO or managing director to be combined. Regarding the issue of conflict of interests, Article 69 seeks to regulate the potential for conflicts of interest between agents and principals by requiring the general assembly to authorise any transaction or contract between the company and one or more directors. The CL 1965 also requires the annual renewal of the authorisation of any such contract of more than one year in length and prohibited members to vote on any issue in which they have a vested interest and requires the chairperson to notify the general assembly of any personal interests of board members.

As to the rights of shareholders and general assembly, Article 87 of the CL 1965 grants any shareholder owning 20 shares or more the right to attend general assembly meetings, where shareholders are entitled to discuss any issue concerning corporate performance. Article 83 entitles any qualifying shareholder the right to appoint another shareholder who is not a director

the meetings, in take benefits, a certain percentage of the profits, or a combination of two or more of these benefits. If, however, such remuneration represents a certain percentage of the company's profits, it must not exceed 10% of the net profits after deduction of expenses, deprecations and such reserves determined by the general assembly pursuant to the provisions of this Law or the company's bylaws, and after distribution of a dividend of not less than 5% of the company's capital to the stockholders. Any determination of remuneration made in violation of this provision shall be null and void. The board of directors' report to the Ordinary General Assembly must include a comprehensive statement of all the amounts received by members of the board of directors during the fiscal year in the way of salaries, share in the profits, attendance fees, expenses, and other benefits, as well as all the amounts received by the members in their capacity as employees or executives of the company, or in consideration of technical, administrative, or advisory services."

²⁹⁷ Saudi Ministry of Commerce. (1994). New regulation regarding audit committees for Saudi Arabian corporate sector. *Saudi Accounting Magazine (SAM)* 4: pp.15-18.

²⁹⁸ *Ibid*, p.17.

to vote on his or her behalf at such a meeting. Article 84 requires the annual general assembly meeting to be held at least once a year, no more than six months after the end of the fiscal year. The disclosure and transparency requirements are covered by Article 89 CL 1965 which states that every public listed company is required to issue an annual report including a board report, financial statements and a report by the external auditor. To facilitate the availability and accessibility of this information to as many shareholders as possible, the report must be published in a national newspaper issued in the same city as the company's headquarters. To ensure access to information for all shareholders, the CL 1965 requires the company to make the annual report available at least 60 days before the annual general meeting. Finally, Article 88 encourages shareholders to exercise the right of attendance by requiring the publication of details of the general assembly meeting, including the agenda, date, time and location, in a daily newspaper at least 25 days in advance.

4.5.3 difficulties facing the Saudi Governance Framework 2006

Whilst the CL 1965 and the CGR 2006 is a vital component in the governance framework, they tend to overlap in a certain area which creates ambiguity in the interpretation of the requirements. The CL 1965 was formulated and implemented by the Ministry of Commerce and Industry, whilst the CGR was formulated and implemented by the CMA, which is a semi-governmental body. The CL 1965 oversees the formation and regulation of all types of companies allowed by Saudi law, including joint liability companies, limited liability companies, professional companies and joint stock companies.²⁹⁹ On the other hand, the CGR is only enforceable against companies traded on the Saudi stock exchange. listed companies are regulated by both the MOCI and CMA which creates an overlap between the ministry and authority. This created a dual corporate governance system. Adding to this dilemma, the corporate governance provisions in the CL 1965 are not integrated under a specific part of the law but are scattered around in different parts of the CL 1965. Therefore, the corporate governance provision in the CL 1965 and the CMA lack coherence and integration. For instance, the CGR 2006 stipulates more stringent reporting requirements on disclosure and transparency in the annual board reports than what is required in the CL 1965.³⁰⁰ The CL 1965 and CGR 2006 both offer their own definition of shareholders rights namely; their rights to bring an action against a board member, the rights to vote and to attend the general assembly.

²⁹⁹ CL 1965. Article 2-5 and 10.

³⁰⁰ CGR 2006. Article 8-15.

The CRG provides greater information regarding the boards' sub-committees than the CL 1965. Furthermore, both CL 1965 and CGR 2006 offer their own descriptions of board activities, such as remuneration of board members and the conduct of board meetings.

However, there are some similarities which were discussed in the preceding section including the conflicts of interest provision that can be found in Article 18(b) of the CGR and Article 69 of the CL 1965. When both articles constantly agree there will be no reason for controversy, however, controversy arises when the codes conflict with each other.

This subsection outlines the preserved obstacles to the development of an efficient and effective framework of internal corporate governance in Saudi Arabia. Saudi Arabia has adopted the Anglo-American model of corporate governance and has consequently inherited two of its main issues; the comply or explain approach and its shareholder rather than stakeholder approach.

The first issue is that it is not mandatory to obey the Saudi corporate governance rules, mirroring the 'comply or explain' approach of the UK.³⁰¹ Although there are advantages of opting for a soft law approach instead of hard law in the regulations, such as flexibility and the ability for quick amendments, it was considered inappropriate for Saudi Arabia. This was due to the high ownership concentration in Saudi listed firms, including government ownership,³⁰² whereas ownership is notably more diffuse in the UK.³⁰³ La Porta et al argue that controlling shareholders tend not to support good governance reforms, with the result that larger shareholders may tend to exploit smaller ones.³⁰⁴

The other major issue that stems from the Anglo-American influence of the internal corporate governance framework in Saudi Arabia, has led to a bias in the CL 1965 and the CGR 2006 towards the protection of the rights of shareholders, to the detriment of provisions in favour of other groups of stakeholders. Failure to address directly the rights of the shareholders can lead to misinterpretation by firms and practitioners. Thus, while the code requires a company to

³⁰¹ Hussainey, K. and Al-Najjar, B. (2012). Understanding the Determinants of Risk Metrics/ISS Ratings of the Quality of UK Companies Corporate Governance Practice, *Canadian Journal of Administrative Sciences*, 29(4), pp.366-377.

³⁰² *Ibid*, p.366

³⁰³ Aguilera, R. and Cuervo-Cazurra, A. (2009). Codes of Good Governance, *Corporate Governance: An International Review*, 17(3), pp.376-387.

³⁰⁴ La Porta, R. Lopez-de-Silanes, F. and Shleifer, A. (1999). Corporate Ownership Around the World, *Journal of Finance*, 54(2), pp.471-517.

adopt policies on its relationships with its stakeholders, it does not specify who these stakeholders are, nor does it clarify how the company should implement these provisions or assess its outcome. These issues were preserved as a consequence of the adoption of the Anglo-American model without the necessary customisation of the model to the local and corporate environment in Saudi Arabia.

4.6 conclusion

This chapter presented the development of the corporate governance framework in Saudi Arabia. The chapter responded to the research question, namely, how did the corporate governance framework develop. The chapter provided a brief history on the development of the Saudi capital market and the increased international pressure that led to the enactment of the Capital Market Law in 2003, the creation of a regulatory body, namely the CMA, the authorities responsible for disputes in the capital market and the issuance of Saudi Arabia's first corporate governance regulations in 2006.

The Saudi corporate governance regime adopted the Anglo-American model with more emphasis placed on the rights of shareholders. It was noted that the Saudi governance regulations was implemented in a soft law form that could have complemented the regulatory and legislative framework of corporate governance. However, it was argued that such an approach is not appropriate, and that the Saudi regulator did not consider the hierarchical social structure and the concentrated nature of ownership prevalent in Saudi Companies, such as rich family and government institutions. It is concluded that corporate governance in Saudi Arabia was still at early stages of development and that there was a lack of research on their effectiveness thus causing challenges to the Saudi regulator when seeking to improve how listed companies operate. The identified challenges and criticisms presented in this chapter will be re-visited in chapter 6 where the chapter will assess whether the subsequent legislation and regulations has tackled or met these challenges. However, the following chapter will focus on the UK Company Law and the Corporate governance framework which will be used a benchmark for any recommendations suggested subsequently.

Chapter Five

UK Company Law and corporate governance framework

5.1 Introduction

The board of directors is recognised as the cornerstone of corporate governance and plays a key role in the governance of the company on behalf of the shareholders. As such, directors are in a position of trust and might abuse that position to gain a profit at the expense of the company and therefore at the expense of the shareholders. In order to achieve the research aims, first, we must extend our understanding of the UK experience regarding the duties of directors and the development of corporate governance in the UK. This chapter will provide the necessary background framework and will serve as a reference point for possible recommendations of the Saudi corporate governance framework. This chapter will, be divided into two section. The first section will offer a critical review of existing legislation concerning director duties. The second section will highlight the evolution of corporate governance in the UK.

5.2 Background to Directors' Duties

UK company law confers practically unlimited management powers on the board of directors. It is therefore, no surprise that the legal system had to devise some means of controlling the directors' exercise of those powers and did so by categorising directors as fiduciaries and by applying some common law rules and strict fiduciary principles on them designed to ensure a certain minimum standard of behaviour. Accordingly, prior to the coming into effect of the Companies Act 2006 (the "2006 Act"), the duties of directors were governed in the main by some set of common law rules of negligence and equitable principles and, to some lesser extent, by statutes which imposed on directors certain standards. As fiduciaries, directors owe certain duties to their company and are expected to act in a certain manner in the way they handle the affairs of the company on whose behalf they are acting.³⁰⁵

Directors must act bona fide in what they, not the law, consider is in the best interest of the company. This meant that they were under a duty to act in the best interest of present and future shareholders, balancing the short-term interest of present shareholders with the long-term interest of future members, with shareholders' interest defined in terms of enhancing shareholder value.³⁰⁶ The test for whether a director has acted bona fide was essentially

³⁰⁵ *Percival v Wright* (1902) 2 Ch. 421 Ch D.

³⁰⁶ per Lord Green MR in *Re Smith and Fawcett Ltd* [1942] Ch304; at p.306.

subjective. Director could not for instance, use their powers to benefit themselves or any third party.³⁰⁷ It is settled law that the principle that directors must act in the best interest of the company, is not exclusively those of its shareholders but may include those of the creditors in circumstances where the company is insolvent,³⁰⁸ the company's employees and shareholders (section 309, Companies Act 1985) and, perhaps, the beneficiaries of a trust of which the company is trustee.³⁰⁹ Directors derive their powers from the company's constitution,³¹⁰ Some powers are given for a specific purpose, for instance, the power to allot shares.³¹¹ Directors are under a duty to exercise their powers for a proper purpose and not for any collateral purpose and in doing so must act within the limit of that power.³¹² It will be improper for instance, for directors to use their share allotment powers to attempt to alter the balance of power between members or to entrench themselves in office even if the directors consider the share allotment to be to the best interest of the company.³¹³

The common law also imposes a duty on one exercising discretionary power to exercise such power only for the purpose for which that power is given; to give proper consideration to matters which are relevant and exclude from consideration matters which are not relevant.³¹⁴ This duty is akin to what, in public and administrative law, is a duty imposed on public body decision makers to make decisions rationally.³¹⁵ This is a familiar principle in judicial review cases where the applicants seek to have the court quash the decision of a public body on the basis of irrationality and was for the first time, applied in a first instance case³¹⁶ in relation to the decision of company directors to forfeit a member's share for non-payment of a call.

Equity precludes a fiduciary from engaging in any transaction where his personal interest will or may conflict with that of those on whose behalf he is acting.³¹⁷ This principle applies where the conflict is between the fiduciary's duty to the principal and his personal interest and his duty to a third party. However, unless ratified by the company, a contract entered into by a

³⁰⁷ Lord Green MR in *Re Smith & Fawcett Ltd* [1992] Ch 304 at 306.

³⁰⁸ *Lonrho v Shell Petroleum Co Ltd* [1980] 1 WLR 627; per Lord Diplock at p634; and *West Mercia Safety wear Ltd. V Dodd* {1988} BCLC 250.

³⁰⁹ *Hurley v BGH Nominees Pty Ltd* [1984] 37 SASR 499, Walter J at p.510.

³¹⁰ Setford. (2011). The Companies Act 2006. Available:

http://www.setfords.co.uk/documents/The_Companies_Act_2006.pdf. Last accessed 9/11/2017.

³¹¹ *Ibid.*

³¹² *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] AC821; *Re Smith; Fawcett Ltd; Lee Panavision Ltd v Lee Lighting Ltd* [1992]; *Re Cameron's coal brook Steam Coal, and Swansea; Lougher Railway Co, Bennett's Case* {1854} 5 DeGM's G284; *Turner Ltd* at p 298.

³¹³ *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] AC821.

³¹⁴ *Edge v Pensions Ombudsman* [2000] Ch 602 at p.207.

³¹⁵ Lord Green MR in *Associated Provincial Picture House Ltd v. Wednesbury Corporation* [1948] 1KB 223.

³¹⁶ *Hunter v Senate support Ltd* [2004] EWHC 1085 (Ch).

³¹⁷ *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134.

director on behalf of its company is voidable if the director was in a position of conflict when he entered into that transaction; he failed to disclose the details of that conflict prior to concluding the transaction and there was no informed consent.³¹⁸

Unless otherwise expressly provided, a fiduciary is precluded from making a profit from his position and will be made to account for any profit he makes.³¹⁹ The essence of this rule was explained by Dean J in *Chan v Zacharia*³²⁰ (an Australian case which has been cited with approval by the English Court)³²¹ as being to preclude a fiduciary from being influenced by personal considerations rather than the best interest of those on whose behalf he is acting. As fiduciary, a director is not allowed to make any profit from his position as a director unless that profit is disclosed and there was informed consent to him to earn the profit. A director will be made to account for all such secret profits and it will not matter that the company did not suffer any injury by reason of the director's dealings.³²²

In order to preserve and exercise independent judgement on matters concerning the company's best interest, directors must not fetter their discretion, they must not for instance, enter into an agreement with third parties as to how they may exercise their powers unless they consider, bona fide, that it is to the best interest of the company to do so.³²³

Directors must act in accordance with the company's constitution. Hence directors could not pay dividends out of revenue profits if the company's constitution requires that it may only be paid out of capital profit; such transaction is voidable at the instance of the company.³²⁴ Whether or not the company avoids the transaction, any director involved in such transaction including the director who authorised it will be liable to account to the company for any gain he has made directly or indirectly and to indemnify the company for any resulting loss or damage. A third party dealing in good faith with the directors -was protected under S35A of the 1985 Act; the section deemed directors' powers under the company's constitution to be free from any limitation.

³¹⁸ *Aberdeen Rly Co v Blaikie Bros* [1854] 1 Macq 461.

³¹⁹ *Keech v Sandford* [1726] Sel Cas Ch. 61; *Regal (Hasting) Lit v Glliver* [1967] 2AC 134; *Boardman v. Phipps* [1967] 2 AC 46 and Lord Herschell in *Bray v Ford* [1896] AC 44 at p. 51-52

³²⁰ [1984] 154 CLR 178.

³²¹ *Don King Production line v Warren* [2000] 1 BCLC 607 at pp629-630.

³²² *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443; *Parker v McKenna* (1874) 10Ch App 96, 124-125.

³²³ *Fulham Football Club Ltd v Cabra Estates Plc* [1994] 1 BCLC 363.

³²⁴ Companies Act 1985, s322A.

There is authority to suggest that directors, in the exercise of their discretion, are expected to act fairly as between different class of member. The power conferred on directors by the constitution is not unfettered; it is subject to “the time-honoured rule that the directors’ powers are exercised in good faith in the interest of the company, and that they must be exercised fairly as between different shareholders”.³²⁵

Hoffman LJ in two lines of cases³²⁶ indicated that the standard of care and skill expected of directors in the conduct of the company’s affairs is that stated in Section 214(4) of the Insolvency Act 1986. This approach was subsequently followed in a number of other cases including *Cohen v Selby*.³²⁷ Directors are expected to exercise the standard of care and skill expected of a reasonably diligent person having the general knowledge, skill and experiences that may reasonably be expected of a person carrying out the same function as the director and having the general knowledge, skill and experience of the director. This duty arises from the circumstance that the director assumes responsibilities for the property and affairs of the company. It is a duty both in equity and common law of tort and while it might also be contractual, the duty does not depend on the existence of any contract.³²⁸

5.3 The need for reform

UK company law was arguably in need of reform, but the question has been which kind of reform and how best to achieve it; should it be by legislation or self-regulation or a combination of both. Traditionally directors’ duties have been fragmented comprising of regulatory and self-regulatory mechanisms. Arguably, there was neither a coherent framework governing company law nor any attempt to modernise the whole spectrum of company law.³²⁹ The regulatory approach, which ensured that directors had to comply with their duties and obligations, had been somewhat random and inconsistent, embracing fiduciary duties, common law duties and duties imposed by statute under various legislation such as the CA 1985, the Company Directors’ Disqualification Act 1986; the Insolvency Act 1986 and the Financial

³²⁵ *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11, per Goulding J at p.21.

³²⁶ *Re D’jan of London Ltd, Copp v D’jan*. [1994] 1 BCLC 561; and *Norman v Theodore Goddard* [1991] BCLC 1028.

³²⁷ [2001] 1 BCLC 176 at 183.

³²⁸ *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145; *Bristol & West Building Society v Mothew* [1998] Ch1.

³²⁹ Saleem Sheikh.(2008). A guide to the Companies Act 2006. (2008) (1), 11.

Services and Markets Act 2000. The self-regulatory mechanisms were a helpful aid, however not binding, such as the UK Listing Rules and City Code on Takeovers and Mergers.

In September 1999, the Law Commissions of England and Wales and Scotland jointly published a consultation paper on company directors, with particular emphasis on regulating conflicts of interest and formulating a statement of duties.³³⁰ The commission was charged by the DTI with the objective of determining whether or not the statutory provisions with regard to the directors' duties could be "reformed, made more simple or dispensed with altogether".³³¹ They were also to consider the possibility for a statutory statement of the duties owed by a director to the company under general law as well as their fiduciary duty and to make recommendations.

The Law Commissions considered full codification and partial codification of directors' duties. A full codification of the duties would have consisted of a statutory statement of all directors' fiduciary duties and the duty of skill and care. This would have been an exhaustive list of directors' duties and would have replaced the common law. Partial codification would have comprised a statement of the settled duties but would not have been an exhaustive list of directors' duties. The common law would continue to apply to the duties not covered by the statute but be superseded in relation to the duties set out in the statement.

Full codification might make the law more certain, consistent, accessible and comprehensible but that it would be difficult to deal with those situations where the duties are not yet well settled, any attempt to codify such duties might well restrict the ability of the law to develop. Another argument against full codification was the difficulty in defining the director's duty of care. The standard of care that a director must show in carrying out his duties has evolved over a long period of time to adapt to commercial conditions, and to set this in statute would freeze it at the time of enactment.³³² The commission concluded for legislative restatement and the concern of those who had issue with loss of flexibility, were to be addressed by ensuring that the restatement was at a high level of generality by way of a non-exhaustive statement of principles, i.e. whilst the duties would still be comprehensive and binding, it would not prevent the court inventing new general principles outside the field.³³³

³³⁰ Law Commissions and the Scottish Law Commission, company directors, Regulating Conflicts of Interest and Formulating a Statement of Duties (September 1999), Law Com No261, Scot Law Com No 173.

³³¹ *Ibid.*

³³² *Ibid.*

³³³ Dignam, A. and Lowry, J. (2010). *Company Law*. 7th ed. oxford: Oxford University Press, pp.330-341.

The government recognised that there were inadequacies in the law and it required radical change. It set about by appointing the steering group whose task was to review all aspect of UK company law and make recommendations between 1998-2000. The committee issued several consultation documents, in turn culminating in two White Papers in 2002 and 2005 leading to the CA 2006. Considering the Law Commissions recommendation, the Steering Group made recommendations on directors' duties. The recommendations included:

- A need for a statutory statement on directors' main fiduciary duties and his duty of care and skill. The standard of care should be judged by a twofold objective/subjective test³³⁴
- The language used in the statement should be drafted in broad and simple term, and it should not be exhaustive.

The Steering Group published a draft Statement of Directors' Duties which was proposed to be included in future Companies Act. In the draft statement, there were seven main duties mentioned; loyalty, obedience, no secret profit, independence, conflict of interest, interest of employees and fairness. This draft statement of duties formed the basis for the general duties under the 2006 Act.

The government reflected upon the recommendations of the Steering Group and the Law Commissions and then published its first White Paper on company law reform, Modernising Company Law.³³⁵ In the Paper, the then Secretary of State for Trade and Industry, Patricia Hewitt, highlighted that British company law was created in the 19th century and that it was “a source of competitive advantage. However, it had now become a competitive disadvantage”,³³⁶ she considered that company law had failed to adapt to the changing role for small businesses and internal market and that it needed change, it needed modernising, it needed to be simplified.

In March 2005 the Government published another White Paper, Company Law Reform. This Paper set out the proposal for a majority of the framework of company law. This built on the work that was carried out by Company Law Review, the Government White Paper in 2003 and Partial draft to the Company Law Reform Bill. The Company Law Reform 2003 was seen by the Secretary of State as providing the essential blueprint for the reform proposed by the Government.

³³⁴ *Ibid*

³³⁵ Department for Trade and Industry (2002), Modernising Company Law, July 2002. Cm5553-1.

³³⁶ *Ibid*.

According to the White Paper, the company Law reform programme was focused on a number of key objectives including enhancing shareholder engagement and long term investment culture. This required a sufficient and effective dialogue between the owners of the company and those who control it; it required defining clearly the roles and the obligations for both parties. Therefore, a new Companies Bill would provide clarity on the duties of directors and ensure that they are understood.

The law on directors' duties was fragmented according to the 2005 White Paper. This was because some of the duties could be identified in various case laws instead of the Companies Act. However, one of the obstacles was that those who became company directors might not fully understand their duties under the law. The Government in the White Paper placed emphasis on directors' duties, and how they were essential to company law. The statutory statement would be drafted in a way that would reflect -modern business need. The Government would apply the principle of 'Enlightened Shareholder Value' namely that a director's main objective should be the company's success for the benefit of its members as a whole. The statutory statement was intended to be flexible to allow room for interpretation and development.³³⁷ It was also intended to be widely accessible and understood and the language used to draft the statement was plain and ordinary. The overriding reason therefore for any reform was, according to the Government, to make the law on directors' duties simple, clear to ensure that they are understood by directors, and easily accessible.

5.4 The General Duties

The 2006 Act introduced some changes to the old laws and codified some of the common law and equitable principles. The Act introduces a statutory statement of general duties which puts into statutory form the common law rules and equitable principles. The provisions for the new general duties have been the subject of extensive comments by legal practitioners and directors' representative bodies, especially the provisions in section 172. Although it is said that these changes will bring much benefit to companies, but some critics have argued that in the short term it may well create confusion and uncertainty in some areas. The intention here is not to reproduce these comments and criticisms (which time has shown did not happen) but to briefly

examine the general duties, particularly the section 172 duties; and how they differ from the old common law rules and fiduciary principles they are intended to replace. The anticipated impact of section 172 will be analysed as well as how the section may be interpreted by the courts.

Apart from the changes introduced by the statement of general duties, the overall purpose seems to be to ensure the continuity of the statement, as far as possible, with the existing law. Hence, section 170(3), which sets out the relationship between the statement and the law that it is intended to replace, provides that the “general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director”.³³⁸ The general duties are to “be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties”,³³⁹ the reason being that common law rules and equitable principles may well continue to develop outside company law and that the connection should not be lost, despite the enactment of the statutory statement.³⁴⁰ Lord Goldsmith considers this might be an advantage in that “it will enable the statutory duties to develop in line with relevant developments in the law as it applies elsewhere”.³⁴¹ This seems to suggest that the continuity between the new statement of general duties and the common law rules and equitable principles is designed deliberately.³⁴²

5.4.1 Duty to act within powers

Section 171 contains the duty to act within powers is essentially like the previous fiduciary duties on directors to act within their powers and for the proper purpose. This section codifies the common law rules that directors must act within powers or under the company constitution. A director must only exercise his powers for the proper purpose or may find himself incurring personal liability.³⁴³

³³⁸ UK companies Act 2006. s.170(3)

³³⁹ UK Companies Act 2006. s.170(4).

³⁴⁰ Explanatory Note accompanying the Companies Act 2006 (Explanatory Note) at paras 305, copy is available at http://www.opsi.gov.uk/acts/acts2006/en/ukpgaen20060046_en_1 . last accessed 22/5/2016

³⁴¹ Lords Grand Committee, 6 February 2006, col. 242, quoted in Companies Act 2006, Duties of company directors, Ministerial statements, DTI June 2007, at p 6.

³⁴² Omar, P. (2009). In the wake of the Companies Act 2006: an assessment of the potential impact of reforms to company law. *International Company and Commercial Law Review*, p.48.

³⁴³ UK Companies Act 2006, s178.

5.4.2 Duty to exercise independent judgment

Section 173 of the Act imposes a positive duty on a director to exercise independent judgement. A recent court of Appeal decision reinforces the importance of this duty. Directors have a fiduciary duty to safeguard the assets of the company and for that purpose to take reasonable steps to prevent and detect fraud and other irregularities. It is a breach of that duty for “directors of a company to allow themselves to be dominated or bamboozled by one of their numbers”³⁴⁴ so much so that they fail to detect fraud or to speak out when the dominant director is committing fraud on the company.³⁴⁵

5.4.3 Duty to exercise reasonable care, skill and diligence

Section.174, the duty to exercise reasonable care, skill and diligence codifies the common law rule of duty of care and skill, and prescribes the degree of “care, skill and diligence’ expected from a director: the standard of care, skill, and diligence that would be exercised by a reasonably diligent person with; (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and (b) the general knowledge, skill and experience that the director has.”³⁴⁶

5.4.4 Duty to avoid conflicts of interest

The duty only applies to a transaction between a director and a third party, it does not extend to a transaction between a director and his own company.³⁴⁷ The section makes it easier for directors to enter into transactions with third parties when directors’ interests conflict with company’s interests. Previously, shareholders’ approval would have been required to enable a director to enter into transactions with third parties. However, now such transactions can be authorised by the non-conflicted directors on the board provided that certain requirements as listed in section 175 (5) & (6).³⁴⁸ Such authorisation is only effective if the conflicted directors have not actually participated in the decision-making process or if the decision would have been valid even without the participation of the conflicted directors. Board authorisation of

³⁴⁴ Per Popplewell J in *Madoff Securities International Limited (In Liquidation) v Raven and Ors* [2013] EWHC 3147 J

³⁴⁵ *Lexi Holdings Plc (In Administration) v Luqman & Others* [2009] EWCA Civ 117; *Re Westmid Packing Services Ltd* [1989] 2 BCLC 646.

³⁴⁶ UK Companies Act 2006. s.174

³⁴⁷ Those transactions are governed by CA 2006 s.40 to 41

³⁴⁸ *Ibid.*

conflicts of interest will be the default position for private companies. However, public companies will need certain provisions in the constitution to allow this.³⁴⁹ This is however not permitted in respect of the acceptance of benefit from third parties which is dealt with under section 176.

5.4.5 Duty not to accept benefits from third parties

This duty contained in section 176 restates the existing ‘non-profit’, the rationale for this rule is to preclude directors from being influenced by personal considerations rather than the interest of the company. The principles in *Don King Productions*³⁵⁰ will, therefore, continue to apply in the interpretation of this section although it is doubtful whether a director will be absolved from breach of the section on the basis of prior disclosure and consent as was the case under the old rule. However, if the acceptance of such benefit would not reasonably be considered as likely to give rise to a conflict of interest, the director could not be said to be in breach.³⁵¹

5.4.6 Duty to declare interest in proposed transaction or arrangement

Section 177 of the 2006 Act requires a director to disclose his interest in any transaction proposed between the director and the company and to declare the nature and the extent of the interest to the other directors.³⁵² This is more than was required under S317 of CL 1985 which simply requires directors to declare their interest. The duty to declare interest extends to any person connected to the director. Interest must be disclosed unless in situations where the interest is considered unlikely to give rise to conflict or if other directors are already aware of the interest.³⁵³

5.4.7 Duty to promote the success of the company

The section that has aroused the most interest is s.172 of the Act which imposes on directors the duty to act in a way they consider, acting in good faith, would most likely promote the interest of “the company for the benefit of its members as a whole, and in doing so, to have regard to, among other things, (a) the likely consequence of any decision in the long term; (b)

³⁴⁹ UK Companies Act 2006, s175(5)(b).

³⁵⁰ [2000] 1 BCLC 607.

³⁵¹ UK Companies Act 2006, s176(4).

³⁵² *Ibid.*

³⁵³ UK Companies Act 2006, s177(6).

the interest of the company's employees; (c) the need to foster the company's business relationships with suppliers, customers and others; (d) the impact of the company's operations on the community and the environment; (e) the desirability of the company maintaining a reputation for high standards of business conduct; and (f) the need to act fairly as between members of the company."³⁵⁴ The duty is owed to the company.³⁵⁵ Section 172(1) is further qualified by two subsections, allowing for the displacement of the section 172(1) duty in the event of insolvency and for companies embodying altruistic objectives to promote these over the interests of the members.³⁵⁶ The result is that, especially in the "altruistic" provision, directors might have other foci than the members.

The novelty of this section is its embrace of the concept of 'enlightened shareholder' value theory which sees the basic goal of the company as generating long-term rather than short-term shareholder value, based on appropriate financial discipline, competitive advantage and within a framework which is economically, ethically and socially responsible and sustainable, and where profit maximisation is qualified by external considerations. analogous to the way in which profit optimisation theories are put forward. Margaret Hodge, acknowledged that the section "marks a radical departure in articulating the connection between what is good for a company and what is good for society at large".³⁵⁷ She asserts that the success of a company for the interest of its shareholders as a whole is not incongruent with "society's aspirations for people who work in the company or in supply chain companies, for the long-term well-being of the community and for the protection of the environment". Pursuing the interest of shareholders and embracing the responsibilities of the statutory constituencies are complimentary, not contradictory purposes. She maintains that in the long-term, a business would perform better and be more sustainable when it has regard to the statutory constituencies in its pursuit of success.

Notably, under s.172, the interests of the members of the company are still supreme, insofar as the directors are to act in a manner that would promote the success of the company for the benefit of its members as a whole. The factors listed in s.172 are only items to be considered in determining this overall question. Although s.172 may have struck a balance between the traditional shareholder value approach and the stakeholder approach it can still be criticised for

³⁵⁴ UK Companies Act 2006 s.172

³⁵⁵ UK Companies Act 2006, s. 170 (1).

³⁵⁶ UK Companies Act 2006 s.172(3)-(4).

³⁵⁷ Hodge, M. (2007). *House of Commons Hansard*. [online] Publications.parliament.uk. Available at: <https://publications.parliament.uk/pa/cm200607/cmhansrd/cm070626/wmstext/70626m0002.htm> [Accessed 25 Dec. 2016].

not going the full stretch to protect the other stakeholders since the interests of members is still clearly paramount. Pursuant to the exact word of s.172, a director would not be in breach of their duty as long as they can show that they acted in good faith. It has been noted that s.172 imposes mainly a subjective test.³⁵⁸ Section 172(3) provides that the duty imposed by s.172 has effect subject to any rule of law requiring directors to consider or act in the interests of creditors. Perhaps s.172 does not in reality change directors' practice substantively. s.172 of the Companies Act 2006 is based on the equitable fiduciary duty which was formulated in combination with the duty to act within powers, by Lord Greene M.R. in *Smith & Fawcett Ltd*,³⁵⁹ this principle was confirmed by Arden L.J. in *Item Software (UK) Ltd v Fassihi*.³⁶⁰

On the other hand, an area of concern in relation to s.172 is how would directors prioritise the interests of the statutory constituencies if there are competing interests? For instance, if a decision taken by the director benefits the employees but has a detrimental effect on the environment, which route should the director take? Furthermore, the reference to “others in” s.172(1)(c) is seen as too wide and ambiguous, although the meaning could be limited using the *eiusdem generis* rule.³⁶¹

5.4.7.1 Duty to act in good faith

The test to be applied in determining whether a director has acted in accordance with his s.172 duty is a subjective one. A director must act in the way he considers (not what the court may consider), in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.³⁶² “The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interest of the company. The issue is as to the director’s state of mind.”³⁶³ The court is not to be required “to take the management of every playhouse and brewhouse in the Kingdom.”³⁶⁴ Furthermore, “There is no appeal on

³⁵⁸ Davies, P. and Worthington, S. (2008). *Gower & Davies: Principles of Modern Company Law*. 8th ed. Sweet & Maxwell, p.506.

³⁵⁹ *Smith & Fawcett Ltd*, Re [1942] Ch. 304 CA.

³⁶⁰ *Item Software (UK) Ltd v Fassihi* [2005] 2 B.C.L.C. 91 CA (Civ Div).

³⁶¹ Ajibo, C (2014). A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory, 2 *Birkbeck Law Review* 37, p.55.

³⁶² *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306; s.172, 2006 Act.

³⁶³ *Regentcrest Plc v Cohen* [2001] 2 BCLC 80 at 105, per Jonathan Parker J.

³⁶⁴ *Carlen v Drury Ves & B* [1812] 154 at 158, per Lord Eldon LC.

merit from management decision to courts of law: nor will the courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.”³⁶⁵ In the case of *Re Southern Counties Fresh Foods Ltd*³⁶⁶, the court compared the new form of words in section 172 with the old acting “bona fide in the interests of the company” and concluded that they came to the same thing. *Re Southern* also confirmed that the test under the first limb of s.172 is subjective thus affirming the pre-2006 common law position as set out in *Re Smith & Fawcett Ltd*.

5.4.7.2 The success of the company for the benefit of the members as a whole.

There are three expressions that stand out from the provisions in section 172(1) – “success of the company” for the “benefit of the members as a whole ...”.and must “have regard to”.

The expression, ‘success’ is not defined in the 2006 Act nor is there any guidance in the 2006 Act as to how success is to be measured. What constitutes the ‘success of the company’, by what yardstick may one judge whether an action or proposed course of actions by directors have advanced or would most likely advance the success of the company? Is success to be determined by how much annual dividend are paid to shareholders or the market value of the company’s shares? Would high-risk investment be considered adverse to the promotion of the success of the company especially following recent invents in the financial market? What would be the appropriate time frame to measure the success of a company – short term or long term? Would directors who award themselves large bonuses and perks be able to justify their decision under section 172(1)? Does the requirement in section 172(1)(a) that directors should have regard to the likely consequence of any decision in the long run suggest that Parliament intends that the success of the company must be considered on long-term rather than on short-term basis?

The DTI’s guidance to the Company Law Bill suggests that ‘success’ in relation to a commercial company is considered to be its “long-term increases in value”. Lord Goldsmith in his ministerial statement³⁶⁷ stated that the starting point in determining what is success is to establish what the members of the company define as the objectives they wish the company to achieve. In other words, success in the context of section 172(1) means what the members collectively want the company to achieve. For a commercial company, Lord Goldsmith

³⁶⁵ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 ALL ER 1126 at 1131, per Lord Wilberforce.

³⁶⁶ [2008] EWHC 2810.

³⁶⁷ Hansard HL, 9 May 2006, col. 846.

considers this will usually mean long-term increase in value, for charities and other public interest companies success may mean the attainment of the company's object; the objective for which the company was established. It is therefore for directors, acting in good faith, to decide what course of actions would best meet these objectives and hence promote the success of the company.

It must be noted that the section does not require that the action must necessarily promote the success of the company; the director is merely required to "act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole".³⁶⁸ It would seem therefore that an action by directors need not necessarily promote the success of the company provided the directors believed, in good faith, that the action would be most likely to promote the success of the company. The decision as to what will promote the success of the company and what constitute that success would seem therefore the directors' good faith judgement and not the courts.³⁶⁹ The question will be whether the directors, after having had regard to all the relevant statutory constituencies, honestly believed that their chosen action or omission would promote the success of the company. If the answer to that question is in the affirmative, then it would seem there can be no appeal on the merit to that management decision, the courts will not "assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at"³⁷⁰ and it would not matter whether that belief was unreasonably held provided that it was honestly held.³⁷¹

The expression "for the benefit of members as a whole" raises two interesting questions. What constitutes the "benefit" so far as members are concerned, and what is meant by the expression "members as a whole"? The term "members as a whole" is a well-used expression in company law and should not engender any controversy; it had been regarded as meaning the present and future shareholders.³⁷² Usually, it is assumed that the only benefit members derive from their company is the financial returns on their investments although how those returns are valued may differ from member to member. The assumption that shares are acquired only for their financial gains may not be entirely correct. There are members whose only interest in the

³⁶⁸ UK Companies Act 2006, s172(1).

³⁶⁹ Webarchive.nationalarchives.gov.uk. (2005). *Guidance on key clauses to The Company Law Reform Bill*. [online] Available at: <https://webarchive.nationalarchives.gov.uk/+http://www.dti.gov.uk/bbf/co-act-2006/white-paper/page22800.html> [Accessed 20 Sep. 2015].

³⁷⁰ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, per Lord Wilberforce at p832.

³⁷¹ *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598.

³⁷² *Gainman v National Association for Mental Health* [1972] Ch. 317 at 330; *Brady v Brady* [1987] 3 B.C.C. 535 at 552, CA.

company is to see share prices go as high as possible in the shortest of time so that they can sell on their allotted shares, make their profit and move on to another investment. A lot of this happened in the early nineties when some of the public utility companies were privatised. There are other members who are there for the long-term and whose interest is in seeing long term year-on-year increase in dividend flow. There are however other members whose interest may not be financial, as illustrated by the case of CAS (Nominees) Ltd v Nottingham Forest F. C. Plc³⁷³ where the “primary driver of value of a controlling interest in a football club” was the desire of certain members to control and influence the affairs of the club. It seems therefore that the benefit of members may be more than just financial gain even though in most instances, financial return on investment is the major reason for investing in a company.

5.4.7.3 Duty to have regard to the statutory constituencies.

The duty on directors to have regard to the statutory constituencies appears to be subordinate to the overriding duty of directors to act in what they consider, acting in good faith, would be most likely to promote the success of the company for the benefit of members as a whole. It introduces wider corporate social responsibility into a director’s decision-making process. It has been suggested that the expression “have regard to” means “give proper consideration to”; it is “not about just ticking boxes”.³⁷⁴ Already, directors’ duty to take account of all material considerations in the exercise of their discretion had been recognised in a first instance case,³⁷⁵ which applied the principle first declared by Lord Greene in *Associated Provincial Picture Houses Ltd v Wednesbury Corporation*³⁷⁶: the law “imposes on a person who is entrusted with the exercise of a discretionary power” a duty to exercise the power “for the purpose for which it is given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant”³⁷⁷. It seems likely that this principle, which was first declared in relation to a public authority’s exercise of discretionary power, may now become firmly enshrined in determining the merit of directors’ decisions and actions under section 172(1), particularly if the duty to have regard to the statutory constituencies is interpreted as meaning ‘giving proper consideration’ to such relevant matters.

³⁷³ [2002] 1 BCLC 613.

³⁷⁴ Hodge, M. (2007). *Ministerial Statement, House of Commons Hansard*. [online] Publications.parliament.uk. Available at: <https://publications.parliament.uk/pa/cm200607/cmhansrd/cm070626/wmstext/70626m0002.htm> [Accessed 25 Dec. 2016].

³⁷⁵ *Hunter v Senate Support Services Ltd* [2004] EWHC 1085 (Ch), [2005] 1 BCLC 175.

³⁷⁶ [1948] 1 KB 223.

³⁷⁷ *Edge v Pension Ombudsman* [2000] Ch 602 at p 627.

Notwithstanding the difficulties with s.172, there is an advantage. Most importantly, s.172 signals the importance of corporate social responsibility in underlining the fact that companies do not exist in vacuum and that corporate decisions impact a large number of stakeholders. The highlighting of corporate social responsibility is said to add to the overall creditability of a jurisdiction as it shows that leaders are prepared to enforce the responsibility that companies owe to society, and at the same time reaping the reward of economic development.

S.172 can be viewed as guidance for those corporations engaged in stakeholder management strategy, to assist the board in prioritising the company's goals, social and environmental strategies. Directors should be able to determine, following the statutory guidance in s.172, what is the most appropriate means to promote the success of the company in the long term taking into account the various statutory factors and the current circumstances of the company.

5.5 Development of Corporate governance in the UK

Corporate governance refers to administrative powers that are exercised over corporate bodies. The foundations for modern corporations were laid in the nineteenth century, then various management theories were developed during the twentieth. It was not until the twenty-first century that governance became seen globally as largely a matter of ensuring that the forces acting on corporate entities were not only effective but legitimate.³⁷⁸

In the UK, the development of corporate governance can be seen to have begun early in the 20th century when public companies took the significant step of being listed on the stock exchange, widening the dispersion of shareholders and thus weakening the shareholder-management link. Upon joining the EEC in 1973, the UK was faced with continental corporate governance models such as the two-tier board common in the Netherlands and Germany, whose widespread adoption was proposed by the Community. The UK rejected this proposal, however, preferring unitary boards on which non-executive directors (NEDs) sat alongside the executive directors who were responsible for the everyday conduct of corporate business. In response to the proposed two-tier system, the UK government formed a committee under Lord

³⁷⁸ R Tricker, (2000). 'Corporate Governance: A Subject Whose Time Has Come', in R Tricker (ed) Corporate Governance. Ashcroft Publishing 2000.p.33

Bullock, which recommended that unitary boards should continue in partnership workers' representative boards, but British firms did not welcome this proposal.³⁷⁹

Europe has nonetheless influenced governance in Britain, according to Pannier; for example, the EU Commission's proposal to enhance corporate governance, issued in 2003,³⁸⁰ has led to company law in member states including the UK being amended in various ways.³⁸¹

Behind the increasing numbers of measures taken in the UK to regulate corporate governance lie a number of factors, including concern arising from several instances of corporate financial collapse such as those of Polly Peck and Bank of Commerce International in the early 1990s.³⁸² A strengthened awareness of corporate governance practices has also arisen from the greater investment of pension funds, insurance companies and other institutional investors in the shares of public companies and the consequent increase in their concern regarding their exposure to the risks inherent in these shareholdings. Successive advances in information and communication technology have also played a part in enhancing investors' awareness and understanding of corporate governance issues. At the same time, companies have increasingly sought and expected to obtain external funding, giving rise to the increasing importance of corporate governance and its role in reassuring prospective investors that their money is in safe hands. Indeed, Mallin et al. have observed an appreciation throughout the UK stock market of the need to boost confidence, thus improving the climate for investment, with the result that corporate governance has assumed an ever-greater importance.³⁸³

5.6 The Financial Reporting Council

The health and growth financial market contribute directly to the overall development of an economy and ensuring that the UK financial market function in an efficient way there is an inherent need for investors to have the confidence to invest. It was for this reason the Financial

³⁷⁹ *Ibid.*

³⁸⁰ Commission of the European Communities, Communication from the Commission to the Council and the European Parliament: 'Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward'. Brussels, 21.5.2003, COM (2003) 284 final.

³⁸¹ M Pannier, 'New European Company Law and Corporate Governance - the UK and the New Member States' (2005) EBLR 1366.

³⁸² B Nevzat and G Fraser, *The Turquoise Conspiracy: Asil Nadir, the Collapse of Polly Peck and the Persecution of a Family* (1999). For more information on the BCCI scandal, see P Truell and L Gurwin, *False Profits: The inside Story of BCCI, the World's Most Corrupt Financial Empire* (Houghton Mifflin, Boston, MA 1992).

³⁸³ C Mallin, A Mullineux and C Wihlborg, 'The Financial Sector and Corporate Governance: The UK Case' (2005) 13 CG 533.

Reporting Council (FRC) was established as an organisation, that “officially took over the role of review and updating the UK corporate governance code”³⁸⁴ to promote high standards of corporate governance and reporting with the objective of fostering investment.³⁸⁵

Investors need to have reasonable confidence that the companies that they are investing are effectively governed and that any risk taken is on an informed basis.³⁸⁶ The confidence of the investor should be based on four main principles; effective company boards which communicate well, effective and robust accounting, auditing and reporting standards, reliable annual reports and accounts and the sound regulation of the auditing and actuarial profession.³⁸⁷ The FRC is the UK’s independent regulator and is responsible for setting and promoting high-quality corporate governance standards in listed companies. The FRC is also responsible for establishing the standards for accounting, auditing and actuarial profession and regulating their respective bodies and enforcing disciplinary arrangement when necessary.³⁸⁸ Nevertheless, assessing the compliance levels of companies is no the responsibility of the FRC, as the code is voluntary.³⁸⁹

The FRC’s approach in promoting the quality corporate governance and reporting in the UK can be summarised as follows:

- 1) Maintaining and reviews the UK Corporate Governance Code.
- 2) Implementing and monitoring the standards of corporate reports.
- 3) Encouraging companies to publish reports a fair, balanced and understandable way.
- 4) Overseeing the standards of the actuarial profession.
- 5) Conducting investigative, monitoring and disciplinary procedures to uphold the integrity of the accountants, auditors and actuaries.
- 6) Contributing to key development in relation to stakeholder issues on national and international platforms.
- 7) Engaging in with stakeholder regularly and responding to the concerns.

³⁸⁴ Yeoh, P. (2018). Corporate Governance in the UK: A Time for Reflection. *Business Law Review*, 36(4), p.130.

³⁸⁵ Frc.org.uk. (2018). *Financial Reporting Council*. [online] Available at: <https://www.frc.org.uk/frc-for-you/frc-mission> [Accessed 22 Jan. 2016].

³⁸⁶ Frc.org.uk. (2018). [online] Available at: <https://www.frc.org.uk/getattachment/de950642-4c6d-4909-b965-5707108fc55a/TheFRCanditsRegulatoryApproach.pdf> [Accessed 22 Feb. 2016].

³⁸⁷ Ibid.

³⁸⁸ Ibid.

³⁸⁹ FRC Listing Rule 12.43 A requires listed companies to report on their level of compliance with the code.

8) Operating a Financial Reporting Lab that connects companies and investors together to participate in the improvement of company reporting.³⁹⁰

5.7 Reports and Codes

The Cadbury Report 1992

The essence of all the below reports and recommendations can be traced back to its source in the 1992 report of the Cadbury Committee, which is widely agreed to constitute the earliest comprehensive set of recommendations on the financial aspects of the operation and governance of British companies. The Cadbury Committee launched by the London Stock Exchange, the Financial Reporting Council and key members of the accountancy profession in May 1991.³⁹¹ Under its chairman, Sir Adrian Cadbury, the committee drew up a detailed set of recommended steps to attain best corporate governance practice. Its findings had as their main themes the board's controlling and reporting functions and the subsequent role of the internal auditors. The Cadbury Report was the first to establish a set of reporting criteria which all UK organisations should use to demonstrate the extent of their compliance with its recommendations.

In this way among others, the Cadbury report is seen as the forerunner of all contemporary UK reports on corporate behaviour and practices. The main topics covered by this extensive report are activities and practices related to the board, to internal control matters, to auditing and to relations between the company and its shareholders.³⁹² Upon receipt of the report, the UK government ruled that after a further two years, its findings and effectiveness would be the subject of a detailed review by another committee. This process has in fact continued for many years, making Cadbury the forerunner on British corporate governance.

The Greenbury Report on Directors Remuneration, 1995

The sole purpose of the Report on Directors' Remuneration, issued in July 1995 by a group chaired by Sir Richard Greenbury, was to respond to growing concern among shareholders and the wider public concerning the way company directors' remuneration was decided. Sir

³⁹⁰ Frc.org.uk. (2018). *Financial Reporting Council*. [online] Available at: <https://www.frc.org.uk/frc-for-you/frc-mission> [Accessed 22 Jan. 2016].

³⁹¹ Laura F. Spira and Judy Slinn, (2012), *The Cadbury Committee: A History* (OUP)p.45-46.

³⁹² Ecgi.org. (1992). *The Financial Aspects of Corporate Governance*. [online] Available at: <http://www.ecgi.org/codes/documents/cadbury.pdf> [Accessed 1 Apr. 2016].

Richard, then chairman of Marks & Spencer, headed a study whose members represented the cream of UK industry and which produced a set of innovative recommendations on this question. The report states clearly that its recommendations should be valid for application to the compensation packages of the senior executives of all companies.³⁹³ Notably, the members of the group declared that they perceived the system of directorial remuneration in the UK to be on a par with those of European countries and far below the standards set by companies in the USA. One of their objects was to ensure that directors' overall remuneration packages were constantly under scrutiny by the company's shareholders.

The main aim of the report, however, was to eradicate any errors and misjudgments by setting out in simple terms the main steps needed to improve the settling of decisions on directors' remuneration. The Greenbury Report recommended the formation of an independent subcommittee to supervise the auditing of directors' pay and incentives. This independence would make it easier to implement the rules that emerged from the audit committee's deliberations. The Greenbury Report discussed best practice in detail, highlighted areas of action and covered not only remuneration policy but also service contracts. It included a list of disclosure requirements illustrated by examples of disclosure formats which would help practitioners to understand the reporting criteria used.

The Final Hampel Report, 1998

In January 1998, the Committee on Corporate Governance built on the advances made earlier by the Cadbury and Greenbury reports by producing a set of findings on the major principles that it perceived to underlie the founding and operation of any corporate entity. The so-called Hampel Report set out the rules by which corporations should abide in their activities, with particular emphasis on the roles and responsibilities of their directors and their shareholders.

The Hampel Report was the product of extensive research consisting of multiple group discussions, exchanges of letters, interviews and a rigorous evaluation of the existing literature on the subject of corporate governance.³⁹⁴ Among the major UK institutions which participated actively in furnishing the report's authors with the necessary information were the Institute of

³⁹³ Greenbury, R. (1995). *Remuneration: Report of a Study Group*. [online] Ecgi.org. Available at: <http://www.ecgi.org/codes/documents/greenbury.pdf> [Accessed 1 Apr. 2016].

³⁹⁴ Committee on Corporate Governance, 'Final Report' (1998).

Directors, the London Stock Exchange, the Confederation of British Industry, the Consultative Body of Accountancy Bodies and the National Association of Pension Funds.

The contribution of the Hampel Report can be summarised as covering those vital aspects of corporate governance which the earlier Cadbury and Greenbury recommendations had omitted to deal with.

The Turnbull Report on Internal Control 1999

The Turnbull Report of 1999, whose full title is Internal Control: Guidance for Directors on the Combined Code, was a response to the call by the London Stock Exchange for recommendations constituting a system of effective internal control for publicly listed companies. Upon its publication, Paul Geradine, who was then head of listing at the LSE, wrote to the companies listed on the exchange in praise of the Turnbull Report, requesting that those companies should replace the now outdated Rutterman guidance by complying with the rules set out by Turnbull. The report aimed to explain to members of the boards of listed companies a comprehensive system of internal controls which would serve to protect the assets of each corporation while at the same time safeguarding the interests of all of its shareholders.³⁹⁵

In the report, the Turnbull committee urged companies of the need to conduct regular internal audits of their organisations. It also advised any companies which at the time had no system of internal audit to create one by adopting its recommendations. The overall aim of the report was to summarise the aims, duties and responsibilities of company directors and to provide them with guidance on risk management and on financial and operational control measures.

The Combined Code, 2000

In May 2000, the Committee on Corporate Governance issued a report entitled The Combined Code: Principles of Good Governance and Code of Best Practice, which succeeded in setting the standard for the principles of good corporate governance in the UK. The rules contained within this document were soon adopted by the London Stock Exchange, which called on all of the companies whose shares it listed to comply fully with the report's recommendations. The Committee on Corporate Governance made it clear that the Combined Code to some extent served to summarise the recommendations made earlier by the Cadbury and Greenbury

³⁹⁵ The Institute of Chartered Accountants in England & Wales, Internal Control: Guidance for Directors on the Combined Code' (1999) <http://www.ecgi.org/codes/documents/turnbul.pdf> Last accessed 20 April 2016.

reports.³⁹⁶ It differed importantly in the inclusion of a new set of codes that created specifically as amendments to the recommendations of Cadbury and Greenbury. In its final version, the Combined Code recommended that each company should issue two separate statements, one of which would detail its compliance with the code and the other of which would explain its reasons for any noncompliance.

The Higgs Report on Non-executive Directors 2003

In January 2003, Derek Higgs produced, at the behest of the UK government, a report on the role and responsibilities of nonexecutive company directors.³⁹⁷ This document was, as has been made clear, just one in a sequence of reports published with the aim of improving and updating the UK's policies on corporate governance, the best known among these being the Cadbury, Greenbury, Hampel and Turnbull reports. What prompted the commissioning of the Higgs report in particular was the perception of a need to rehabilitate corporate governance rules following a series of financial crises in the UK and the bear market which had ensued.

The report's seventeen chapters and several annexes run to over a hundred pages. It provided a novel perspective on nonexecutive directors' roles and included a recommendation that companies should create a new post of senior independent director. Another innovative proposal was for nonexecutive board members to meet annually—or indeed more frequently if appropriate—without the other directors being present. It also included several insightful guidelines on the effectiveness of management practices such as recording the attendance of board members at meetings.

The Smith Report on Audit Committees, 2003

The Smith Report on audit committees of January 2003 offers guidelines to company directors to help them to understand the aims of audit committees and to facilitate the establishment of unbiased relationships between the audit committee members and other directors. It also emphasises that while the audit committee forms an integral part of the company and is

³⁹⁶ The Committee on Corporate Governance, 'The Combined Code: Principles of Good Governance and Code of Best Practice. Available at:http://www.ecgi.org/codes/documents/combined_code.pdf> [Accessed 20 April 2016]

³⁹⁷ Higgs, D. (2003). 'Review of the Role and Effectiveness of Non-Executive Directors. *Department of Trade and Industry*, [online] p.97. Available at: <http://www.ecgi.org/codes/documents/higgsreport.pdf> [Accessed 21 Apr. 2016].

answerable to the board of directors, it should nonetheless act with complete independence, free from interference by any other organ or agent of the company.

The Smith Report provides guidance to all of the people who work with the audit team to give them a clearer understanding of its rules. The committee's main functions are listed under the headings of supervision, assessment and review.³⁹⁸ Arranging the guidance in this order provides clear definitions of the respective roles and responsibilities of members of the audit committee, managers and company directors. The guidance is made particularly accessible by printing in bold type its most fundamental requirements, with which every member of the audit team must comply in order that the relationship between the company and the external auditors will be free of conflict. The report also places its recommendations within the broadest possible perspective by making comparisons at an international level with auditing rules from other countries and continents.

The Combined Code on Corporate Governance 2003

The Code on Corporate Governance of 2003 superseded the 1998 report of the Hampel Committee. Indeed, all of the versions of the code follow the format and general content of that issued in 2003 until 2010, which was the first code to require all companies to adopt its principles and guiding principles in their financial reports. One of its most important innovations was the inclusion of a 'comply or explain' clause, requiring each company to state clearly to its shareholders why it had not complied with any of codes. The document, comprising 92 pages, was comprehensive in its inclusion of the recommendations of Turnbull and of Smith for good practice by internal committees on control and audit respectively. It also discussed the Higgs Report in detail and many commentators consider it to serve as a guide to all of the later versions of the Combined Code

Internal Control: Revised Guidance for Directors on the Combined Code

The Guidance on Internal Control, also known as the Turnbull Guidance, has been described as very successful in fulfilling the broad aim of developing an internal corporate control system. This document sets out the rules that it is most important for every director to follow in order to obtain the best possible results when addressing novel risks, evolving conditions and changing expectations in the market. So great has been the positive influence of the Guidance, since it was published in 1999, that executives of many companies have reported significantly

³⁹⁸ The Financial Reporting Council Limited, 'Audit Committees: Combined Code Guidance' (London 2003).

improved internal control processes, despite a lack of detail on exactly how such controls should be implemented.³⁹⁹ The document comprises five sections, including one on the importance and objectives of the internal control process. It places special emphasis on directors' responsibilities for the maintenance and review of internal control processes. The Guidance is easy to follow for directors, in that its sections and subsections are all numbered and indexed. It also benefits from the appending of a handy set of clear instructions to members of the board as to how they should discuss internal control priorities with managers and from an appendix which discusses matters such as informational flow, risk assessment, controlled activities and self-monitoring.

Good Practice from the Higgs Report, June 2006

The Higgs Report was published in January 2003 at the behest of the Secretary of State for Trade and Industry, Patricia Hewitt, and the Chancellor of the Exchequer, Gordon Brown. It established definitions of the roles and responsibilities of nonexecutive directors and other senior members of the board, including the chairman and the chief executive. In addition to defining the roles of these top-level office bearers, it made recommendations on the appointment process applicable to senior directors and provided detailed guidance for remuneration committees on deciding compensation packages.⁴⁰⁰ The Higgs report has also been commended for clearly explaining the issues surrounding the pre- and post-induction of nonexecutive directors. It has justifiably been suggested that the Report sets a high standard which all UK corporations should do their very best to adhere to in the appointment of new members to the board of directors.

The Combined Code on Corporate Governance of June 2006

In the 2006 edition of the Combined Code on Corporate Governance, the Financial Reporting Council offers an overview of significant financial reporting practices that companies, their officers and their shareholders are expected to follow. There is a section comprehensively summarising corporate responsibilities corresponding to the financial reporting procedures. The main section provides definitions and information on roles and reporting structures relating to company directors, directorial and executive remuneration, auditing and shareholder relations. In each section, the main principle is elaborated with supporting material on

³⁹⁹ 'The Combined Code on Corporate Governance. (2003). *Financial Reporting Council*, [online] pp.27-42. Available at: http://www.ecgi.org/codes/documents/combined_code_final.pdf [Accessed 22 Apr. 2016].

⁴⁰⁰ The Financial Reporting Council, 'Good Practice Suggestions from the Higgs Report' (2006) http://www.ecgi.org/codes/documents/frc_gp_2006.pdf Last accessed 20 April 2016.

subsidiary principles and multiple subdivided code provisions. Relatively a subsection of the report is devoted directly to elaborating the actual codes applicable to institutional shareholders. The document concludes with three schedules that offer further guidance on matters such as nonexecutive directors' liabilities, disclosing corporate governance arrangements and performance-based remuneration.⁴⁰¹

The Revised Combined Code on Corporate Governance

The June 2008 revised version of the Combined Code on Corporate Governance is built on around the 2006 version. It included guidelines on the governance of UK companies both large and small designed to help them take important management decisions appropriately. The content of the original report focused on protecting the interests of companies and their shareholders by offering detailed guidance on their operations; whereas, the revised version comprised a more global overview allowing a more comprehensive interpretation of the codes of governance.

The 2008 document specifically highlights the soft law status of the code. It states that managers are free to modify the corporate rules, as long as it results in the cause of good governance being upheld.⁴⁰² The 2008 version also differs from earlier versions in its inclusion of a deeper analysis of the rules on transparency and disclosure. In order to make it more comprehensive, it has been covered in a separate section explaining the various overlaps between these rules on transparency and disclosure on one hand and elements of the Combined Code on the other. Overall, the 2008 Corporate Governance Code follows a pattern similar to that of the preceding report apart from it discussing more exhaustively a range of managerial matters; furthermore, the complex codes are explained as simply as possible.

The Walker Reports and Recommendations

Having been adversely affected by the 2008 crisis, the United Kingdom government had been obliged to implement a bank rescue.⁴⁰³ In 2008, the government allocated £500 billion to

⁴⁰¹ The Financial Reporting Council Limited, 'The Combined Code on Corporate Governance' (2006) 29 <http://www.frc.org.uk/documents/pagemanager/frc/Combined%20code%202006%20OCTOBER.pdf>. Last accessed 20 April 2016.

⁴⁰² Good practice suggestions from the Higgs report. (2006). *Higgs Suggestions for Good Practice*, [online] p.7. Available at: http://www.ecgi.org/codes/documents/frc_gp_2006.pdf [Accessed 18 May 2016].

⁴⁰³ Swaine, J. (2008). *Bank bailout: Alistair Darling unveils £500billion rescue package*. [online] Telegraph.co.uk. Available at: <https://www.telegraph.co.uk/finance/financialcrisis/3156711/Bank-bailout-Alistair-Darling-unveils-500billion-rescue-package.html> [Accessed 16 Jan. 2017].

stabilise the UK economy.⁴⁰⁴ The decision was made within a few days of the largest fall in the FTSE100 index recorded in a single day since 1987.⁴⁰⁵ However, the government was able to provide £400 billion of funds by implementing a £100 billion programme of short loans.⁴⁰⁶ In 2009, the announcement of the Goldman Sachs results brought the subject of corporate governance to the forefront of British minds.⁴⁰⁷ Sir David Walker was then appointed to suggest improvements to the corporate governance regime. His report maintained that purpose of corporate governance must be to protect shareholders' rights by ensuring that strategic checks and balances are in place. The Walker report recommended that the board of directors of any bank or other financial institution should provide business awareness sessions and personalise its approach to the development of NEDs, who would be expected to commit 30 to 36 days to their directorship of a major bank. The report also recommended that the FSA's interview process for NEDs should involve senior advisors making assessments.⁴⁰⁸

As to their functions, members of the unitary board should be willing to challenge the executive's proposals and strategies. The directors should be informed of any material changes in the share register and should make contact with shareholders. Moreover, in order to be authorised by the FSA, fund managers must indicate on their websites their full commitment to stewardship principles.⁴⁰⁹

Other recommendations of the Walker report concerned the governance of risk. The recommendation states that institutions must separate risks taken by the board from the audit committee, which must have responsibility for oversight of all such risks. Each financial institution must employ the services of a chief risk officer, whose participation in oversight is essential. Another recommendation states that the risk committee should observe good practice in strategic transactions and that the board must oversee the approval or rejection of all propositions and take external advice before making a decision.⁴¹⁰

⁴⁰⁴ *Ibid.*

⁴⁰⁵ News.bbc.co.uk. (2008). *Stocks slide despite reassurances*. [online] Available at: <http://news.bbc.co.uk/1/hi/business/7655288.stm> [Accessed 20 Apr. 2017].

⁴⁰⁷ Allen, K. (2018). *Campaigners attack Sir David Walker's report on banking*. [online] the Guardian. Available at: <https://www.theguardian.com/business/2009/nov/26/walker-report-attacked-by-campaigners> [Accessed 20 Apr. 2017].

⁴⁰⁸ David, w. (2018). *The Walker Report*. [online] Icaew.com. Available at: <https://www.icaew.com/technical/corporate-governance/codes-and-reports/walker-report> [Accessed 20 May 2016].

⁴⁰⁹ *Ibid.*

⁴¹⁰ *Ibid.*

A major issue throughout the crisis was executive remuneration and bonuses; this is the main reason for the government to commission the Walker report, which recommended that the remuneration committee's remit is extended to all policy areas affecting remuneration. In particular, it argues that if any nonbinding resolutions on a remuneration committee report attract less than three-quarters of the votes cast, then the chairman must stand for re-election, whatever the terms of his or her appointment.⁴¹¹

Corporate Governance Code 2010

In 2010 the Financial Reporting Council published what became known as the UK Corporate Governance Code, retaining the previous 'comply or explain' approach.⁴¹² The 2010 UK Corporate Governance Code (2010 Code) incorporated the recommendations of the Walker Report and following the review on the effectiveness of the Combined Code 2009.⁴¹³ Two major conclusions were derived from the review of the combined code. Firstly, the importance of adhering to the spirit of the code was seen as important as adhering to the letter of the code.⁴¹⁴ The second conclusion was the importance of the relationship between the shareholders and the board of directors.⁴¹⁵ The 2010 Code saw many structural changes and has upgraded some of the supporting principles to the position of the main principle, including; the responsibility of the chairman to lead the board,⁴¹⁶ the role of the executive director in challenging and developing the company strategy, the necessity of the board to contain a balance of skill and experience, independence and knowledge and directors should allocate appropriate time to perform the responsibilities in an effective manner.

The 2010 Code also saw the amendment to principle A.1 to include that the board is responsible for the long-term success of the company, as well as the amendment of the supporting principle on the appointment to the board to contain new wording. As part of this new wording, the 2010 Code encouraged boards to consider the benefit and value of diversity, including gender diversity when making appointments to the board.⁴¹⁷ Additionally, the 2010 Code amended the supporting principle E.1 on dialogue with shareholders and assigned the responsibility to the chairman to ensure that all directors are aware of the concerns of the shareholders. The re-

⁴¹¹ *Ibid.*

⁴¹² Mailian, C.A. (2013), *Corporate governance* 4th edition, Oxford press, pp.33

⁴¹³ Revisions to the UK corporate governance-code (formally the combined code). (2010). *The Financial Reporting Council*, [online] p.6. Available at: <https://www.frc.org.uk/getattachment/3c363c1c-76ff-4faf-8c7d-7d8aac801cd2/May-2010-report-on-Code-consultation.pdf> [Accessed 20 May 2016].

⁴¹⁴ Bourne, N. (2011). *Bourne on company law* 6th edition, Routledge, New York. p. 211

⁴¹⁵ *Ibid*

⁴¹⁶ UK Corporate Governance Code 2010 Code, A.3.

⁴¹⁷ *Ibid*, B.2

election of directors has been amended to state that directors that FTSE 350 company directors should be subject to annual re-election.⁴¹⁸

Corporate Governance Code 2012

The financial reporting council announced in October 2011 its intention to amend the 2010 code with a view to strengthening boardroom diversity. The principle of boardroom diversity was first introduced in the 2010 Code. The amendments of the 2012 Code was largely influenced by the recommendations of Lord Davis between “Women on boards” review in 2011. The Davis report recommended that “The financial reporting council should amend the UK Corporate Governance Code to require listed companies to establish a policy concerning boardroom diversity.”⁴¹⁹ The Davis review made several recommendations including; all FTSE 350 companies chairman should set an aspirational target of the percentage of women they aim to include in their boards between 2013 and 2015,⁴²⁰ female representation on FTSE 100 boards should be at least 25% by 2015, improving the disclosure regarding diversity policies and reporting on the progress towards attaining their gender diversity goals. The impact of the Davis review will be further discussed in chapter seven.

Corporate Governance Code 2014

In September 2014, the Financial Reporting Council issued the corporate governance Code 2014 and similar to the 2012 Code, it contained the same main principles; leadership, effectiveness, accountability, remuneration and relations with shareholders.⁴²¹ The changes to the code were limited. The main changes to the code were the new requirement for companies to publish the going concerns statement⁴²² and the future viability statement.⁴²³ The changes to the 2014 Code were to implement the recommendations of Lord Sherman report in 2012 from his inquiry into “going concerns and liquidity risks; lessons for companies and auditors.”⁴²⁴ Lord Sherman’s final report made several recommendations including the meaning and

⁴¹⁸ UK Corporate Governance Code 2010, B.7.1

⁴¹⁹ Lord of Abersoch, D. (2011). Women on boards. *Davis review*, [online] p.23. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31480/11-745-women-on-boards.pdf [Accessed 25 May 2016].

⁴²⁰ *Ibid*, p. 6

⁴²¹ UK Corporate Governance Code 2014.

⁴²² *Ibid*, C.1.3

⁴²³ *Ibid*, C.2.2

⁴²⁴ Sharman, L. (2012). *Going concerns and liquidity risk, lessons for companies and auditors, Final report and recommendations of the Panel of Inquiry*. [online] Frc.org.uk. Available at:

purpose of the going concerns assessment needing to be more clear, consistent and more integrated with directors planning and risk management with more focus on solvency and liquidity risks which could threaten the survival of the company. Additionally, Lord Sherman report's recommended that enhancing the role of the auditors. The FRC should include the requirement of an explicit statement to be included in the auditor's report, having reviewed the director's ongoing concern and assessment process, if the auditors wish to add or emphasise anything in relation to the disclosure of the robustness of the assessment process.

The 2014 Code amending the provisions regarding the remuneration and placed greater emphasis on ensuring the remuneration policy is designed in line with the long-term success of the company. That responsibility lies with the remuneration committee.⁴²⁵ Moreover, when designing the scheme for performance-related remunerations, the committee should include a 'clawback' provision enabling the company to recover or withhold any remunerations when appropriate.⁴²⁶ The 2014 Code also provided that in the case of a significant proportion of shareholders voting against any resolution at the annual general meeting, during the publication of the results, the company should explain how it intends to engage with the shareholders in order to understand their reasons or concerns for voting against such a resolution.⁴²⁷

Corporate Governance Code 2016

The 2016 Corporate Governance Code was published in September 2016 by the FRC and like its predecessor contained minimal changes. The changes that occurred within the 2016 Code were related to EU regulations and directives. The European Parliament and council of European Union issued in 2014 EU Regulation EU / 537 / 2014 and Directive 2014 / 56 / EU covering requirements regarding statutory audit of public-interest entities and the statutory audit of the annual account and consolidated accounting.⁴²⁸ The EU regulation and directive took effect on the 17th of June 2016; the code saw minimal changes as the code larger consistent with the EU regulation and directive. The only change occurred was in section C.3 affecting audit and audit committees which saw the addition of an extra sentence to provision C.3.1,

<https://www.frc.org.uk/getattachment/4a7f9880-0158-4cf0-b41e-b9e1bf006bd7/Sharman-Inquiry-final-report-FINAL.pdf> [Accessed 30 May 2016].

⁴²⁵ UK Corporate Governance Code 2014, D.1.

⁴²⁶ *Ibid*, D.1.1

⁴²⁷ *Ibid*, E.2.3

⁴²⁸ *Developments in Corporate Governance and Stewardship*.(2016). p.23 [online] Available at: <https://www.frc.org.uk/getattachment/ca1d9909-7e32-4894-b2a7-b971b4406130/Developments-in-Corporate-Governance-and-Stewardship-2016.pdf> [Accessed 30 May 2016].

requiring members of the audit committee to have “competence relevant to the sector in the sector the company operates”.⁴²⁹ Provision C.3.7 required external auditors contracts to be tendered at least every ten years was removed as this requirement was super-seeded by the new requirement in Section 485-8 CA2006 to implement EU directives and regulations. New wording has been added to provision C.3.8 that set out the requirement of the audit committee should give advance notice of audit re-tendering plans.⁴³⁰

5.8 Post Corporate Governance 2016 Structures

In September 2016, the Department for Business Energy and Industrial Strategy (BEIS) launched an enquiry on corporate Governance with specific focus on directors’ duties, executive’s pay, the composition in the boardroom, including gender balance in executive positions and workers representation.⁴³¹ The BEIS enquiry was precipitated by the corporate governance’s failings that were highlighted by the work the two previous committees into the demise of British Home Store (BHS)⁴³² and the employment practices at Sports Direct.⁴³³ The BEIS enquiry was also prompted by UK Prime Minister Theresa May’s commitment to the overhaul of corporate governance within the UK. In her campaign for her leadership of the Conservative party (and so to become Prime Minister) Theresa May stated “I want to see changes in the way that big businesses are governed. The people who run big businesses are supposed to be accountable to outsider non-executive directors, who are supposed to ask difficult questions, think about long-term and defend the interest of shareholders. In practice, they are drawn from the same narrow social and professional circles as the executive team.”⁴³⁴ During a key speech in her bid to become the leader of the Conservative party, Theresa May promised a move towards a German-style workers representation on boards, “If I am Prime Minister, we are going to change that system, and we are going to have not just consumers represented on

⁴²⁹ UK Corporate Governance Code 2016, C.3.1

⁴³⁰ *Ibid*, C.3.8

⁴³¹ *Commons select committee; Cooperative Governance inquiry*(2016) . [online] Available at: <https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/news-parliament-2015/corporate-governance-inquiry-launch-16-17/> [Accessed 20 Jan. 2017].

⁴³² Business, energy, industrial strategy. (2016). *The sale and acquisition of BHS inquiry*. [online] Available at: <https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2015/the-sale-and-acquisition-of-bhs-inquiry-15-16/> [Accessed 24 Jan. 2017].

⁴³³ Publications.parliament.uk. (2018). *Employment practices at Sports Direct*. [online] Available at: <https://publications.parliament.uk/pa/cm201617/cmselect/cmbis/219/21902.htm> [Accessed 24 Jan. 2017].

⁴³⁴ May, T. (2016). *We can make Britain a country that works for everyone*. [online] CCHQ Press. Available at: <http://press.conservatives.com/post/147947450370/we-can-make-britain-a-country-that-works-for> [Accessed 24 Jan. 2017].

company boards, but also employees.”⁴³⁵ However, these promises were soon reiterated shortly after securing her position as Prime Minister.⁴³⁶

The launch of the BEIS select committee inquiry in September 2016 was followed with a public consultation on a Green Paper on the reforms of corporate governance in November 2016.⁴³⁷ The Green Paper showed a backtrack on the above-mentioned promises, specifically workers representation on company boards. Whether the backtrack is a recognition of legal pragmatism, such as conflicts that employee’s representative directors would encounter in their duty to the company, specifically to the members as a whole, at the same time having to regard the interest of employees. On the other hand, the backtrack could be in relation to political pragmatism, seeing as the big donors of the Conservative party are largely made up of big businesses.

The Green Paper published by the government signified several changes to the structure of UK corporate governance and sought consultation on several issues including shareholder influence on executive pay, strengthening the voice of customers, employees and wider stakeholders, and the extension of some features of corporate governance to extend to large privately held companies. The Green Paper was designed to stimulate debate on the abovementioned issues and to contribute to the strengthening of the UK corporate governance framework.⁴³⁸ In February 2017, the FRC published its response to the Green Paper and proposed reforms to be carried out on four key areas; executive remuneration, the interest of stakeholders, the accountability of large privately held companies and the effective enforcement of the law.⁴³⁹ The FRC proposed to extend the role and remit of the remuneration committee to cover pay policies throughout the company. The remuneration policy should have a greater link to achieving the company’s strategy and outcomes in the long-term performance of the company.⁴⁴⁰ On the interest of stakeholders, the FRC proposes additional requirements on companies to report more effectively on how directors have discharged their duty under Section 172.⁴⁴¹ In addition, the FRC proposed its willingness to develop and introduce

⁴³⁵ *Ibid.*

⁴³⁶ Asthana, A. and Walker, P. (2016). *Theresa May; “I won’t force companies to appoint workers to their boards.* [online] The guardian. Available at: <https://www.theguardian.com/business/2016/nov/21/theresa-may-force-firms-appoint-workers-boards-cbi> Last Accessed [Accessed 24 Jan. 2017].

⁴³⁷ GOV.UK. (2016). *Government launches review of corporate governance.* [online] Available at: <https://www.gov.uk/government/news/government-launches-review-of-corporate-governance> [Accessed 29 Nov. 2016].

⁴³⁸ *Ibid.*

⁴³⁹ Frc.org.uk. (2018). *FRC response to Green Paper on corporate governance reform.* [online] Available at: <https://www.frc.org.uk/news/february-2017/frc-responds-to-green-paper-on-corporate-governanc> [Accessed 27 Feb. 2017].

⁴⁴⁰ *Ibid.*

⁴⁴¹ *Ibid.*

corporate governance and reporting requirements for large private companies, seeing as these companies carry great importance to the public interest and generally benefit from their limited liability status, they should be held more accountable to stakeholders.⁴⁴² Finally, the FRC proposes the extension of its powers to carry out investigations and prosecutions on all directors for “financial reporting breaches and associated issues of integrity”.⁴⁴³ It is worth noting that the FRC enforcement powers only extend to accountants and actuaries.

The FRC announced its plans for “fundamental review of the UK corporate governance code” considering, amongst other things, the concerns highlighted by the Green Paper.⁴⁴⁴ The report by BEIS select committee on corporate governance was published in April 2017.⁴⁴⁵

The BEIS report noted that whilst it believed that there is no need for an overhaul of corporate governance in the UK, there is scope for major improvements. The main recommendation of the report can be summarised as follows. Firstly, the report recommended the amendment to the corporate governance code to include a requirement on board to report how they have fulfilled the duties to have regard to the interest of the wider group of stakeholders (employees, customers, suppliers etc.) under s.172 of the Companies Act 2006.⁴⁴⁶ Whilst the committee acknowledges the benefit of the “comply or explain” approach embedded in the code and does not advocate further regulations, it believes that enforcement regarding s.172 should be improved. The report states that “directors should be required to report in an accessible, narrative and bespoke form on how they have complied with their duties under section 172. This will force directors to at least actively consider how they meet these requirements during the year and increase the prominence of these other factors throughout the company and also in the minds of shareholders.”⁴⁴⁷ The committee recommends that an overall rating system should be introduced to rate the level of compliance by companies with the code and the results such be made public. The committee recommends that the FRC to be granted additional powers to carry out the recommendation. Secondly, in relation to NEDs, the committee suggest that the NEDs should demonstrate their ability to devote sufficient time to each company if the serve on numerous boards.⁴⁴⁸ Thirdly, the committee advocates the introduction of a voluntary

⁴⁴² *Ibid.*

⁴⁴³ *Ibid.*

⁴⁴⁴ *Ibid.*

⁴⁴⁵ It should be noted that the BEIS does not form part of the government, however, their role is to scrutinize the work of government departments, therefore, unless the government agrees, their recommendation may not be followed.

⁴⁴⁶ Business, energy, industrial strategy committee; (2018). *Corporate governance Report*. P.17 Available at: <https://publications.parliament.uk/pa/cm201617/cmselect/cmbeis/702/702.pdf> Last accessed 6/7/2017.

⁴⁴⁷ *Ibid.*, p.18.

⁴⁴⁸ *Ibid.*, p.66

code of corporate governance for private companies who have more than 2000 employees.⁴⁴⁹ Fourthly, issue of pay, the committee advocates the phasing out of long-term incentive due to the complexity associated with such plan in favour of remunerating CEOs mainly through basic pay. The committee also noted that bonuses should not be used for routine achievements. Furthermore, all origination should publicly information about their CEO and senior executives pay ratio to average employees.⁴⁵⁰ Lastly, on the question of the composition of the board, the committee suggested that although no business case for homogeneous boards, diversity should be pursued in the wider sense encompassing “diversity in gender, ethnicity, social mobility and diversity of perspective.”⁴⁵¹

5.9 Conclusion

This chapter investigated the position of the law on directors’ duties prior to the enactment of the Companies Act 2006. It was noted that directors’ duties were governed mainly by common law rules and equitable principles and to some extent by statutes. The need for reforming the Companies Act and codifying the duties of directors was presented. The UK company act needed to be reformed; directors’ duties were fragmented and there were calls for the full or partial codification of the law. The ‘new’ general duties were also examined.

The chapter then reviewed the development of the UK corporate governance code and it was noted that corporate scandals have historically provoked the enacting of legal instruments that have responded to financial concerns and public outrage, however, while leaving unaddressed many major problems afflicting the business world. Indeed, a market model and a legislative model whose common concern is mainly with compliance and accountability are widely criticised as stifling the performance and efficiency of public companies. This awareness has driven an ever stronger need for the developments in governance over the past decades and as a reaction to them. The UK system has developed over the past 30 years, however, the Saudi system of corporate governance is considered quite novel. One of the aims of this chapter was to show the constant process of development and what would be recommended is that a similar mechanism like to the FRC to be established in Saudi Arabia. The objective of this independent body is to monitor and review the governance regulations in Saudi Arabia, as well as to consult and make amendments on a regular basis. The matters discussed in this chapter will be useful

⁴⁴⁹ *Ibid*, p.36

⁴⁵⁰ *Ibid*, p.49

⁴⁵¹ *Ibid*, p.56.

and will be drawn upon in subsequent chapters where the state of corporate governance laws, codes and regulations in Saudi Arabia will be discussed and compared to the situation in the UK.

Chapter Six
Saudi Company Law and Corporate Governance Legal Framework

6.1 Introduction

On November 2015, the Council of Ministers in the Kingdom of Saudi Arabia approved the new Saudi Companies Law 2015 (CL 2015),⁴⁵² 50 years after the first Companies Law (CL 1965) was enacted.⁴⁵³ Prior to the CL 2015, business organisations in Saudi Arabia were governed by the CL 1965. The CL 1965 was amended numerous times in its 50-year history. Many scholars criticised the law as outdated and no longer served its purpose.⁴⁵⁴ The CL 2015 significantly updates the law that is applicable to all companies in Saudi Arabia.⁴⁵⁵ The CL 2015 has entered into force 150 days after it was published on 4 December 2015 in the Official Gazette (Umm Al Qura).⁴⁵⁶ All current companies will be required to comply with the new CL 2015 within one year from the effective date, i.e., early May 2017. The CL 2015 reflect the evolution of the Saudi economy in the years since 1965 and the necessity for a new framework that is compatible with the current business environment.

Key factors have affected the Saudi economy in recent years and necessitated a more robust legal framework, such as Saudi Arabia's accession to the World Trade Organisation in 2004, and the increase of foreign investment in the Kingdom, the growth of the Saudi Arabian stock market and the development of Sukuk market. Also, the diversification of the Saudi Economy and the shift into new industries outside the hydrocarbon-based economy, and the greater role small and medium-sized business play in the economy, which needed a more efficient regulatory environment to ensure success.

6.2 The need for reform

In spite of the early emergence of commercial and economic activities, following the discovery of oil in 1938, there were no official laws that regulated the affairs of companies until 1965.

⁴⁵² Department, K. (2018). *Ministry of Commerce and Industry*. [online] Mci.gov.sa. Available at: <https://mci.gov.sa/cl2015/Pages/main.aspx> [Accessed 10 Sep. 2017].

⁴⁵³ Mci.gov.sa. (2018). *Companies Law*. [online] Available at: <https://www.mci.gov.sa/en/LawsRegulations/Projects/Pages/LawDetails.aspx?LawId=07140004-6a05-48e3-bb04-a8250094bb85> [Accessed 16 Jan. 2018].

⁴⁵⁴ See Alsubaie, M. (2012). *Corporate crimes committed during the phase of incorporation of companies in Saudi Arabia: a legal analysis*. [online] Research Online. Available at: <https://ro.uow.edu.au/theses/3669/> [Accessed 12 Oct. 2018].

⁴⁵⁵ The Saudi Companies Law 2015 has not been officially translated and is only available in Arabic. The author will translate the relevant articles of the Law to reflect the true meaning of the in Arabic. Additionally, since there are some articles that have not been changed or have been only slightly restructured from the Companies Law 1965 the author may use the official translation of the Companies Law 1965 without changing the substance of the law.

⁴⁵⁶ Um Al-Qura issue No. 4595, available at <http://www.uqn.gov.sa/Archive/Issue4595/News/PDFVersion/UM-ALQURA.4595.pdf>. Last Accessed 23/4/2017.

During that time, commercial activities were governed by Sharia Law, without any official written law or regulations.⁴⁵⁷ The first attempt to govern any commercial activities was a regulation issued by the Commercial Council Law in 1931, also known as Nizam Al Majalis Al Tijari. The Commercial Council Law aimed to organise and regulate all commercial activities in Saudi Arabia.⁴⁵⁸ In the same year, a company registry system was established by The Commercial Counsel Law which required all companies to sign up to the register. The Saudi government, in an effort to support the regulation of companies, established the first Commercial Court Law 1931, which is regarded as the first court in Saudi Arabia.⁴⁵⁹ However, after facing challenges the Commercial Court Law was repealed in 1955.⁴⁶⁰ After 10 years, the Saudi Legislator issued the Companies Law 1965 (CL 1965) which was seen as the primary legislative body governing all aspects of commercial activities.

Over the past decades, Saudi Arabia witnessed a rapid shift in its businesses environment, this was accompanied by social and political changes coupled with the Saudi government's aim to create a more inviting environment for foreign investors. A legislative gap was created due to the insufficiency of the Saudi legal system. This can be attributed to two underlying reasons. Firstly, the novelty of the commercial judicial authorities, secondly, the rapid growth of the business environment in a fairly short time. As previously mentioned, Saudi Arabia joining the World Trade Organisation was an important step in attracting foreign investments.⁴⁶¹ Perhaps the issuance of the new CL 2015 is an indication that the Saudi legal system heading towards "a system with more modern legal institutions and significantly modern legal principles".⁴⁶² The issuance of the CL 2015 could prove that.

6.3 Saudi companies law 2015

The new CL 2015 came into effect on May 2016, the fact that the CL 1965 had not changed for over fifty years, it is evident that it was out of date. In spite of the lengthen process that resulted in the issuance of the new companies law, the efforts of the Saudi legislator cannot be

⁴⁵⁷ Hamdallah, M.(2005) *The Saudi Commercial Law*. Al-Khawarism, Jeddah, 2005. Arabic edition. p. 25

⁴⁵⁸ *Ibid.* p.26

⁴⁵⁹ *Ibid.*

⁴⁶⁰ *Ibid.*

⁴⁶¹ The General Council of the World Trade Organisation successfully adopted Saudi Arabia's terms of accession on the 11th of November 2005.

⁴⁶² H Esmaili, (2009) , On A Slow boat towards the rule of law: The nature of law in the Saudi Arabian legal System. *Arizona Journal of International & Comparative Law*, p.48.

overlooked as the CL 2015 has updated several provisions. The CL 1965 used to refer to the Ministry of Commerce and Industry as the main authority in dealing with listed companies rather than the CMA, thus causing a clash between the two authorities. This caused great confusion, especially since the enactment of the Capital Market Law 2003, which refers to the CMA as the only authority responsible for regulating the capital market.⁴⁶³ Significantly, the CL 2015 solves this issue whereby it refers to the responsibilities of the Ministry and the responsibility of the CMA in a specific article. Part 12 of the CL 2015 addresses the issues of jurisdiction between the Ministry of Commerce and Industry and other relevant agencies or authorities. The CL 2015 states that “without prejudice to the provisions of the law and the powers of the Saudi Monetary Agency set forth in related laws, particularly the Banking Control Law, Cooperative Insurance Companies Control Law and Finance Companies Control law, the (CMA) will have the powers to supervise and control the joint stock companies listed on the CMA and issue rules regulating their operation, including the regulation of Merger transactions of any of the parties is a company listed on the Capital Market”.⁴⁶⁴ Article 219 of the Saudi CL 2015 assigns supervision of listed companies to the CMA. This amendment bridges the legislative gap in the jurisdiction that was previously noticed and was addressed in a memorandum between the Ministry of Commerce and Industry and the Capital Market Authority.⁴⁶⁵ This section will highlight key provisions regarding JSC under the CL 2015.

6.3.1 The main provisions of CL 2015

6.3.1.1 Authorities of the board of directors

The CL 2015 has given the board of directors of a joint stock company broad authority to administer and manage a JSC’s operation. The CL 2015 states that the board of directors shall enjoy full powers in the management of the company for achieving its purpose unless explicitly excluded in the CL 2015 or the articles of association.⁴⁶⁶ Additionally, the JSC is bound by all the acts performed by the board of directors within the limits of its competence unless the concerned person has mal fides or knows that such actions were beyond the competence of the board.⁴⁶⁷

⁴⁶³ Capital Market Law 2003, Article 3.

⁴⁶⁴ *Ibid*, article 219.

⁴⁶⁵ Almulhim, M.H. (2016). A Critique of Saudi M&A Laws. *SJD Dissertations*, 2, P.188. Available at <http://elibrary.law.psu.edu/sjd/2>. Last accessed 23/1/2017.

⁴⁶⁶ CL 2015, at article 75.

⁴⁶⁷ *Ibid*, Article 77.

6.3.1.2 Remuneration of Directors

The CL 2015 placed more restrictions on the salary and compensation of the members of the board of directors than previously did in the CL 1965.⁴⁶⁸ Both laws placed a limitation of the annual remuneration of directors; specifically, if the remuneration represents a certain percentage of the company's profits, both laws state that the compensation must not exceed 10% of the net profits.⁴⁶⁹ Furthermore, the CL 2015 places a further restriction on the remuneration received by members of the board of directors, stating that in all cases the total remuneration, whether in cash or in kind, shall not exceed SAR 500,000 per annum (equivalent to \$133,333).⁴⁷⁰

6.3.1.3 Shareholder investigations

The CL 2015 permits shareholders who represent at least 5% of the capital to have the right to ask the Capital Market Authority (CMA) to order the inspection over the company if they found anything suspicious concerning the acts of the members of the Board of Directors or the auditors in the affairs of the company. The CMA has the right to order an inspection over the management of the company on the expense of the complainants, after hearing the statements of the members of the Board of Directors and auditor in a special session. If the complaint proved to be true, the referred CMA may order as it deems of a bundle temporary measures, and call for the General Assembly to take the necessary decisions. The CMA has the power to dismiss the members of the Board of Directors and the external auditor and appoint an interim manager.⁴⁷¹

6.3.1.4 Accounts and Reports

The Board of Directors must prepare the company's balance sheet, profit and loss account and a report on the activities of the company and its financial position for the last fiscal year. The CL 2015 requires the report to include the proposed method for the distribution of the net profits.⁴⁷² The chairman, CEO and financial manager are now required to sign the financial statements and the report on the financial position and operations.⁴⁷³ The board chairman must

⁴⁶⁸ *Ibid*, Articles 76 (1) (2).

⁴⁶⁹ *Ibid*, Article 76.

⁴⁷⁰ *Ibid*, Article 76 (3).

⁴⁷¹ *Ibid*, at Article 100.

⁴⁷² *Ibid*, at Article 126(2).

⁴⁷³ *Ibid*, at Article 126(3).

provide the shareholders with the company's financial statements, board's report, auditor's report, unless these documents are published in a daily newspaper distributed in the area where the head office is located; and must send copies of such documents to the MoCI and the CMA, if the company is listed in the stock market at least fifteen days, instead of 25 days under the CL 1965, before the date of the ordinary general assembly.⁴⁷⁴

6.3.1.5 Auditor

The CL 2015 restricts a JSC from reappointing the same external auditor for more than five years consecutively. An auditor that has been appointed by the JSC for five years may only get appointed again after two years of the expiration of his five-year period.⁴⁷⁵

6.4 Companies Law 2015 and Corporate Governance mechanisms

For the first time, the CL 2015 contained several articles that directly deal with the context of corporate governance. Perhaps one of the most significant introductions to the CL 2015 was the clear determining of the responsibilities and the jurisdiction of the MoCI and the CMA. However, this was not the only change. The CL 2015 saw the introduction of the audit committee in company law. The CL 1965 did not contain any stipulation in relation to the audit committee. However, the CL 2015 devoted a whole chapter to dealing with this central committee and its importance within the context of corporate governance.

In Article 101, the CL 2015 provides that the formation of the audit committee must be made by a resolution issued by the ordinary general assembly. The audit committee must be formed from the non-executive directors, whether the shareholder or others, provided that the number of its member is not less than three and not exceed five.⁴⁷⁶ The ordinary general assembly is responsible for the setting out the duties of the audit committee and regulations of its work as well as the remuneration of its directors. The audit committee's meeting will be only valid upon the attendance of majority members. Furthermore, Article 102 provides that the resolutions can be issued by the attendees' majority votes. However, in the case of a tie, the chairman will have the casting vote.⁴⁷⁷

⁴⁷⁴ *Ibid*, at Article 126(4)

⁴⁷⁵ *Ibid*, at Article 126 (1).

⁴⁷⁶ CL 2015, Article 101.

⁴⁷⁷ *Ibid*, Article 102.

The CL 2015 provides the audit committee with a with the power to monitor the company's works, review the company's registers and statements and ask for any clarification or statement from the board of directors or executive management. Moreover, the CL 2015 gives the audit committee the power ask the board of directors to call for the general assembly meeting, if the board of directors obstructs its work or the company is exposed to severe damage or loss.⁴⁷⁸ Lastly, the auditing committee must review the company's financial statements, reports and notes that were submitted by the auditor; opine thereon and prepare a report about its opinion as to the adequacy of the internal control system in the company and any other works included in the scope of its competence. The board of directors shall lodge sufficient copies of such report in the head office of the company at least ten days before the date of the general assembly meeting and provide any shareholder, who desires so, with a copy. the report shall be recited during the general assembly meeting.⁴⁷⁹

Secondly, Article 95 introduced cumulative voting as a mandatory requirement under the new CL 2015 when electing the members to the board of directors, whereby ever share shall not be counted more than once.⁴⁸⁰ This is a significant addition to the CL 2015 which aimed at providing minority shareholders with the increased opportunity to elect their representatives to the board.⁴⁸¹ Thirdly, the CL 2015 states that a director may not simultaneously occupy the post of chairman and any other executive post.⁴⁸² Under the CL 1965, the chairman was permitted to combine his position with any other executive position. Fourthly, the CL 2015 has significantly increased the penalties for violations of the Companies Law. Under the CL 1965, the penalties were considered weak as the maximum fine was SAR 20,000 and the maximum prison sentence was only one year.⁴⁸³ However, the CL 2015 specify the types of violations that warrant criminal sanctions and sets out clearly defined penalties. Under the CL 2015, violations of the CL 2015 could result in a fine of SAR 5 million as well as jail sentence for up to five years.⁴⁸⁴ It is evident that the reforms brought in the CL 2015 had a significant impact in the context of corporate governance. The CL 2015 has provided a more appropriate legal framework for corporate governance to thrive and will contribute to a more fair and effective corporate governance principles.

⁴⁷⁸ *Ibid*, Article103.

⁴⁷⁹ *Ibid*, Article 104.

⁴⁸⁰ *Ibid*, Article 95.

⁴⁸¹ Y Wenjia, (2015). Cumulative Voting: In the Us (Declining), in China (Rising) and the EU (Not Adopted). *European Company and Financial Law Review* 79, p. 95

⁴⁸² CL 2015, Article 81.

⁴⁸³ CL 1965, Articles 229-231.

⁴⁸⁴ CL 2015, Articles 211-213

6.5 Sharia law and Directors' Duties

Since the founding of the Saudi state, Sharia law has been widely recognised as the foundation of the state. As previously stated in Chapter 3, in 1992 the Saudi government officially introduced the Basic Law of Governance which explicitly stated that the Quran and the Sunnah (the teaching and actions of Prophet Mohammed PBUH) is the only constitution of Saudi Arabia. Several authors have highlighted the role of Sharia law in the duties of directors in order to develop Islamic corporate governance. These duties must be tested against Sharia law and those that are consistent will be accepted and those that are not should be rejected.⁴⁸⁵

Contractual liability in the context of Sharia can be divided into two parts depending on the type of legal transaction. The first type is in relation to what is known as Dhaman contracts and the second type of contract is known as Amanah contracts. Dhaman contracts referred to a contract of guarantee where the guarantor underwrites any obligation or claim that should be fulfilled by the owner of the asset and held accountable under any circumstances. Contracts of sale and loans are examples of this type of contract. The second type of contract is Amanah contracts whereby the recipient of money or a commodity is considered a trustee, examples include agencies and all forms of companies.⁴⁸⁶

Sharia law requires that any person who is recognized as a trustee must avoid any conflicts of interest and insider dealing which considered as fundamental elements in the fiduciary duty of loyalty.⁴⁸⁷ From Sharia perspective, a trustee is personally held liable in cases of negligence or aggression. The concept of negligence is recognised as the absence of care in the maintenance and the protection of commodities or money that have been placed in the care of a trustee. Additionally, the term 'negligence' also includes a breach of duties by the trustee. In relation the level of care expected from a trustee, Islamic scholars have clarified this position by stating that as the adequate level of diligence that experts consider is acceptable under normal circumstance.⁴⁸⁸

⁴⁸⁵ Baydoun, N and Willett, R. (1997). Islam and Accounting: Ethical Issues in the Presentation of Financial Information. *Accounting, Commerce and Finance: The Islamic Perspective*. 1(1), p.1, also see Lewis, M. (2001). Islam and accounting. *Blackwell Publishers Ltd*, 25(2), p.103

⁴⁸⁶ Wahbah, Z. (1967). *Islamic Jurisprudence in its new style*, Dar Alkitab, Damascus, p.580

⁴⁸⁷ Beveridge, N (1991). The Corporate Directors Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction, *DePaul Law Review*, 41, p.688.

⁴⁸⁸ Siraj, M, (1993). *liability of aggression in Islamic jurisprudence compare to tort liability in Law*, Dar Alddirasat Aljame'iah, Beirut, pp.251-257

In relation to aggression, Islamic scholars pointed out that acts that directly or indirectly cause damage to the money or the commodities constitute aggression. In addition, acting beyond powers would be included in the meaning of aggression in Sharia.⁴⁸⁹ The pretence of being skill or competent when one is not can fall within the meaning of aggression and the person will be held liable for the damage caused their actions.⁴⁹⁰

This section will aim to identify the duties of directors from Sharia perspective. However, in order to achieve this aim, it is crucial to gain an understanding of the position of the director in the context of Sharia. In Islamic literature, there are several types of companies that can exist within the context of Sharia. The first type is referred to as Mudharabah, which is an arrangement where a single investor or a group of investors entrust an entrepreneur, known as Mudharib, with capital. This capital is then used to commence trading and then gives the investor their principle investment together with a pre-agreed percentage of the profits and the remaining percentage is kept by the Mudharib as compensation for his time and effort. However, If the business fails, the investor bears all the capital loss and the Mudharib losses would be limited to his time and effort.⁴⁹¹ This was unanimously approved by Muslim Scholars which stated that the profits are ought to be shared in the agreed upon percentage and the losses are shared in the same amount as invested capital.⁴⁹² In the context of companies, the board of directors are recognised as Mudharib and the Shareholders are recognised as the capital owners.⁴⁹³ Sharia scholars assume that the director (Mudharib) is an agent and therefore, must act in a certain manner and within the agreement between him and the shareholders.⁴⁹⁴

Normal agents must work in an instructed manner whilst a Mudharib has greater powers. A Mudharib should not undertake any harmful action to the people who trust him and must work in their best interest and within his powers. However, Mudharib will not be held accountable for the losses unless it was due to his negligence or aggression whereby he will be accountable for the damage.⁴⁹⁵

⁴⁸⁹ Wahbah, Z. , *Islamic Jurisprudence in its new style*, Dar Alkitab, Damascus, 1967, p.488.

⁴⁹⁰ Ibn Al-Qayyim, J , *Alteb Alnabawy*, Dar Ehyaa Alkutob, Egypt, 1957, p.105

⁴⁹¹ Abdul Rahim, A. (1998), "Issues in corporate accountability and governance: an Islamic perspective", *American Journal of Islamic Social Sciences*, 15(1), p.55.

⁴⁹² Ibn Qudamah. A.(1989), *Almugni*, Dar Hajar, Egypt, , p.145.

⁴⁹³ Alkhafif, A. (1978) *Companies in Islamic jurisprudence*, Dar Alnahdhah Alarabiyyah, Egypt, p.62.

⁴⁹⁴ *ibid*

⁴⁹⁵ Ad-Desouki, M. (1978). *Hashiyat ad-Desouki*. Beirut: Dar Alfekir, p.378.

6.5.1 General Duties under Sharia law

This section will discuss the recognised duties of directors from a Sharia perspective. Whilst some authors have advocated that from a Sharia preceptive directors' duties are based on the principles of accountability, transparency and trustworthiness. It was argued that this does not provide the full view of Sharia. Whilst the principles mention only considered the prescriptive duties, which requires actions by the director, it ignores the proscriptive duties, which requires restraint on the part of a director.⁴⁹⁶ For instance, the duty to promote the success of the company is balanced with not accepting any benefits from third parties.

6.5.2 Duty to act in Good Faith

From a Sharia viewpoint, the duty to act in good faith has been recognised through the concept of stewardship. This is view is demonstrated by a Hadith from the Prophet Muhammed PBUH, when he stated “ All of you are guardians and are responsible for your wards and things under your care”⁴⁹⁷ As guardians, the directors are responsible to act in the best interest of the company to achieve its success. The promotion of the success of the company is not considered to be limited to the realisation of profit for the shareholder but must also take into account the interest of all stakeholders. Furthermore, the profit must be achieved in compliance with Sharia. In other words, equitable distribution of wealth to all stakeholders in the form of Zakat (alms giving), the prohibition in dealing with interest (usury), fraud and insider dealing.⁴⁹⁸ Honesty and fair dealing are considered as a fundamental business rule in Islam, therefore, an owner of a business or director of a business must act in a highly ethical manner and must not deceive or exploit others. Moreover, listed companies are considered as Mudharabah within the Sharia context and the board of directors are viewed as Mudharib that have been trusted by the capital owners (shareholders) to run the company. The Mudharib is required to produce good financial returns by investing the capital in a diligent manner that avoids unusual risks that will ensure the long-term success of the company. Islamic scholars have stated that a Mudharib is considered to be a trustee and must not take any unusual risk otherwise he will be held personally liable towards the aggrieved party.⁴⁹⁹

⁴⁹⁶Malekian, E. and Daryaei, A. A. (2010). “Islamic Values Forward into Better Corporate Governance Systems.” Available at <http://www.globalresearch.com.my/proceeding/icber201> Last accessed 22/5/2018.

⁴⁹⁷ al-Almany, M. (2009). *Sahih Bukhari*. 1st ed. Riyadh: Darussalam, p.209.

⁴⁹⁸ Abu-Tapanjeh, A (2009) Corporate governance from the Islamic perspective: A comparative analysis with OECD principles. *Critical Perspectives on accounting*, 20(5), p.556.

⁴⁹⁹ Ibn Qudāmah, M., Fāris, M. and Sa’danī, M. (1994). *al-Kafi fi fiqh al-Imam Ahmad ibn Hanbal*. Beirut: al-Maktab al-Islami / Dar Ibn Hazm, p.350.

6.5.3 Duty of Care

Islam has emphasised the importance of acting with efficient care over 1400 years ago. Islamic texts have recognised the duty of exercising reasonable care, skills and diligence. This was demonstrated in a Hadith of the Prophet Muhammed PBUH where he stated “If any of you undertakes to do any work, God loves to see it, do it well and with efficiency.”⁵⁰⁰ From a Sharia viewpoint, if a Mudharib does not exercise reasonable care and diligence he will be liable for any damages created his actions.⁵⁰¹

6.5.4 Duty to act within powers

Islamic scholar takes the view that a Mudharib is limited to the powers stipulated in the agreement between him and the shareholders. Any action that deviates from the agreement is deemed as aggression. Therefore, acting beyond the powers is prohibited under Sharia law and a director will be held liable for the damages suffered by his actions.⁵⁰²

6.5.5 Duty to avoid conflicts of interest

A director of a company is forbidden from placing themselves in situations where he has or can have, direct interest from any transaction that made for the company unless authorised by the shareholders. According to Sharia law, private interest is subordinate to the public interest. Therefore, if a director is faced with a situation where his personal interest conflict with the interest of the company, the interest of the company must always prevail, otherwise he will be in breach of his duty.⁵⁰³

6.5.6 Duty not to accept profits from third parties

The principles of Sharia law prohibits directors from receiving any unauthorised benefits from others under any circumstances. This is illustrated by a Hadith from the Prophet Muhammed PBUH when he appointed a man with the task of collecting zakat and in the

⁵⁰⁰ Al-Mosuli, A. (2018). *Musnad Abu Ya'la al-Mosuli*. Lebanon: Dar al-Kotob al-Ilmiya, p.349.

⁵⁰¹ Ibn Qudāmah, M., Fāris, M. and Sa'danī, M. (1994). *al-Kafi fi fiqh al-Imam Ahmad ibn Hanbal*. Beirut: al-Maktab al-Islami / Dar Ibn Hazm, p.357.

⁵⁰² Ibid, p.359.

⁵⁰³ Al-Shatibi, I. (2012). *The reconciliation of the fundamentals of Islamic law*. Reading: Garnet Publishing, p.88.

process of collection, the man accepted a present from a third party. The prophet said “Why hadn't he stayed in his father's or mother's house to see whether he would be given presents or not?” This Hadith reveals that an employee, including company directors, must not accept any benefit from third parties under any circumstance.

6.6 Fiduciary duties of Director in Saudi Company law

The governing laws of most companies provide that the company shall be managed by the board of directors. It has been recognised by the courts that the relationship between the director and the company is a fiduciary duty. Moreover, the duty of loyalty and care has been recognised in numerous cases as the core fiduciary duties.⁵⁰⁴ In spite of this wide recognition of those duties, the Saudi companies Law 2015 has no specific mention of the fiduciary duties of directors. It was argued by Al Rimawi that the concept of fiduciary duty is generally underdeveloped in the Middle East.⁵⁰⁵ The Saudi legislator has failed to clearly define the duty of care in the CL 2015 which makes it difficult to hold directors accountable for their breach under Saudi law. It may be assumed that despite the lack of specific mention of the duty of care and loyalty in the Saudi Company law, Saudi law does recognise the concept directors fiduciary duties. As previously mentioned in Chapter three, Sharia law is the constitution of Saudi Arabia, therefore, the role of Sharia is to reject inconsistencies with their principles and develop ways to deal with specific issues where there is no legal precedent.⁵⁰⁶ Therefore, even if the CL 2015 fails to clearly mention these duties, they have been addressed under Sharia law. This was demonstrated in the case of the chairman of ABDAR company where he was sued on the grounds of negligence when the chairman failed to arrange the required loan of \$13 million which caused huge losses to the company. The Commercial court at the Board of Grievances ruled that the chairman was negligent and was liable to the company for the damages by breaching his duty of care.⁵⁰⁷ In relation to the duty of loyalty, which is defined as the avoidance of conflicts of interests,⁵⁰⁸ the CL 2015 prohibits conflicts of interest,⁵⁰⁹ however, it is

⁵⁰⁴ Cieri,R et al,(1994), "The fiduciary duties of directors of financially troubled companies" *Journal of Bankruptcy Law and Practice* 3.4, p.405.

⁵⁰⁵ Al Rimawi,L, (1999), “Emerging Markets of the Middle East: A Critique of Selected Issues in Arab Securities Regulation”, *Journal of Financial Regulation and Compliance*, 7 (2),p. 160.

⁵⁰⁶ Al-Jeber,M, (2000), *The Saudi Commercial Law*, King Fahad National Library, Riyadh, pp.6.

⁵⁰⁷ The Board of Grievances the Commercial court, Judgment Number. 10421/1 in 2011.

⁵⁰⁸ Beveridge,N. (1999), *The Corporate Directors’ Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction*, *DePaul Law Review*, 41, p.688.

⁵⁰⁹ CL 2015, Article 71,72 and 74.

recommended that for the sake of clarity and certainty, the concept of fiduciary duties should be clearly specified in the CL 2015, instead of being scattered in principles and regulations.

6.7 General duties

6.7.1 Conflicts of interest

The duty regarding conflicts of interest is addressed in article 71 of the CL 2015 and states that member of the board of directors of JSC “should not have any interest whether directly or indirectly, in the transactions or contracts made for the account of the company, except with an authorization from the Ordinary General Assembly, to be renewed annually”.⁵¹⁰ The Saudi Companies Law 2015 amended the provision of conflicts of interest set out in the 1965 CL and added the requirement that the interested member shall not participate in voting on the resolution to be adopted on.⁵¹¹ The member must inform the board of directors of any interest he may have in the transactions or contracts made for the account of the company and the declaration must be recorded in the minutes of the meeting. If the member of the board of directors fails to disclose his or her interest, the company or any related party may recourse to the court to invalidate the contract or oblige a member of the board to pay compensation for any lost profit or interest gained from the director’s undisclosed interest.⁵¹²

Whilst the CL 2015 amended the provision regarding conflicts of interest some may argue that there is still more room for development. For instance, the word ‘interest’ is not clearly defined in the Saudi Companies Law 2015. The Law does not state that the only kind of interest is a financial interest and the Saudi Companies Law 2015 does not specify the kind of interest that falls under this provision. This may not be considered a point of contention in the United Kingdom; however, this is a significant point for Saudi companies for reasons unique to the region and specifically to Saudi Arabia. Saudi Arabia contains many tribes and that creates an environment of social networks which are interwoven and extremely complicated. The broad language and the lack of a clear definition of the term “‘interest” could open the door for disputes brought to the courts for reasons that are not purely financial but more social and political.

⁵¹⁰ CL 2015, Art. 71

⁵¹¹ CL 2015, art 71 (1).

⁵¹² *Ibid*, at art 71 (2).

6.7.2 Non-competition

Article 72 of the CL 2015 provides that a director of JSC must not, without authorisation renewed annually from the ordinary general assembly, participate in any commercial activity that is in competition with that of the company.⁵¹³ If a director breaches the duty set out in Article 72, the company has the right to seek damages under Article 78(1) of the CL 2015. However, the issue of a director competing with the company for third-party accounts has not been addressed in Article 72.

6.7.3 Errors of Judgment

Article 78(1) of the Saudi Companies law states that members of the board of directors of JSC will be held responsible for damages sustained by the company, the shareholders or third parties due to their maladministration of the affairs of the company or if they violate the provisions of the Companies law or the company's articles of association. Directors will be liable if a wrongful act arises from a resolution issued and adopted by them.⁵¹⁴ Article 78(1) of the Saudi Companies Law 2015 does not define what constitutes 'maladministration'.

The broadness of the language used in Articles 78 and may prompt management liability for even minor mistakes thus making directors and managers overly cautious and may discourage them from pursuing business opportunities or avoid certain transactions with even moderate risk of fear of falling foul of such provisions.

6.7.4 Act within the scope of powers.

Whilst the board of directors of a JSC enjoy full powers in the management of the company to achieve its purposes under Article 75, the board directors will be held liable for 'wrongful acts' that arise from a resolution issued by them. It may be inferred that 'wrongful acts' in this context may in some circumstances also include: not acting honestly, abusing his or her powers, not exercising reasonable skill and care in performing their duties and not acting in the best interest of the company. This Article should have been included more provision that state what constitute wrongful acts.

⁵¹³ *Ibid*, Article 72.

⁵¹⁴ *Ibid*, at Article 78(1).

6.7.5 Management Liability under Companies Law 2015

The managements' liability is regulated in CL 2015 and can found in Article 78(1) the provisions state that any person(s) involved in the management of a company will be held personally and jointly liable to the company, the shareholders and third parties for the violation of their duties under the Companies Law, breaches of the company's articles of association and errors of management. Liability for acts of fraud and forgery are expressly mentioned in the wording of Articles 78(3). In the case of JSC directors, the Liability for fraudulent acts is based on a majority decision by the board. As for majority decisions, dissenting members of the board cannot be held liable, provided that their objection is recorded in the minutes of the meeting.⁵¹⁵ A director who was absent from the meeting at which a resolution was adopted will not be released from liability unless he can prove that he was not aware of the resolution or unable to object to the decision after becoming aware of it.⁵¹⁶ The liability claim against a director or a is limited to five years from the end of the fiscal year after the harmful act occurs.⁵¹⁷

6.7.6 Fraudulent Acts

The directors of a JSC and the managers of an LLC are liable for damages or loss caused by their fraudulent actions.⁵¹⁸ However, 'fraud' is not defined by in the law. One of the various definitions of fraud under Islamic law is "where there is a matter that is concealed by one party, where it (this concealment) can raise a sense of inequality as well as tyranny to another party"⁵¹⁹ it remains uncertain whether the Saudi courts will apply such a definition in assessing in the liability of company directors.

6.7.6 Infringement of the Company's Articles of Association

Articles 78(1) state that violations of the company's articles of association will render a director liable for damages sustained by the company, the shareholders and third parties. The articles

⁵¹⁵ *Ibid* , Article 78(1).

⁵¹⁶ *Ibid* , at Article 78(2)

⁵¹⁷ *Ibid* , Article 78(3).

⁵¹⁸ *Ibid* , at Articles 78(1), 78(3), 164(4) and 165(4).

⁵¹⁹ Alam, N., Gupta, L. and Shanmugam, B. (2018). *Islamic Finance*. Cham: Palgrave Macmillan US, p.88.

of an association may not relieve any director from any duty imposed in the provisions of the CL 2015. However, they may introduce additional duties to a director.

6.8 New Corporate Governance Regulations 2017

This section will discuss the newly issued Saudi corporate governance Regulation and examine the extent to which the Saudi corporate governance Regulation has been developed. Accordingly, the section will be separated into several sections. The first section will provide a general overview of the motives and the timing for the issuance of the new Corporate governance regulation (CGR 2017). The second section will then examine the key definition provided in the CGR 2017. Thirdly, the key provisions governing the rights of the shareholders, the board of directors, composition of the board, board's sub-committees and the relationship between the board and the stakeholder will be discussed.

6.8.1 Overview

In 2006, the Capital Market Authority (CMA) issued its first corporate governance regulations in Saudi Arabia, which then included 19 articles distributed on five parts. At that time, corporate governance concepts and principles were new to the Saudi capital market. The concept of corporate governance itself was strange to the Saudi economy.⁵²⁰ For these reasons, the governance regulation was mostly indicative. The first article stated at the time that corporate regulation is indicative unless the text includes some of the mandatory provisions contained therein.⁵²¹ However, the new CGR 2017 imposes itself as a mandatory regulation consisting of 12 parts and 98 articles in addition to a model of the remuneration schedule for board members.

6.8.2 Timing and underlying objectives of the CGR 2017

The underlying objectives of the new CGR 2017 are driven by the desire of the Ministry of Commerce and Industry (MoCI) and the CMA to renew, highlight, and prioritise the importance of corporate governance in listed companies in a practical manner. Indeed, the

⁵²⁰ Hussainey, K. and Al-Nodel, A. (2008). Corporate governance online reporting by Saudi listed companies. *Research in Accounting in Emerging Economies*, 8, p.37.

⁵²¹ Saudi Corporate Governance Regulation Issued by the Board of the Capital Market Authority Pursuant to Resolution Number (8-16-2017) Dated 16/5/1438H Corresponding to 13/2/2017G CGR 2006, Article 1.

benefits achieved by high-quality corporate governance are not only limited to companies, but they also exceed them and extend to benefiting the economy directly due to the role played by sustainability and growth of companies in boosting the economy and increasing the Gross Domestic Product (GDP).⁵²²

In April 2017, the CMA replaced the 2006 Saudi Corporate Governance Code with newly-approved CGR 2017, for companies listed on the Saudi Stock Exchange (Tadawul). These updated regulations came as a welcome step as it provided shareholders and board members with enhanced rights, giving a sense of clarity and transparency to their actions, and defining their respective roles and responsibilities.

The publication of the CGR 2017 at this particular time is part of the effort by the CMA to harmonise its own rules with Companies Law 2015 (CL 2015). Recently, Saudi Arabia has concentrated its efforts on attracting additional foreign investment by opening Tadawul to direct foreign investors for the first time. This required enhancing the regulatory oversight of listed companies on Tadawul, and reworking its standards so they are in line with those of leading global exchanges.⁵²³

The timing of the publication of CGR 2017 is of critical importance given that Saudi Arabia is at the midst of implementing Vision 2030. Vision 2030 is a royally-decreed initiative that aims to create a more diversified economy in Saudi Arabia and the reduction on the dependency on oil.⁵²⁴ This would be achieved by restructuring state-owned enterprises and creating several stable programmes designed to reduce unemployment, promoting foreign investment and increasing the participation of the corporate sector in Saudi Arabia.⁵²⁵

The MoCI and the CMA conducted a comprehensive review of regulations for the work of listed companies in light of the provisions of the CL 2015. The updated corporate governance regulations in light of provisions of relevant Saudi regulations and the best international practices in this field. To this end, they reviewed several regulatory rules in both Arab and international experiences, including governance principles set by OECD, Basel Committee on Banking Supervision (BCBS), the International Governance Network (ICGN), the

⁵²²Alotaibi, M. (2015). The Importance of Corporate Governance In Saudi Arabia economy. *Journal of WEI Business and Economics*, [online] 4(1), p.23. Available at: <http://westeastinstitute.com/journals/wp-content/uploads/2015/05/2.Alotaibi-Mohamed-Meteb.pdf> [Accessed 9 Oct. 2018].

⁵²³Huber, H. (2015). KSA Market Opening to Foreign Investor. *Riyad Capital*, [online] pp.1-2. Available at: http://www.riyadcapital.com/en/Images/KSA%20Market%20Opening%20to%20Foreign%20Investors%20-%20Eng%20-%20F_tcm10-6094.pdf [Accessed 10 Nov. 2017].

⁵²⁵ *Ibid.*

International Financial Institute (IIF) and the UK Corporate Governance Code as well as corporate governance rules applied in the GCC countries.⁵²⁶ Additionally, the MoCI and the CMA did benefit from the main principles of corporate governance in Saudi banks, which are all listed companies and the regulation of governance in insurance companies, which are also listed companies issued by Saudi Arabian Monetary Authority.⁵²⁷ This regulation has been also concerned, in particular, with rights of shareholders in listed companies, such as their rights to fair treatment without discrimination, access to information that enables them to exercise their full legal rights and rights of other stakeholders in these companies. All these rights were ensured and confirmed by the CL 2015.⁵²⁸ The regulations came to put these rights within a comprehensive governance framework to protect them from any breach or infringement and place legal safeguards that establish the stability of Saudi stock market and achieve fairness integrity and transparency in transactions of all companies.

The main objectives of the 2017 CG regulations can be summarised as follows; a) improving the role of the company's shareholders and enabling the exercise of their rights; b) clarifying the roles and responsibilities of the board of directors, the committees and executive management, and the company's decision-making mechanisms; c) achieving greater transparency, impartiality, openness and competitiveness on the market and in the business environment in general; d) dealing with, avoiding, and disclosing conflicts of interest; e) enhancing accountability and internal control mechanisms for company employees; f) protecting the rights of stakeholders; g) supervising corporate action; and h) raising the professional standards of listed companies.⁵²⁹ The next section will highlight the key definitions of the new Corporate Governance Regulations

6.9.Key Definitions

6.9.1 Non-executive and independent directors

The biggest obstacles that faced implementing the concepts of corporate governance in Saudi Arabia is the types of membership in the board, as the board consists of independent, executive and non-executive members. The companies faced a problem in applying the previous regulation for lack of clarity in details. The member could have been independent and non-

⁵²⁶ *Ibid.*

⁵²⁷ *Ibid.*

⁵²⁸ CL 2015, Articles 87, 80 and 90

⁵²⁹ CGR 2017, Article 3.

executive at the same time, however, the new regulation provided more explanation of the meaning of independence and the meaning of the non-executive member

The CGR 2017 defines an independent director as “a non-executive member of the Board who enjoys complete independence in his/her position and decisions and none of the independence affecting issues stipulated in Article 20 of these Regulations apply to him/her.”⁵³⁰ Additionally, A non-extensive director has been defined as “a member of the Board who is not a full-time member of the management team of the Company and does not participate in its daily activities”⁵³¹

6.9.2 Related parties

In comparison to CGR 2006, the new regulations provide an elaborate list of persons that are considered ‘related parties’. The following list is intended to identify and avoid any situation that may raise conflicts of interest. According to the CGR 2017, the following persons are considered ‘related parties’:

- a) Substantial shareholders of the company
- b) Board members, their affiliates and their relatives
- c) Senior executives, their affiliates and relatives
- d) Board members and senior executives with a substantial shareholding of the company
- e) Entities, other than companies, that are owned by board members, senior members, or their relatives
- f) Companies in which board members, senior executives, or any of their relatives, are a partner or founder
- g) Companies in which any board members, or their relatives, are a member of the board of directors or are one of its senior executives
- h) Listed companies in which members of the board, members of the senior management team, or any of their relatives, own 5% or more
- i) Companies which are under the influence of any board members, senior members, or any of their relatives, even if this is limited to these persons giving advice or guidance
- j) Any persons whose advice and guidance is influential on the decision of the company, its board and the senior executives
- k) Holding companies or their subsidiaries

⁵³⁰ CGR 2017, Article 1.

⁵³¹ *Ibid.*

This list of what can be considered to be ‘related parties’ gives an early indication of the approach and the attention to detail that the CMA has taken while drafting the new provisions, and stands in stark contrast to the vague language used in the CGR 2006.

6.9.3 Relatives

Unlike the previous CG regulations, where the definition of relatives extended to the first degree, the new regulations broaden the definition of relatives up to the fourth degree taken into account the cultural and social environment in Saudi Arabia. This is considered as a key definition as the Saudi Arabian culture takes the family as the basis for loyalty, in contrast to western countries such as the US and the UK is macro-level founded on social ideas.⁵³²

6.10 Key provisions in the CGR 2017

6.10.1 Shareholder rights

The CGR 2017 give attention to shareholders, as they are the first to be affected when there is any manipulation or negligence in the company’s management because they may lose their investment. Through the General Assembly, shareholders can vote and influence the company’s decisions. They may also bring sole or collective liability claims for board members according to the conditions stipulated in the Companies Law.⁵³³ When shareholders are active in communicating with the company and engaging with it in talks on strategic objectives and other topics, this reinforces the board’s role in noting that there are those who monitor and follow it up. The new CGR 2017 provides fundamental rights to shareholders by stating that they must be treated fairly and equally by the company and that the board of directors is obliged to seek to protect shareholders’ right.⁵³⁴ The CGR 2017 also ensures that shareholders are not discriminated against by members of the board or the executive management and are granted access to all and any of their rights. However, the CGR 2017 does not amend the procedure of electing board members and maintains the use of cumulative voting when electing members of the board whereby it is not permitted to use the voting right of single share more than once thus enabling minority shareholder to get their representatives on the board.⁵³⁵

⁵³² Hickson, D. and Pugh, D. (1995). *Management worldwide*. London: Penguin, p.194.

⁵³³ CL 2015, Article 80.

⁵³⁴ CGR 2017, Article 4.

⁵³⁵ *Ibid*, Article 8(b).

In its internal policies, the company must specify the exact procedures that are necessary to guarantee that all shareholders are free exercise their rights, including: the right to access the books and document (including information about the company's activities, and its operational and investment strategy)⁵³⁶; the right to supervise the performance of the company and its board members; the right to hold the board members accountable for any breach of the company's by-laws, and to file liability lawsuits against them, or to request the nullification of the resolutions of the general and special shareholders assemblies⁵³⁷; and the right to attend and vote in general assemblies, and on the selection of board and audit members.⁵³⁸ Additionally, the new regulations require that the board of directors provide clear mechanisms for the distribution of dividends.⁵³⁹ Additionally, the CGR 2017 restricts shareholders from interfering in the operation of the board or the executive management, unless the shareholder is a member of the board, or by way of the ordinary general assembly.⁵⁴⁰

6.10.2 The Board of Directors

In Articles 16-40, the new regulations provide detailed conditions governing the members of the board of directors, including the chairman, the independent and non-executive directors, and the secretary of the board. These articles cover matters such as board, composition, appointments, conditions for memberships, and termination of the board. They also include elaboration on the independence issues relating to an independent director; the responsibilities and competencies, duties (including duties of the executive management); oversight over executive management; duties of the chairman; agenda setting; board meeting procedures and activities; compliance with regulations; and rules on developing policies regulating relationships with stakeholders.

The executive management by virtue of its position, the practice of daily work and taking usual decisions, provides plans to run the company's business and propose higher strategic objectives for presenting them to the Board of Directors. which in turn reviews these plans, objectives and discusses them with the executive management to approve them. Hence, the importance of the Chairman of the Board's role has been widened under the CGR 2017 and it provides he must to encourage members to engage in meaningful discussions and to evaluate the executive management project in order to develop it and approve it in the final form.⁵⁴¹ In addition,

⁵³⁶ *Ibid*, Article 5 (5).

⁵³⁷ *Ibid*, Article 5 (7).

⁵³⁸ *Ibid*, Article 12.

⁵³⁹ *Ibid*, Article 9.

⁵⁴⁰ *Ibid*, Article 7.

⁵⁴¹ *Ibid*, Article 27

Article 24 is one of the most important Articles of the new regulation and monitoring its application is very important. Article 24b states that: “it is not permissible to combine the position of Chairman of the Board with an executive position in the company, including the position of managing director, even if the company’s statute stipulated otherwise”.⁵⁴² Moreover, Article 24b provides that: “In all cases, a person shall not have absolute power to make decisions in the company”.⁵⁴³ According to the CMA annual report in 2015, the combination of the post of the chairman and the CEO is considered to be one of the most violated provisions.⁵⁴⁴

6.10.3 Composition of the Board

The composition of the board has been set out in Article 16 and provided that the number of members is not less than three and not more than eleven, and it also requires that the majority of the board be non-executive. Of that number, at least two persons, or a third of total members, must be independent (whichever is greater).⁵⁴⁵ The regulations list conditions for the membership of the board, as well as their independence, ability to lead and guide, financial knowledge, and physical fitness.⁵⁴⁶ CGR 2017 also provides an improved list of issues that would negate the independence of a director, including:

- a) “Owning 5% or more of the shares of the company or any of the company’s affiliates, or a relative (up to the fourth degree) who owns such percentage.
- b) If he/she represents a company that holds 5% or more of the shares of the company or any of its affiliates.
- c) If he/she is a relative of any member of the board of the company or any of the company’s affiliates.
- d) If he/she is a relative of any senior executives of the company, or the any of the company’s affiliates.
- e) If he/she is a board member of any company within the group of companies for which he/she is nominated to be a board member.
- f) If he/she has worked either as an executive or an employee of the company or its affiliates in the past two years, including any consultancy roles.

⁵⁴² *Ibid*, Article 24

⁵⁴³ *Ibid*, Article 24 (b)

⁵⁴⁴ annual report. (2015). *capital market authority*, [online] p.85. Available at: https://cma.org.sa/en/AboutCMA/AnnualReport/Documents/cma_2015_report.pdf [Accessed 12 Aug. 2017].

⁵⁴⁵ CGR 2017, Article 16 (3).

⁵⁴⁶ *Ibid*, Article 18 (guiding article).

- g) If he/she has any direct or indirect interest in the businesses and contracts executed for the company's account.
- h) If he/she receives any remuneration in addition to the remuneration paid for his/her directorship role.
- i) If he/she engages in any competing business.
- j) If he/she served as a director of the company for more than nine years (consecutive or inconsecutive).⁵⁴⁷

6.10.4 Assessment of the Board's Performance

The new regulations have enhanced the board's power in the oversight of executive management, giving the board of directors the authority, based on the recommendation of the nomination committee, to develop the necessary mechanisms to annually assess the performance of the board, its committees, and the executive management, by using key performance indicators linked to the achievement of the company's strategic objectives, the quality of risk management, and the quality of risk control.⁵⁴⁸ Additionally, the new regulations permit non-executive directors to carry out periodic assessments of the chairman, subject to obtaining the opinions of executive directors, without the presence of the chairman in the discussions. Non-executive directors are responsible for identifying the weaknesses and strengths of the chairman and if required, proposing solutions which are in the best interests of the company.⁵⁴⁹

6.10.5 Dealing with Conflicts of Interest and Related Parties

Matters regarding conflicts of interest are detailed in Article 42-49 of the new regulations, including the avoidance, assessment and disclosure of conflicts of interest. The board of directors must develop an explicit and written policy to deal with actual or potential situations involving any conflict of interest which may affect the performance of the executive management, the board of directors, and employees of the company when dealing with the company or other stakeholders.⁵⁵⁰ The policy must include guidelines for informing board members, substantial shareholders, senior executives and employees about how to avoid situations that may lead to conflicts of interest. The policy must also include illustrated

⁵⁴⁷ *Ibid*, Article 20.

⁵⁴⁸ *Ibid*, Article 1 (a) (Guiding Article).

⁵⁴⁹ *Ibid*, Article 41 (f).

⁵⁵⁰ *Ibid*, Article 43.

examples of situations that are relevant to the company's activities and provide clear procedures for disclosing such interest. Furthermore, the policy must include the authorisation procedures in cases of actual conflicts of interest. The CGR 2017 provides that the policy must incorporate the obligation to consistently disclose situations that may lead to a conflict of interest, and the obligation to abstain from voting or taking part in the decision-making process if there is a conflict of interest. As well as clear procedures when the company enters a transaction with a related party, the policy must include a stipulation to notify the CMA and the public without any delay of any contract or transaction with related parties, if it equals or exceeds 1% of the company's revenues, according to the last annual financial statements.⁵⁵¹ The CGR 2017 emphasise that board members must perform their duties with honesty and dignity, and prioritise the interests of the company over their own, must protect the confidentiality of all information relating to the company and must not disclose any confidential information to any person. Finally, the new regulations have included an additional rule for members of the board or senior directors, forbidding them from accepting gifts from any persons who have entered into a commercial transaction with the company.⁵⁵²

6.10.6 Competing with the company

The new regulations did not change the requirements for members that wish to engage in businesses that may compete with the company; however, they elaborate on the original provisions and dedicate Articles 46 and 47 to covering such instances. The CGR 2017 states that any board member who wishes to compete with the company is under an obligation to notify the board of the nature of the competing business they wish to engage. The statement must be recorded in the minutes of the board meeting and the board member must abstain from any voting on related decisions in the board meeting and general assembly. The chairman is tasked with informing the general assembly of the competing business that the board member wishes to engage in. The general assembly may choose to authorise or reject such engagement, and if authorised, this authorisation must be renewed annually.⁵⁵³ However, if the general assembly rejects the renewal of the authorisation, the board member must resign or have their membership terminated, unless they withdraw from such contracts or transactions.⁵⁵⁴

6.10.7 Boards' sub-Committees

⁵⁵¹ *Ibid*, Article 43 (7).

⁵⁵² *Ibid*, Article 49.

⁵⁵³ *Ibid*, Article 46.

⁵⁵⁴ *Ibid*, Article 48.

What is indicative in the new regulation is the increased attention to the boards' sub-committees. The new regulation added a new committee; the risk management committee and elaborated on the work of this committee. The Addition of this committee is seen an important development in corporate governance in Saudi Arabia. In this sense, the decision maker is aware of the importance of studying and analysing risks in the company. This is done through institutional work and periodical reporting.

The CGR 2017 requires the formation of four committees within a company, including; auditing, remuneration, nominations, and risk management. These new regulations also authorise the board of directors to create other committees if they deem it necessary; for example, a corporate governance committee.⁵⁵⁵ The CGR 2015 states that each of these committees must contain a 'sufficient number of non-executive directors'⁵⁵⁶ and that they are chaired by an independent director. The CGR 2017 also requires that all members of the committees comply with the principles of truthfulness, honesty, loyalty, and care, and to prioritise the interests of the company and its shareholders over any personal interests.⁵⁵⁷ Also, the chairman of the board is prohibited from being a member of the audit committee; however, he may be a member of the remunerations, nomination and risk management committee, provided he does not chair of any of these committees.⁵⁵⁸

The CGR 2017 permits all sub-committees to seek the assistance of an expert or specialist, whether internal or external, in performing their duties. Article 52b states that the name of the expert and his relation to the company and its executive management must be recorded in the minutes of the committee meeting.⁵⁵⁹ The CGR 2017 prohibits the attendance of any member of executive management attend these committee meetings unless the committee requests their assistance. This is to ensure its independence and limit any influence that may be exerted upon its members.

6.10.8 The Risk Management Committee

The risk management committee is a new type of committee established by CGR 2017. Article 72 provides that the risk management committee should comprise of at least three

⁵⁵⁵ *Ibid*, Article 95 (Guiding Article).

⁵⁵⁶ *Ibid*, Article 51 (a).

⁵⁵⁷ *Ibid*, Article 51 (a).

⁵⁵⁸ *Ibid*, Article 51 (c).

⁵⁵⁹ *Ibid*, Article 52 (b).

members, the chairman and the majority of its members must be non-executive directors and have an ‘adequate’ level of knowledge in risk assessment and finance.

The risk committee is tasked to develop comprehensive policies for risk management which are consistent with the nature of the company’s activities, monitor their implementation, and review and update them regularly. The committee is also authorised to determine what it deems an acceptable level of risk for the company and providing recommendations for the management of risks that threaten the company’s continuation during the following 12 months.⁵⁶⁰

6.10.9 The Corporate Governance Committee

The new regulations give the board of directors the option to establish a corporate governance committee to oversee any matters relating to the implementation of governance and to prepare annual reports for the board for directors. However, the establishment of the corporate governance committee is left at the discretion of the board of directors.⁵⁶¹ Although this article of the regulation is not compulsory, it does not specify the types of directors that sit on this committee. The ambiguous drafting of this article may allow directors to set up the committee without the supervision of an independent and non-executive directors.

6.10.10 Regulating the relationship with Stakeholders

The CGR 2017 stipulates that the board of directors must put in place clear and written policies and procedures that regulate the relationship of the company with all stakeholders. The aim of this provision is to ensure the protection and safeguarding their respective rights. The policy must include the following:

- 1) “Details of compensation for any damages to the stakeholders as a result of breaching legal or contractual rights.
- 2) Procedures resolving complaints or disputes that may arise between the Company and the Stakeholders;
- 3) Methods for building good relationships with customers and suppliers.
- 4) Rules for professional conduct of Company managers and employees, that are prepared in compliance with the proper professional and ethical standards, and regulate their relationship

⁵⁶⁰ Article 71 (3)(Guiding Article).

⁵⁶¹ Article 95 (Guiding Article)

with Stakeholders, subject to the Board establishing mechanisms for supervising the implementation of, and compliance with such rules.

- 5) Details of the Company's social contributions.
- 6) Ensuring that the Company's transactions with Board members and Related Parties are entered into on terms identical to the terms of transactions with Stakeholders without any discrimination or bias.
- 7) The right of stakeholders to obtain any information relevant to their activities to enable them to perform their duties.
- 8) Treating Company employees pursuant to the principles of justice and equality and without discrimination.”⁵⁶²

It worth noting that the article regulating the boards' relation with stakeholders is one of the twenty articles that are intended to be indicative rather than mandatory. Regulating the relationship between the board and the stakeholders is indeed a welcomed step, however, the compliance with of this Article is optional. This policy and its impact will be discussed further in chapter seven.

6.11 Conclusion

This chapter examined the enactment of the new Saudi Companies Law 2015. The chapter discussed the need for reforming the old Saudi Companies law and presented the key changes in the new legislation. The new companies law provides several provisions that enhance the good practice of corporate governance. The CL 2015 also provides shareholders with improving right and protection. One of the major changes introduced in the new companies law was the recognition of the audit committee in the legislation. The new law gives the audit committee greater independence and authority. The CL 2015 also added a provision that prohibits a director to simultaneously occupy the post of chairman and any other executive post⁵⁶³ In the previous law, the chairman was permitted to combine his position with any other executive position.

The chapter also discussed the duties of directors under Sharia law. The fiduciary duties of loyalty and care have established in Islam over 1400 years ago. However, it was argued that these duties were not clearly specified or defined in the current Saudi companies law. It was

⁵⁶² CGR 2017, Article 83.

⁵⁶³ CL 2015, Article 81.

pointed out that there was a lack of certainty over a number of directors' duties, in particular fiduciary. In fact, it was suggested that these duties need to be clarified and clearly specified in the companies law, rather than depending on the scattered range of rules and principles outside the legislation which will only add to the current uncertainty. The second part of the chapter described the key features of the new corporate governance and the objective and the timing of the publication. It was observed that the introduction of the new CGR 2017 was due to a number of factors. Firstly, the publication of the regulation was to respond to the changes in the new Saudi law. Secondly, the timing of the CGR 2017 is of crucial importance. The Saudi Vision 2030 was issued in 2016 which aims to have a huge impact on the diversification of the Saudi economy, increasing foreign direct investment and restructuring state-owned enterprises. This chapter also provided an overview of the most significant changes in the new regulation. The publication of the new regulations is an important development in corporate governance Saudi Arabia with far-reaching effects on the integrity of the capital market. The new regulation is a significant addition to the Saudi economy, as its serious application and monitoring its implementation may represent a shift in the management of listed companies. After reviewing the Saudi company law and corporate governance legal framework in Saudi Arabia, the following chapter will review the current practices of the Saudi corporate governance concerning the board of directors in the light of those in the UK.

Chapter Seven

The Board of Directors in Saudi Corporate Governance as Compared to the UK

7.1 Introduction

This chapter will debate the key research question, namely whether the current Saudi corporate governance attains international standards using the UK best practices as a benchmark. This chapter will review and compare the current practices of the board of directors in Saudi Arabia and in the UK. The chapter will be separated into several sections. The first section will examine the duties and responsibilities of the board of directors. The structure of the board and the types of directors will be considered in the second section. The third section will discuss the sub-committees with a focus on the audit, remuneration, and nomination committees. The fourth section will examine board members' remunerations. The final section will examine gender diversity in the boardroom.

court reporting, which makes interpreting Saudi law significantly more challenging. Therefore, it is not always possible to arrive at a conclusive interpretation of how a certain court would deal with a particular case.

7.2 Board of Directors' Duties

Following the scandals that led to the collapse of Enron, the WorldCom Company, and the Parmalat enterprise, the corporate board has been at the centre of attention in the debate on corporate governance reform. It is argued that the board of directors' extensive powers in managing the company creates an opportunity whereby the board of directors may depart from the company's objectives and mismanage the company's affairs.⁵⁶⁴ To combat this, international corporate governance principals outline a number of rules that board members must comply with whilst performing their duties. Some company law jurisprudence states that the relationship between a company and its board of directors is a principle-agent relationship, in that it encourages the notion that the board members owe a fiduciary duty to the company.⁵⁶⁵ It is apparent in the literature that a fiduciary duty is separated into three main duties, the duty of care, the duty of loyalty and the duty to act within powers.⁵⁶⁶

Principles regarding this responsibility are sustained by the OECD principles on corporate governance, which states that the fiduciary duty is implied in board members' obligation to

⁵⁶⁴ Adams, R., Hermalin, B. and Weisbach, M. (2010). The Role of Boards of Directors in Corporate Governance: A Conceptual Framework & Survey. *Journal of Economic Literature*, 48(1), pp.58-107.

⁵⁶⁵ Malcolm, D.(1997). 'Directors' Duties: The Governing Principles'. Ramsay, I. *Corporate Governance and the Duties of Company Directors*. Melbourne: University of Melbourne, Centre for Corporate Law & Securities Regulation, p.62.

⁵⁶⁶ *Ibid.*

“act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.”⁵⁶⁷

It has been suggested that the idea of fiduciary duty is an immature one in the Middle East.⁵⁶⁸ This is supported by evidence from the Saudi Companies Law 1965, the Corporate Governance Regulations 2006 and the Saudi Companies Law 2015 failure to refer to the fiduciary relationship between the director and company. However, this position appears to have been clarified, at least in the Saudi Corporate Governance Regulations 2017 which set out the board of directors’ duties of care and loyalty toward the company and its shareholders in its articles.⁵⁶⁹ These duties will be focused on in the next section. It must be noted that when considering the issue of directors’ duties, it is important to remember that the Saudi judiciary does not apply the concept of judicial precedent. In other words, any decision taken by a Saudi court will have no binding authority in similar cases. Furthermore, Saudi Arabia has no prevalent system of

7.2.1 Duty of care

The duty of care is arguably the greatest duty to be imposed on directors given the wide power they have in manage the company’s affairs and ensure that, whilst they are fulfilling their responsibility of achieving the company’s objectives.

Whilst the duty of care in the UK is codified in the Companies Act 2006, there is no single provision in the Saudi Companies law 2015 that explicitly requires a director to exercise the reasonable care, skill and diligence. However, the duty of care can be derived from the articles of association. The shareholder may wish to insert an explicit clause in the company’s articles of association that requires a director to act with skill care and diligence which will ensure its binding force upon directors from the Saudi CL 2015.⁵⁷⁰ It should be noted that the Model Articles of Association provided by the Ministry of Commerce and Industry does not make any reference to the duty of care.⁵⁷¹ Moreover, the question raised here is regarding the extent of such duty can be in the absences of a clear recognition of the duty in the Saudi legislation and the articles of association. At the outset, the Saudi legislation provides that all forms of

⁵⁶⁷ the OECD Principles of Corporate Governance. (2004). *Organisation for Economic Co-Operation and Development.*, p.59.

⁵⁶⁸ Al Rimawi, L Emerging Markets of the Middle East (1997). A critique of selected issues in Arab Securities Regulation. *Journal of Financial Regulation and Compliance*, 7(2), p. 160.

⁵⁶⁹ Saudi Corporate Governance Regulations 2017. Article 21.

⁵⁷⁰ CL 2015, Article 78

⁵⁷¹ Model Articles of Association issued pursuant to the CL 2015. The Saudi Model Articles of Association has recently the website of the Ministry of Commerce and Investment (in Arabic only). Available at: <http://mci.gov.sa/cl2015/Documents/06.pdf> [accessed 6/6/2018]

companies are established by contract.⁵⁷² As mentioned in Chapter two, Sharia is the base for all Saudi legislation, this means that Saudi contract law, drawing on the rules of Sharia would play a role in the regulation of companies.⁵⁷³ According to Sharia jurist, directors are regarded as agents of the company (Shareholders) and their responsibility towards the company are governed by the rules of the agent-principle relationship. Therefore, Sharia rules governing the agent-principle relationship can be used in filling in the gap in the Saudi CL 2015.⁵⁷⁴ As was mentioned in Chapter six, Sharia scholars view that a director (agent) will not be held accountable for damages to the entrusted property unless in cases of negligence and aggression.⁵⁷⁵ Therefore, a director is required to act in a diligent manner and take reasonable care whilst managing the affairs of the company on behalf of the shareholders to avoid accountability. This was demonstrated in the case of the chairman of ABDAR Company, where the court held the chairman was negligent in his duty to arrange a loan of \$13 million. This decision is viewed by the author to be in accordance with Sharia law.

While the CL 2015 does not explicitly recognise the directors' duty of care, the Saudi CGR 2017 position is completely different in relation to listed companies. Article 30(17) requires that each director must act with the necessary care and diligence in his role for the interests of the Shareholders. Furthermore, Article 21(a) requires the board to perform its duty of care, however, it refers to the 'board' instead of the 'individual director'. Although a decision is taken collectively by the board, the liability of decisions should be imposed individually. This means that every board member is under an obligation to perform his duty with care and his failure may expose the director to liability. Therefore, the wording of the article may cause a sense of uncertainty about the nature of the liability of individual directors.

In relation to the position of the UK, the Companies Act 2006 has codified the duty of care and set out the duty in section 174 which states that a "director must act with reasonable care, skill, and diligence, as would be exercised by a reasonable and diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and the general knowledge, skill and experience that the director has".⁵⁷⁶ The standard of care and skill derived from *Norman v Theodore*, whereby the standard expected from a director was measured both

⁵⁷² CL 2015, Article 2

⁵⁷⁴ Please refer to Chapter six for more information on the Sharia views on directors.

⁵⁷⁵ AlBahuti, M,(2000), *Explanation of Muntaha al-Iradat* , A Al-Turki ed, 3rd vol, Al-Resalah,(Arabic Edition),p. 535.

⁵⁷⁶ UK CA 2006 s174.

objectively and subjectively, to decide whether the director had breached the duty to exercise reasonable care and skill.⁵⁷⁷

In contrast, the omission of explicit recognition in Saudi legislation of the duty of care will undeniably reflect on how directors behaviour will be assessed. Therefore, alternative principles may be referred to in the uncodified rules of Sharia. The failure to act with care will result in the director being liable for negligence or aggression. Under Sharia principles, the agent is required to satisfy the standard of the ordinary reasonable man. Certainly, this standard of care is an objective one. According to Al Jaber, a director will have to show reasonable care that an ordinary careful director would satisfy the requirement under Sharia law.⁵⁷⁸ This indicates that the lack of skill or knowledge on the part of the director cannot be considered as an excuse for not meeting the standards of a careful ordinary director.⁵⁷⁹ It also indicates, that highly skilled directors may avoid liability by pretending to be an ordinarily careful director. This position is clearly not consistent with the two-old test (i.e., an objective and subjective standard) applied in the UK.

7.2.2 Duty of Loyalty

The phrase ‘duty of loyalty’ is the principle that a fiduciary has a duty of allegiance to the company, which is achieved by the director avoiding situations that may entail conflicts of interest. It is important to understand what is meant by the term ‘fiduciary’. Millett LJ in *Bristol & West v Motthew* provides a definition of the term as “someone who has undertaken to act for or on behalf of another in a particular matter in circumstances, which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.”⁵⁸⁰

⁵⁷⁷ *Norman v Theodore Goddard* [1991] BCC 14)

⁵⁷⁸ Al Jaber, M, (2000). *Saudi Commercial Law* (Arabic), 5th Edition, Riyadh, p.340.

⁵⁷⁹ *Ibid*, p.339.

⁵⁸⁰ Millett LJ in *Bristol & West v Motthew* [1998] Ch 1 at 18.

Additionally, Finn points out that, “the nature of the obligation determines the nature of the breach. The various obligations of a fiduciary merely reflect different aspects of his core duties of loyalty and fidelity. Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere incompetence is not enough. A servant who loyally does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty”.⁵⁸¹

The duty of loyalty may be expressed as a duty of trust which requires the director to exercise their duty in a fair and honest manner for the benefit of all shareholders whilst considering the objectives of the company to ensure its success.⁵⁸² Section 172 of the UK CA 2006 provides a formation of things to consider in the duty of acting in good faith. It states that “a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters)... the likely consequences of any decision in the long term... the desirability of the company maintaining a reputation for high standards of business conduct... the need to act fairly as between members of the company”.⁵⁸³ The issue of acting in good faith to promote the success of the company has been extensively analysed by several authors.⁵⁸⁴ However, the test applied by the UK courts in determining whether a director had acted in good faith in his s.172 duty is a subjective one. Therefore, a director must act in the way he considered, not the court may consider, in good faith would be likely to promote the success of the company of the benefit of all its members.⁵⁸⁵

Regarding the Saudi position of the duty to act in good faith, the CL 2015 provides the board of directors with the widest powers to manage the company to achieve its objectives⁵⁸⁶ and provides detailed provisions to ensure that directors must not have any personal interest whether directly or indirectly from contracts or transactions made on behalf of the company.⁵⁸⁷ the CL 2015 provides that the articles of associations should be used to clarify the responsibility and of the board of directors.⁵⁸⁸ However, the CL 2015 is silent in relation to the duty of loyalty and the duty to act in good faith and there is no explicit mention to these issues in contrast to the position in the UK CA 2006. Although there is an absence of such provisions in the CL

⁵⁸¹ Finn,P.D. (1977). *Fiduciary obligations*, Sydney: Law Book Co. p.2.

⁵⁸² Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, p. 97.

⁵⁸³ UK Companies Act 2006, s.172(1).

⁵⁸⁴ Please see chapter 5 for the discussion on duty to act in good faith to promote the success of the company.

⁵⁸⁵ *Re Smith & Fawcett Ltd* [1992] Ch 304

⁵⁸⁶ CL 2015, Article 75.

⁵⁸⁷ *Ibid*, Article 71,72 and 73.

⁵⁸⁸ *Ibid*, Article 81.

2015, the duty of loyalty and good faith has been recognised by Sharia law through the concept of stewardship.⁵⁸⁹ Moreover, the issue has been addressed by lower-ranking legislation in the form of corporate governance regulations.

The new CGR 2017 stipulates that the board of directors shall “perform its duties of care and loyalty in managing the company’s affairs and undertake all actions in the general interest of the Company and develop it and maximise its value”,⁵⁹⁰ and the board must work “on the basis of complete information, in good faith and with the necessary care and diligence for the interests of the company and all shareholders”.⁵⁹¹ The new CGR 2017 also introduced three principles which the board of directors must comply with, which are; the principles of truthfulness, honesty and loyalty. The regulations also provided an interpretation of the principles. The CGR 2017 states that principles shall include, the following:

"- Truthfulness: is achieved when the relationship between the board member and the company is an honest professional relationship, and he/she discloses to the company any significant information before entering into any transaction or contract with the company or any of its affiliates.

- Loyalty: is achieved when the board member avoids transactions that may entail conflicts of interest and ensures fairness of dealing, in compliance with the provisions relating to conflicts of interest in these regulations.

- Care: is achieved by performing the duties and responsibilities set forth in the Companies Law, the Capital Market Law and their implementing regulations and the company’s bylaws and other relevant laws".⁵⁹²

It is observed from reviewing the interpretations stated above, it appears to restrict the definition of the principles to procedural cases, such as not following regulations on disclosing conflicts of interests or not following particular laws.

7.2.3 Duty to Avoid Conflicts of Interest

It is generally understood that conflicts of interest within the board occur when a situation affects the objectivity of members’ decisions, due to personal interests or the interests of their relatives.⁵⁹³ A conflict of interest arises when board member encounters situations in which

⁵⁸⁹ Please see chapter 6.5.2 for Sharia viewpoint on the duty of loyalty.

⁵⁹⁰ GCR 2017, Article 21(a)

⁵⁹¹ CGR 2017, Article 30(17)

⁵⁹² CGR 2017, Article 29.

⁵⁹³ *Ibid.*

there is an opportunity for formal action or inducement that has the potential to benefit their private interests.

Conflicts of interest between directors and their companies can occur in a number of different ways; for instance, when there is a transaction between the company and its directors, other than that concerning directors' remuneration, or when there is a transaction between the company and a third party, and at the same time the director has a personal interest in the transaction.⁵⁹⁴ Therefore, a decision taken by the board of directors must be made exclusively for the genuine benefit of the company and maximise its value. Demski argued that a potential conflict of interest is more likely to arise with non-executive directors as they are not totally independent. For example, non-executive directors usually own shares or an option in the company and may hold multiple directorships and the potential for conflict of interest is exacerbated if these posts are in competing companies, seeing as their duties in one company may be in conflict with those for another.⁵⁹⁵ Thus, being a non-executive director does not preclude the occurrence of a conflict of interest situation, and robust regulations must be put in place to prevent such incidences from progressing. However, in cases of conflicts of interest within the Saudi corporate board, Demski's claim appears to be unsupported as no cases have been reported involving a non-executive director. Non-executive directors are encouraged to occupy seats on the board and the board sub-committees, in fact, the Saudi legislator requires that the majority of board members and its sub-committee must be non-executive directors.⁵⁹⁶ In the UK the duty to prevent conflicts of interest is regarded as a crucial part of the fiduciary relationship between the director and the company. If a director does fail to abide by this duty they may be seen as disloyal and unfaithful in performing their fiduciary duty. The no conflict rule was stated in case law before being codified in the CA 2006.⁵⁹⁷ Following the introduction of the CA 2006, the duty to avoid conflicts of interest has been set out in s.175 which states that "A director of a company must avoid any situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company".⁵⁹⁸

The rule set out in s.175(1) prohibits any unauthorised conflicts between the directors' personal interest and that of the company. Section 175(2) CA 2006, affirms the equitable rule, whereby

⁵⁹⁴ Enriques, L., (2000). 'The Law on Company Directors' Self-Dealing: A Comparative Analysis', *International and Comparative Corporate Law Journal*, Kluwer Law International, , 2 (3), p. 303.

⁵⁹⁵ Joel Demski, Corporate conflict of interest, *Journal of Economic Perspectives*, 2003, p.50.

⁵⁹⁶ Saudi GCR 2017, Article 16 (2).

⁵⁹⁷ *Aberdeen Rail Co v Blaikie Brothers* (1843-1860) All ER Rep 249.

⁵⁹⁸ UK CA 2006 s.175 (1).

it states that it is immaterial if the company would have taken advantage of an opportunity, information or property,⁵⁹⁹ the fact that the director has a fiduciary duty towards the company should preclude him, unless authorised⁶⁰⁰, from seeking any interest that may conflict with that of the company. However, section 175 does not apply to self-dealing transactions as they are governed by s.177 or s.182 of the CA 2006.

Regarding the Saudi position, there appears to be no explicit statutory provision that obliges directors to avoid situations of conflicts of interest. However, the Saudi legislator approach is to regulate the actions of a director involved in a conflict of interest situation. The CL 2015 provides articles that govern self-dealing transactions which are set out in article 71(1) CL 2015, competing with the company in article 72 CL 2015 and voiding exploiting company sectors for their own interest in article 74 CL 2015.

In addition, the UK law includes the ‘no-profit rule’ principle which regulates conflicts of interest that prevents a fiduciary from making a profit.⁶⁰¹ The no-profit rule was mentioned in the well-known case *Regal (Hastings) Ltd v Gulliver*.⁶⁰² The House of Lords held that the directors, in this case, were liable to the company for the profits made through their exploitation of an opportunity that became available by the reason and in the course of their directorship.⁶⁰³ Lord Russell states “ the rule of equity which by insist on those, who by use of a fiduciary position to make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or consideration[...]The liability arises from the mere fact of a profit having, in the stated circumstances, been made, however honest and well-intentioned, cannot escape the risk of being called upon to account.”⁶⁰⁴ It must be noted that the case of *Regal (Hastings) Ltd v Gulliver* was an illustration of a case decided on the no-profit rule without the reference to the to the no-conflict rule.

Regarding the Saudi law, the CL 2015 does not include any provision that prohibits a director from making a profit by reason and in the course of their tenure. However, the next section will illustrate the Saudi position in cases involving conflicts of interest cases

In Saudi Arabia, the earliest case of conflict of interest is that of the Saudi Chemical Company in 2009. This case involved a decision by the chairman of the board of Saudi Chemical Company to purchase 15% of the shares of one of its subsidiaries Al Mawarid Company (a

⁵⁹⁹ UK CA 2006, s.175(2).

⁶⁰⁰ UK CA 2006, s.174 (b).

⁶⁰¹ *George Bray v John Rawlinson Ford* (1896) AC 44, 51

⁶⁰² *Regal (Hastings) v Gulliver* [1942] 1 All ER 378, [1967] 2 AC 134n (HL)

⁶⁰³ *Ibid*

⁶⁰⁴ *Ibid*

related party) without notifying or obtaining authorisation from the general assembly, despite the clear interest of the Chairman in the transaction. In addition, the company did not announce that the transaction which involved a related party either on the company's website or the Tadawul website. As a result of these breaches, the CMA imposed a fine for 50,000 Riyals (equivalent to \$13,333) on every member of the board of directors, including the chairman.⁶⁰⁵ Interesting, the fine imposed was not a result of breach of Article 71 of the CL 2015, it was for a breach of Article 28 of the Saudi Listing Rules 2004, which states that "the directors of a company should exercise their powers and perform their duties in such a way as to serve the interest of the company."⁶⁰⁶ As this case was in 2009, the old CGR 2006 applied and it clearly states that any board member must not have any direct or indirect interest without prior authorisation from the from the general assembly to be renewed annually.⁶⁰⁷

A more recent case concerned Emaar: The Economic City Company, which was fined 100,000 Riyals (equivalent of \$26,658) in April 2017 for two violations of Article 71 of the CL 2015.⁶⁰⁸ This was also due to the board's failure to obtain prior authorisation from the ordinary general assembly, regarding the signing of two contracts, on 22/01/2017 worth SAR 50 million (equivalent of \$13.3 million) with the Al Arabia Maintenance and Spare Parts Company (a related party). In this case, a member of the board of directors, had a direct interest in the contracts, as he owned 80% of Al Arabia Maintenance and Spare Company.⁶⁰⁹ It is suggested that additional fines should have been imposed by the CMA on each member of the board for allowing the contracts to be signed without prior authorisation from the general assembly; however, the CMA punished the company, no punishment was imposed on the beneficiary of this contract.⁶¹⁰

Similarly, the condition of informing the members of the board of directors and the shareholders regarding conflicts of interest has been clarified under s.177(1) of the UK's Companies Act 2006. It affirms that "if a director of a company is in any way, directly or

⁶⁰⁵ Cma.org.sa. (2018). *Imposition of a Fine on Emaar, The Economic City due to the violation of the Companies Law*. [online] Available at: https://cma.org.sa/en/Market/NEWS/Pages/CMA_N_2231.aspx [Accessed 12 Dec. 2017].

⁶⁰⁶ Saudi Listing Rules 2004, Article 28.

⁶⁰⁷ Saudi CGR 2006, 18 (a).

⁶⁰⁸ CL 2015, Article 71

⁶⁰⁹ Cma.org.sa. (2018). *Imposition of a Fine on Emaar, The Economic City due to the violation of the Companies Law*. [online] Available at: https://cma.org.sa/en/Market/NEWS/Pages/CMA_N_2231.aspx [Accessed 12 Dec. 2017].

⁶¹⁰ King Abdullah Economic City. (2018). *Emaar Official statement on King Abdullah Economic City*. [online] Available at: https://www.kaec.net/press_releases/emaar-the-economic-city-announces-the-results-of-shareholder-extraordinary-general-assembly-meeting/ [Accessed 12 Oct. 2017].

indirectly, interested in a proposed transaction or arrangement with the company he must declare the nature” of such interest to the other directors.⁶¹¹

7.2.4 Duty to Act within Powers

The CL 2015 confirms that the board of directors have full powers in the management of the company.⁶¹² However, the board of director’s extensive powers are restricted in several ways including restrictions enforced by law, restrictions enforced by the company’s constitution and by resolutions enacted by the general assembly.

Similarly, the board of director’s powers in the UK is clearly defined by the CA 2006, specifically part 10 chapter 2 sections 170-177. Section 171 provides that a director of a company must act within the company’s constitution and only exercises powers for the purpose for which they are conferred.⁶¹³ According to s.171 CA 2006, there are two main elements to the duty to act within powers. The first element is that the director must act within the scope of the company’s constitution which includes the company’s articles and any shareholder resolutions and agreements.⁶¹⁴ Thus any director acting outside definition provided by CA 2006 may be in breach of s.171 CA 2006 and third parties who deal with the company may be able to rely on the ostensible authority of the directors to enforce any agreements or contracts, they do not come within the protection provided by s.40 CA 2006.⁶¹⁵ Also, a company may bring an action against a director for breaching the duty set out in s.171, as a director ultimately owes the duty to the company.⁶¹⁶ For instance, if the companies articles specify the procedure in terms of the issuance and allocation of shares, such as calling of a shareholder meeting to vote and approve such actions, if the director decides to ignore this procedure then the director will be in clear violation of s.171 (A).

The second element of this duty has its roots in the case of *Smith & Fawcett*⁶¹⁷ where Lord Greene MR stated “the proper purpose doctrine” specifically “a director must exercise their discretion bona fide in what they consider, not what a court may consider, is in the best interest of the company, and not for any collateral purpose.”⁶¹⁸

⁶¹¹ UK CA 2006, s.177(1).

⁶¹² CL 2015 Article 75

⁶¹³ UK CA 2006. S.171

⁶¹⁴ Steel, W. (2016). *Directors statutory general duties*. [online] Chesterrep.openrepository.com. Available at: <https://chesterrep.openrepository.com/handle/10034/620212> [Accessed 10 Oct. 2017].

⁶¹⁵ *Ibid.* p.

⁶¹⁶ CA 2006 s.178

⁶¹⁷ Re 1942 Ch.304

⁶¹⁸ *Ibid.*

The Doctrine of proper purposes was reviewed by Lord Wilberforce in a judgement in the Privy Council in the case of *Howard Smith Ltd v Ampol Petroleum Ltd*.⁶¹⁹ Lord Wilberforce clarified the doctrine of proper purposes and provided a test to be used in identifying the doctrine of proper purposes. The test is made up of identifying the nature of the powers involved, the scope and limit within which it may be exercised, examining the substantial purpose for which it was exercised and deciding whether the purpose was proper or not.⁶²⁰ The proper purposes test was used in the case of *Extra Insurance Ltd v Scattergood* which involved the directors diverting funds from one company within its group to another company that was hounded by an aggressive creditor. The court followed the module set out in *Howard Smith Ltd v Ampol Petroleum Ltd* and criticised the actions of the directors, the court was able to identify the substantial purpose of the exercise as allowing the other company to meet its liabilities to the detriment of the plaintiff company. Therefore, the exercise of the directors' powers in dealing with the business assets was considered improper.

The Saudi CL 2015 has not explicitly mentioned that a director owes a duty to act within powers. However, Article 78 of the CL 2015 states members of the Board of Directors shall be jointly responsible for damage sustained by the company, the stockholders, or third parties' due to their mismanagement of the affairs of the company, or their violation of the provisions of this Law or the company's articles of association. Therefore, a director will be held responsible for violating the provision of the CL 2015 or the company's articles of association.⁶²¹

The CL 2015 restricts the powers of the board of directors regarding financial matters. Article 75 states that the board of directors should not contract loans for any term, or "sell or mortgage the real estate property or the place of business of the company, or release the debtors of the company from their liabilities, unless so authorized in the articles of association of the company or a resolution is issued by the ordinary general assembly thus, restricting the powers of the board of directors" in this regard.⁶²² This is a fair provision which protects shareholders capital and safeguards the company's financial position and protects against superfluous private mortgages which may be abused by board members. A private mortgage could be masked as a form of remuneration or a gift, especially if a mortgage is granted with a significantly low rate interest.

⁶¹⁹ *Howard Smith Ltd v Ampol petroleum ltd* 1974 AC.821,

⁶²⁰ *Ibid* .

⁶²¹ CL 2015, Article 78.

⁶²² CL 2015, Article 75.

Similarly, the UK CA 2006 states that a company may not make a loan to its directors without the disclosure of the details of the loan which must be approved by the shareholders via ordinary resolution. CA 2006 s.197 (1)

7.2.5 Board of Directors responsibilities

The board of directors is considered as the main driver that guides the company's activities to fulfil the company's commercial objectives.⁶²³ The significance of the board of directors is clearly recognised when reviewing the CL 2015 and the CGR 2017 whereby the Saudi legislator affirms the vital role that the board of directors play in ensuring that good corporate governance practices are followed in listed Saudi companies. In order to ascertain whether the Saudi laws and regulations that govern the responsibilities of the board of directors attain international standards, it will be compared with international and UK principles on corporate governance.

The G20/OECD principles on corporate governance states “the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and its shareholders.”⁶²⁴

Moreover, the Cadbury report 1992 states that every public company should be headed by an effective board which can lead and control the business. Sir Adrian Cadbury refers to the ways in which the effectiveness of the board can be tested, stating “to test the board effectiveness includes the way in which the members of the board as a whole work together under the chairman – whose role in corporate governance is fundamental – and their collective ability to provide both the leadership and the checks and balances which effective governance demands.”⁶²⁵ The UK's Corporate Governance Code 2016 (CGC 2016) builds on the principles of the Cadbury report and makes additional requirements on the board of directors. The code states that “every company should be headed by an effective board, which is collectively responsible for the long-term success of the company”.⁶²⁶

⁶²³ Al Muneef, I. (2006) Corporate Governance Functions and Duties and Responsibilities of the Board of Directors, Arabic edition, Dar Al Moudar, Riyadh , p. 101

⁶²⁴ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI/e-3, p.45

⁶²⁵ Cadbury, A. (1992). Report of the Committee on the Financial Aspects of Corporate Governance. London, p.19

⁶²⁶ UK Corporate Governance code 2016 A.1.

The board of directors is tasked with the oversight of the executive management and must ensure that the operations of the executive management are in accordance with the policies that have been approved by the board for the benefit of the company and its shareholders.⁶²⁷ The role of the board of directors can be compared of that of a watchdog, in that it can approve or reject a company's policies, performance schemes, and contracts which would serve shareholders' interests, rather than simply agreeing with all executive management decisions.⁶²⁸

The Saudi regulator has assigned several responsibilities to the board of directors which can be Articles 16-40 of the new regulations provide detailed conditions and principles governing the members of the board of directors, including the chairman, the independent and non-executive directors, and the secretary of the board. The articles include discussion of such matters as board formation, composition, appointments, conditions for memberships, termination of the board, independence issues relating to an independent director, responsibilities and competencies, duties (including duties of the executive management), oversight over executive management, duties of the chairman, agenda setting, board meeting procedures and activities, compliance with the regulations and developing policies regulating the relationship with stakeholders. Although the new regulations encourage the company to pay adequate attention to the training of the board members and the executive team, including preparing an induction for recently-appointed board members and executive team members, in order to familiarise them with the nature and progress of the company's business and its activities, it is not a mandatory requirement under the new Saudi regulations⁶²⁹. Unlike the majority of provisions under CGR 2017, which are compulsory, this article is only intended to guide.

It is clear that whilst drafting CGR 2017, the Saudi regulators have paid significant attention to the UK's Code on Corporate Governance, and they appear to have been inspired by its main principles. This would explain the number of similarities between the UK's Code and the Saudi Regulations on corporate governance.

The UK's CGC states that "[t]he directors should receive an induction on joining the board and should regularly update and refresh their knowledge".⁶³⁰ This responsibility is placed on the chairman, and he is responsible for ensuring that all new directors receive a full and tailored

⁶²⁷ Heath, J. and Norman, W. (2004). Stakeholder Theory, Corporate Governance and Public Management: What can the History of State-Run Enterprises Teach us in the Post-Enron era?. *Journal of Business Ethics*, 53(3), p.251.

⁶²⁸ Solomon, J. and Solomon, A. (2004). *Corporate governance and accountability*. Chichester: Wiley, p.7.

⁶²⁹ CGR 2017, Article 41.

⁶³⁰ UK Corporate Governance Code 2016, B.4.

orientation on joining the board, to confirm that the directors' development is regularly reviewed.⁶³¹

It is therefore recommended that the article regarding the assessment and training of board members under Saudi regulations be reclassified as mandatory instead of being viewed as optional guidance. Furthermore, the chairman should be responsible for this task and should ensure that development and training programs are available for all recently-appointed directors whether executive, independent or non-executive. It is also recommended that all directors, regardless of whether they have been recently appointed or not, as well as the chairman, are encouraged to continuously enrol in training and development programs, and regularly update their skills and knowledge. In fact, seeking knowledge, rebuilding and reinforcing understanding and skills, can be found in Shariah principles, as the Holy Quran and the advisory sayings (Hadith) of the Prophet Mohammed (PBUH) encourage the pursuit of knowledge, regardless of age or profession. The Prophet (PBUH) said, "whoever seeks a way to acquire knowledge, Allah would make easy his way to paradise".⁶³²

7.2.6 Main Functions of the Board

The board of directors have the complete power to manage and guide a company's activities for the benefits of the shareholders, in order to ultimately achieve its objectives. Therefore, among the main functions of the board of directors, the board is tasked with

- 1- Laying down plans, policies and strategies of the company in accordance with the main objectives of the company, and supervising their implementations, as well as regularly reviewing them.
- 2- Setting the policies and procedures of the risk management committee and performing regular reviews on such policies.
- 3- Determining the appropriate capital structure of the company and its financial objectives, as well as ratifying the company's budget.
- 4- Overseeing the main capital expenditure of the company and the acquirement and disposal of its assets.
- 5- Setting performance indicators and monitoring the overall performance of the company.

⁶³¹ *Ibid*, at B.4.1.

⁶³² Sahih Muslim 2699.

- 6- Setting the rules and procedures for internal controls and overseeing their performance, as well as developing the policy to remedy any potential or actual conflict of interest for board members, executive management and shareholders.
- 7- Ensuring the integrity of the financial and accounting rules and procedures, as well as the preparation of the company's financial reports.
- 8- Forecasting any potential risks that the company may face, and generally raising the awareness of the culture of risk management. Communication must be transparent when there is any such risk to the stakeholders or any parties related to the company.
- 9- Preparing and approving the interim and annual financial statements.
- 10- Ensuring effective communication channels with shareholders, affording them the opportunity to periodically review the company's business, and notifying them of any major developments in the company.
- 11- Forming specialised committees, specifying the terms, powers, and responsibilities of each committee, and periodically evaluate their performance.
- 12- Specifying all types of remunerations granted to all company employees. Remunerations include fixed compensation, performance-linked remunerations and remunerations in the form of shares.⁶³³:

Lastly, the board must develop a written policy to regulate its relationship with the stakeholders and ensure the company's compliance with such policy. The board must disclose any material information to the shareholders and stakeholders, as well as ensuring the compliance of the executive management of such policies.⁶³⁴ The OECD/G20 principles on corporate governance state that "corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially-sound enterprises".⁶³⁵

The aim of establishing a clear written policy and procedure which regulates the relationship between the company and its stakeholders is twofold. Firstly, a clearly written policy by the board of directors may create a legalized relationship with stakeholders, thus encouraging the board to fulfil its contractual obligations towards them. Secondly, the aim of the written policies and procedures is to protect and safeguard the rights of stakeholders. The Saudi regulator recommends the following policies⁶³⁶:

⁶³³ CGR 2017, Article 22.

⁶³⁴ CGR 2017 Article 22 (4 and 5)

⁶³⁵ OECD/G20 Principles of Corporate Governance, 2015, p.36.

⁶³⁶ CGR 2017, Article 83.

- 1- A clear mechanism must be in place, for the compensation of stakeholders when their rights – established by laws or by contracts – are breached.
- 2- There must be a clear procedure for the resolution of disputes or complaints that occur between the company and its stakeholders.
- 3- Methods for building and fostering good relationships with customers and suppliers and ensuring the confidentiality of all related information must be clarified.
- 4- The rules of professional conduct for company managers and employees must be prepared in accordance with professional and ethical standards and must regulate the latter's relationship with stakeholders. The board will be responsible for supervising the implementation and compliance of such rules.
- 5- The company's social contribution must be outlined.
- 6- All company transactions with board members and any related parties must be entered on identical terms to those entered into with stakeholders. There must be no discrimination or bias in the terms of the transactions.
- 7- Stakeholders will retain the right to obtain any relevant information regarding their activities to allow them to perform their duties. The information must be provided regularly and in a timely manner.
- 8- The treatment of all company employees must be based on the principles of justice and equality and without any discrimination.

It appears that the Saudi regulator recognizes the rights of stakeholders and encourages active cooperation between them and the company as an important part of its operation; however, it is worth noting that the article which regulates the relationship of the company with its stakeholders is only guiding in principle. It would certainly be more efficient if the article takes a mandatory status for listed companies, given the significant effect of the actions of the company on stakeholders.

Unlike the guiding provision provided by the Saudi CGR 2017, the Saudi CL 2015 is silent on any matters relating to the stakeholder. However, the position in the UK is completely different whereby section 172 provides a clear formulation to take into account the interest of the stakeholders and require the directors to consider the company's stakeholder. Section 172 states that "a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to: ... the interests of the company's employees,... the need to foster the company's business relationships with suppliers, customers

and others, ... the impact of the company's operations on the community and the environment"⁶³⁷

Returning to the Saudi CGR 2017, the policy on stakeholders appears to endorse in part s.172 CA 2006 regarding the stakeholder's interests. However, it is not embodied in the CL 2015. It would be beneficial for the corporate governance in Saudi Arabia, particularly from the point of view of directors, to have a similar provision to s.172 to be adopted into CL 2015 to consolidate that policy into one place, being the Saudi Companies law. This process would not require any modification to the current article, provided it there is no conflict between the existing principle and the provision dealing with these matters in the current CGR.

The Saudi regulator requires that the board of directors, upon a proposal from the audit committee, create policies and procedures that stakeholders can follow, in order to report any non-compliant practices and violations of their rights.⁶³⁸ The policy must include a method through which all stakeholders (including employees) can report to the board any behaviour or practices of the executive management that they feel to be in violation of laws and regulations, any doubts regarding financial statements or internal audit controls, or if they feel that any practices are contrary to their best interests in any way. In the event that such complaints are made, the board of directors must initiate an investigation, whilst maintaining the confidentiality of reporting procedures. This can be done by facilitating direct contact with an independent member of the audit committee or any other committees⁶³⁹, i.e. through a dedicated telephone number or an email address. Furthermore, the board must appoint an employee to deal with all correspondence sent by stakeholders.⁶⁴⁰

7.3 Board Structures and types of directors.

There are two systems which dominate board structures worldwide; the dual board system and the single board system. The dual system, which is seen more frequently in countries such as Germany and France, divides the board into two tiers: the supervisory board, where the membership is selected by the company's general assembly, and the administrative body,

⁶³⁷ UK CA 2006, s.172(1)

⁶³⁸ *Ibid*, Article 84

⁶³⁹ CGR 2017 Article 84 (2)

⁶⁴⁰ CGR 2017 Article 84 (3)

which is tasked by the supervisory body to carry out the operations of the company.⁶⁴¹ The advantage of a dual board system is the marked separation between the executive and non-executive members, as well as the clear distinction between the positions of the chairman and the chief executive.⁶⁴² Additionally, the dual board system permits shareholders' representatives to sit on the board, thus empowering the stakeholders.⁶⁴³

Both Saudi Arabia and the UK adopt the unitary or single board system, which is composed of executive and non-executive directors, as well as independent directors. The CGR 2017 states that the company's articles must specify the number of board members and that they must be less than three but not exceed 11.⁶⁴⁴ The CGR 2017 also stipulates that the majority of the board must comprise of non-executive and independent directors, and the number of independent directors must be at least two directors or one-third of the board members, whichever is greater.⁶⁴⁵

According to Jensen and Meckling, boards who are dominated by non-executive directors may mitigate the agency problem. This is due to the monitoring and control powers at their disposal to curb any opportunistic behaviour displayed by the executive management.⁶⁴⁶ A number of studies have investigated the relationship between boardroom composition and firm performance. For instance, Dehaena et al found that there was a positive correlation between the number of non-executive directors and the financial performance of the company⁶⁴⁷ and similarly did Lefort and Urzua found a positive relationship between the number of independent directors and the performance of the company.⁶⁴⁸

Certainly, the UK CGC and recognise the important role of non-executive directors to constructively challenge and assist in developing proposals on strategy. The non-executive directors should inspect the performance of the executive management in meetings and monitor their performance. The UK CGC has also stated that are responsible for the remuneration of the executive directors as well as having a prime role in the appointment and removal of executive directors. Furthermore, the UK CGC states that the board should appoint an

⁶⁴¹ Bosch, F. (1999), 'On the Supposed Independence of Two-Tier Boards: Formal Structure and Reality in the Netherlands', *Corporate Governance: An International Review*, 7 (1), p. 31.

⁶⁴² *Ibid.*

⁶⁴³ *Ibid.*

⁶⁴⁴ CGR 2017 Article 17 (A)

⁶⁴⁵ CGR 2017 Article 16 (3 and 4)

⁶⁴⁶ Jensen, M and Meckling, W (1976), Theory of the firm: Managerial behaviour, agency costs and ownership structure, *Journal of Financial Economics*, 3, (4), p.305-360.

⁶⁴⁷ Dehaene, A., De Vuyst, V. and Ooghe, H. (2001). Corporate Performance and Board Structure in Belgian Companies. *Long Range Planning*, 34(3), pp.383-398.

⁶⁴⁸ Lefort, F., & Urzúa, F. (2008). Board independence, firm performance and ownership concentration: evidence from Chile. *Journal of Business Research*, 61(1), p. 615-622.

independent non-executive director to assume the role of a senior independent director.⁶⁴⁹ The UK code states:

“the board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve an intermediary for the other directors when necessary. The senior independent director should be available to all shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is appropriate”.⁶⁵⁰

Similarly, the Saudi regulator recognises the essential role played by independent directors and has therefore assigned them several additional duties such as expressing their independent opinions on strategic matters.⁶⁵¹ Furthermore, the independent director must ensure that the interests of the company and its shareholders are taken into consideration and prioritise their interest in any cases that may involve conflicts of interest.⁶⁵² The independent director should also oversee the development of the company’s corporate governance rules and confirm the implementation of these rules by the executive team.⁶⁵³

In Saudi Arabia, the number of non-executive directors usually depends on what sector the company is based. For instance, two of the most known banks in Saudi Arabia have a majority of non-executive directors on the board. Saudi Hollandi Bank and Samba Bank both have 8 out of 10 of their board members as non-executives. In contrast, family-owned companies have the least number of non-executive directors; for example, in the Al-Zamil Investment Co., five out of eight members of the board are family members.⁶⁵⁴

7.3.1 Separations of roles

Under Saudi Companies Law 1965, a single member was permitted to combine the roles of the chairman and the chief executive.⁶⁵⁵ However, it was argued that when an individual combines the two top positions in the company, he may be inclined to adopt personal strategies which will have a negative impact on the company as a whole.⁶⁵⁶ Furthermore, Mallette argues that in combining both roles, the chairman has to make decisions that may lead to a conflict of

⁶⁴⁹ UK CGC 2016, A.4.1.

⁶⁵⁰ UK Corporate Governance Code 2016, A.4.1

⁶⁵¹ CGR 2017 Article 31 (1)

⁶⁵² *Ibid*, Article 31 (2)

⁶⁵³ *Ibid*, Article 31 (3)

⁶⁵⁴ For full list of board of directors in Saudi listed companies see: www.Tadawul.com Last accessed 22/3/2016.

⁶⁵⁵ CL 1965 Article 79.

⁶⁵⁶ Jensen, M and Meckling, W. (1976), Theory of the firm: Managerial behaviour, agency costs and ownership structure, *Journal of Financial Economics*, 3, (4), 305-360

interest. He also claims that CEO duality can enable the CEO to set the agenda of the board, as well as to exert influence, to the extent of controlling the selection process of the board. Thus, the role duality can alter the board's ability to effectively monitor the executive management.⁶⁵⁷ The Saudi legislator permitted the combining of the two positions for over 50 years, until the publication of CL 2015, in which article 81 stated: "a single member may not hold the position of a chairman and an executive position in the company".⁶⁵⁸ This stipulation has also been incorporated into CGR 2017; article 24 reads "in all cases, no person shall have sole and absolute power to take decisions in the company".⁶⁵⁹ The approach of the Saudi regulator with regards to the separation of powers is similar to that of the UK corporate governance code 2016, which states that "no one individual should have unfettered powers of decision" and that "the role of the chairman and the chief executive should not be exercised by the same individual. The division of responsibility between the chairman and the chief executive should be clearly established, set out in writing and agreed by the board".⁶⁶⁰

Despite it is recommended that the positions of CEO and the chairman be held by separate individuals, several Saudi listed companies, particularly those companies with the majority of shares being held by the state or by wealthy families, appear to ignore this requirement. For instance, the role of chairman and chief executive of Al Rahji Bank is held by the son of the founder of the bank.⁶⁶¹ Another example can be seen in Al Zamil Holding Company, where until recently, the post of the chairman and CEO were occupied by the founder of the company. Therefore, it appears that the post of the chairman and CEO have been filled on the basis of social ties, rather than being based on qualification, skills, and experiences. However, it must be noted that this practice is not just confined to Saudi Arabia. For instance, in one of the largest companies in the UK, Marks and Spencer, the roles of CEO and chairman was occupied by Sir Stuart Rose from 2008 until 2011. This combination of roles goes against the corporate governance code recommendations.⁶⁶²

⁶⁵⁷ Mallette, P and Fowler, K. L. 1992. Effects of board composition and stock ownership on the adoption of "poison pills." *Academy of Management Journal*, 35: 1010-1035.

⁶⁵⁸ CL 2015 Article 81.

⁶⁵⁹ CGR 2017 Article 24.

⁶⁶⁰ UK Corporate Governance code 2016 A.2.1

⁶⁶¹ Mr. Abdullah Bin Suleiman Al Rajhi is now an executive director having served previously as the chairman and the CEO of Al Rahji Bank

⁶⁶² Mallin, C. (2016). *Corporate governance*. 5th ed. Oxford, U.K.: Oxford University Press, p.190.

7.4 Gender Diversity on Boards of Directors

The participation on board of directors has recently gained global attention and considered as a key topic in corporate governance.⁶⁶³ Despite the recent progress towards gender balance in the labour force of many European economies, women are still largely underrepresented in the leadership position and particularly in executive positions. At the international level, women representation on boards remains to be a slow upward trend, whereby in 2014 women occupied just over 12% of board seats in the largest international companies with an increase of only 3% since 2009.⁶⁶⁴

The 2014 Catalyst Report⁶⁶⁵ studied the board composition of 44 countries and found that Norway reported the highest number of women participation on corporate boards with 40.9% of board seats occupied by women. The report also found that Saudi Arabia was ranked 44 out of the 44 countries chosen for the study with only 0.1% of board seats occupied by women in 2014.⁶⁶⁶ Norway is the leading country in terms of the number of female directors currently serving in listed companies. Recent statistics have shown that female participation on corporate boards in Norway has risen to almost 42%.⁶⁶⁷ However, the significant process that Norway has made in board gender diversity is primarily attributed to their adoption of quotas legislation as early as 2003.⁶⁶⁸ Norway is not the only country to adopt such legislation, many European countries have opted to adopt quotas to increase female participation on company boards. For instance, Italy, Belgium and France have all decided to enact binding quotas whilst countries like Greece, Denmark, Austria and Sylvania have placed quota requirements for state-owned

⁶⁶³ Hill, B., Lunn, M. and Morrison, W. (2015). Saudi Arabia: An Overview of Executive Compensation, Board Structure, and Sustainability. *Drake Management Review*, [online] 4(1\2), p.6. Available at: <http://faculty.cbpa.drake.edu/dmr/0412/DMR041205R.pdf> [Accessed 13 Oct. 2017].

⁶⁶⁴ MCSI, Governance Issue Report 2014 Survey of Women on Boards. (2014). *ESG research*, [online] p.2. Available at: <http://Governance Issue Report: 2014 Survey of Women on Boards> [Accessed 10 Nov. 2017].

⁶⁶⁵ Catalyst. 2014. Catalyst Census: *Women Board Directors*. Available at: <http://www.catalyst.org/knowledge/2014-catalyst-census-women-boarddirectors> [accessed 20 May 2016]

⁶⁶⁶ *Ibid*

⁶⁶⁷ Statistics Norway.,(2015) “*Board and Management in Limited Companies*”, Available at <https://www.ssb.no/en/virksomheter-foretak-og-regnskap/statistikker/styre/aar/2015-03-20?fane=tabell&sort=nummer&tabell=221768> [accessed 20 August 2016]

⁶⁶⁸ Teigen, M (2015) “Gender Balance on the Boards and Management of the Norwegian Business Sector” in Gender Balance on Company Boards. Oslo: *Institute for Social Research*, pp.8-10

companies.⁶⁶⁹ Moreover, in 2015, legislation in Germany was introduced that requires at least 30% female representation on the supervisory boards of the largest listed companies.⁶⁷⁰

7.4.1 Gender Board Diversity in UK Board of Directors

In the United Kingdom, the Government Equalities Office of Statistics revealed that in the FTSE 100 female directors hold 23.5% of board seats and that statistics that there were no all-male boards in any of the FTSE 100 companies. This represented an increase of 11% since 2012 in female representation on company boards. The increase has been attributed to government campaigns, voluntary initiatives and legal disclosure requirements.⁶⁷¹

The Davis review was commissioned in 2010 by the coalition government to review the barriers that prevented more women from reaching the boardroom and make recommendations on what the government and businesses can do to increase women representation on boards.⁶⁷²

In 2010, women representation on corporate boards was only 12.5%, although that figure represents an increase of 3.1% from 2004, the progress was deemed too slow.⁶⁷³ Concerned the lack of progress, Lord Davis began to examine the situation by considering the number of women occupying board seats in FTSE 350 companies. Lord Davis consulted with a wide range of parties, including stakeholders, senior business figures, women business leaders, women networks, executive hiring firms and women who occupied positions just below executive level. Over the course of the consultation, Lord Davis discovered that many women who are qualified and ready to hold seats on corporate boards faced complex barriers that ultimately prevented them from reaching corporate boards.⁶⁷⁴ Firstly, a significant number of women were overlooked in development opportunities and it was evident that there were disparities in the way women were mentored and sponsored compared to their male colleagues. Secondly, gender behavioural traits were key reasons that would prevent more women from reaching executive and boardroom level, whereby women often undervalued their own experience and

⁶⁶⁹ Valsan, R. (2016), 'Board gender diversity and the enlightened shareholder value principle' *The Company Lawyer*, 27(6), pp. 171-177.

⁶⁷⁰ Reuters, (2015) German Parliament Approves Legal Quotas for Women on Company Boards, available at: <http://uk.reuters.com/article/2015/03/06/uk-germany-women-quotasidUKKBN0M214W20150306> [accessed 20 August 2016]

⁶⁷¹ Davies, Lord Mervyn. 2011. *Women on boards*. London: Department for Business, Innovation and Skills. Available at: <http://www.bis.gov.uk/assets/biscore/businesslaw/docs/w/11745womenonboards>. [accessed 23 August 2016]

⁶⁷² *Ibid.*

⁶⁷³ *Ibid*

⁶⁷⁴ *Ibid*

skill level. Thirdly, the relatively small number of female role models who are successful board members tended to re-enforce the stereotype of the difficulties in reaching high positions in a corporate environment. Finally, due to the high number of women occupying leadership positions in academia, media and other professions outside the corporate environment, women tend to be overlooked as it is viewed they do not possess the relevant corporate experience, which contributes to the fears that they may not understand certain corporate issues.⁶⁷⁵ Lord Davis also found that “Informal networks in board appointments, the lack of transparency in the way which executive search firms operate” presented a significant barrier that stood in the way of women reaching corporate boards.⁶⁷⁶

In 2011 the Davis Review made several recommendations, including:

1. That all FTSE 100 companies should aim for at least 25% female representation on boards by 2015. (A target that was reached six months ahead of schedule)⁶⁷⁷
2. All FTSE 350 should set aspirational targets for the percentage for women on their boards⁶⁷⁸
3. Quoted companies should disclosure of the number of women on the percentage of women on the board, in senior executive positions and the overall proportion of women in the company.
4. Amending the UK Corporate Governance Code to require listed companies to establish a policy that addresses the issue of diversity in the boardroom. The policy should include measurable objectives for application of the policy and annual disclosure of the policy and the progress.

Annual reports were published by the steering board between 2011 and 2015 to review and track the progress of companies in reaching the goals of female representation on boards. The recommendation of the Davis Review works well together with the gender diversity disclosure requirements are set out in the UK CA 2006 and the UK Corporate governance code. Section 414 (8)(c) of the CA 2006 requires quoted companies to include in the annual strategic report

⁶⁷⁵ *Ibid*

⁶⁷⁶ *Ibid*, p.19

⁶⁷⁷ Davis, Lord Mervyn. (2015). *Women on boards Davis Review five year summary*. . London: Department for Business, Innovation and Skills. Available at: <https://www.gov.uk/government/publications/women-on-boards-5-year-summary-davies-review>. [accessed 23 August 2016].

⁶⁷⁸ Davies, Lord Mervyn. 2011. *Women on boards*. London: Department for Business, Innovation and Skills. Available at: <http://www.bis.gov.uk/assets/biscore/businesslaw/docs/w/11745womenonboards>. [accessed 23 August 2016].

a breakdown at the end of each year showing the number of each sex who were employed by the company including directors and senior managers.⁶⁷⁹

The UK corporate governance code also recommends that the directors should be appointed on merit and “With due regard for the benefit of diversity on the board, including gender”.⁶⁸⁰ The UK CGC also states that a separate section of the annual report must include a description of “The board's policy on diversity, including gender, any measurable objectives that it has set out for the implementation of the policy, and progress on achieving the objectives”.⁶⁸¹ In The UK, large companies tend to be closely scrutinized by the market and the media. These disclosure requirements tend to incentivise large and well-known companies to meet the public’s expectations for diversity on boards. Companies who achieve the required level of diversity are sometimes rewarded by diversity awards or indexes. Diversity indexes are considered powerful market tool which shines the spotlight on gender equality issues. For instance, the annual Davis Report ranks FTSE 100 companies on their gender diversity performance.⁶⁸² Similarly, a female FTSE 100 index is incorporated into the annual report of Cranfield School of Management, where the report ranks FTSE 100 companies on the number of female directors currently occupying seats on boards.⁶⁸³ Additionally, annual awards can be seen as an important tool to promote gender equality, whereby a diversity award can be awarded to companies that promote gender diversity on their boards. An example of this is “The Breaking the Mould Awards” This is an award ceremony that is organized annually in the UK by the Institute of Directors, the Mail on Sunday and the 30% Club where an award is presented to companies in recognition to their efforts in encouraging the appropriate representation of women. These incentives have helped to foster the idea of gender equality, even if companies did not believe in such a policy, the risk of bad publicity in the media may serve as an incentive and help promote greater gender diversity.

⁶⁷⁹ CA 2006 414A (8)(c)

⁶⁸⁰ UK Corporate Governance Code, 2016, Principle B.2.

⁶⁸¹ *Ibid*, B.2.4.

⁶⁸² Davis, Lord Mervyn. (2015). *Women on boards Davis Review five year summary*. London: Department for Business, Innovation and Skills. Available at: <https://www.gov.uk/government/publications/women-on-boards-5-year-summary-davies-review>. [accessed 23 August 2016].

⁶⁸³ Vinnicombe, S. (2018). *Gender and Leadership*. [online] Cranfield.ac.uk. Available at: <https://www.cranfield.ac.uk/som/expertise/changing-world-of-work/gender-and-leadership> [Accessed 13 Nov. 2016].

7.4.2 Benefits of a Gender Diverse Board

Norway is considered to be the leading nation in terms of the number of females serving on boards, therefore it is important to get an insight into the benefits a company may gain from female directorship. Nelsen and Huse conducted a study which sampled 201 Norwegian firms found that women directors have a positive impact the boards strategic control and decreased the level of conflict.⁶⁸⁴

Presence of a more diverse board would help avoid instances of “Group-think”. Janis defined group-think as “A mode of thinking that people may engage in when they are deeply involved in a cohesive in-group, where the members striving and unanimity override their motivation to realistically appraise alternative course of action”.⁶⁸⁵ The phenomenon where the desire for harmony and conformity in a group may lead to irrational decision making.⁶⁸⁶ Furthermore, Branson argues that companies operate in a diverse market and their board should be a reflection on the diversity of the market. Dialogue is essential for a board to function effectively,⁶⁸⁷ the dialogue should be both constructive and challenging to avoid issues that may arise from “Groupthink”. Groupthink has been uncovered as one of the reasons for the financial crises in the United Kingdom.⁶⁸⁸ One of the methods to ensure against issues arising from groupthink is to ensure that there is a constructive debate in the boardroom. Having a diverse board is one of the ways to ensure against such a problem. Diversity in the composition of the board promotes differences of approach and experience. According to the UK corporate governance code, diversity is also a very important tool for ensuring effective engagement with key stakeholders and help achieve the company’s strategy.⁶⁸⁹ Therefore, the Saudi CGR should include an article that ensures that a mandatory number of seats should be held by female directors.

According to Catalyst Research Series “the bottom line”, boards with more female participants achieve better financial results than boards with fewer women participants. The research also found that companies with more women on boards had an average of 16% higher

⁶⁸⁴ Nielsen, Sand Huse, M (2010), The Contribution of Women on Boards of Directors: Going Beyond the Surface. *Corporate Governance: An International Review*, 18(2), pp. 136-148,. Available at: <https://ssrn.com/abstract=1577969> [accessed 2 April 2017]

⁶⁸⁵ Janis, I. (1982). *Groupthink*. Boston, MA: Wadsworth/Cengage Learning, p.8.

⁶⁸⁶ Al-Janadi, Y., Rahman, R. A., Omar, N. H. (2013) Corporate Governance Mechanisms and Voluntary Disclosure in Saudi Arabia. *Research Journal of Finance and Accounting*, 4 (4), 25-35.

⁶⁸⁷ UK Corporate Governance Code 2016, B.2.

⁶⁸⁸ *Ibid*

⁶⁸⁹ *Ibid*.

Return On Sales and 26% higher Return On Investment.⁶⁹⁰ However, the research also confirmed that in order to reap the benefits of gender diversity on boards, at least 3 or more women are needed on each boardroom this is to create a “critical mass”⁶⁹¹ of women and thus leading to higher financial performances⁶⁹². Adding to this, Linda Eling et al found that the presence of 3 or more women on boards can change the dynamics of the boardroom and “enhances the likelihood that women’s voices and ideas are heard”.⁶⁹³

7.4.3 Gender diversity in Saudi Boards

One of the main goals of vision 2030 is providing equal opportunities for both genders. This goal can be used as a catalyst for the promotion of gender diversity on company boards. The increase of Saudi women’s representation on boards can bring many benefits as discussed above. Furthermore, the benefits of a more gender diverse board can broaden the perspective of the board and make use of interpersonal skills to promote collaboration which can widen the context of discussions in the board.

S. Mtango rightly argued that the issues surrounding women participation in the workforce in Saudi Arabia are determined primarily by traditions and regulations that are often sanctioned by law. Adding this, he argued that the main issue of women participation is not that it is derived primarily from Sharia principles, but rather it is subject to interpretation. The interpretation of Sharia Law is left to government-appointed individuals who may have an agenda that would limit the rights of women in the workplace.⁶⁹⁴

The Saudi Arabian Basic Law 1992 states that the constitution of Saudi Arabia is the Holy Quran and the Sunna (Traditions of the prophet Mohammed PBHU) which together contains the main principles of Sharia. The Quran and the Sunna did not place any restrictions on the rights of women to enter the workforce or placed any limits on women in that regard. The Basic

⁶⁹⁰Catalyst. (2014). Catalyst Census: *Women Board Directors*. [online] Available at:

<http://www.catalyst.org/knowledge/2014-catalyst-census-women-board-directors> [accessed 22 January 2016]

⁶⁹¹The critical mass theory was first introduced by Kanter 1977 who argued that once gender minority reaches 35% of the team it would lead to a balance gender team and only then that gender diversity can improve the team’s performance.

⁶⁹²Lee,L., Marshall,R., Rallis,D, and Moscardi,M. (2015), (*Women on Boards: Global Trends in Gender Diversity on Corporate Boards* MSCI. [online] p.5. Available at:

<https://www.msci.com/documents/10199/04b6f646-d638-4878-9c61-4eb91748a82b> [accessed 22 January 2016]

⁶⁹³ *Ibid.*

⁶⁹⁴ Mtango, S. (2004). A State of Oppression? Women's Rights in Saudi Arabia. *Asia-Pacific Journal on Human Rights & the Law*, 5 (1), 49-67.

Law 1992 contains a chapter on the “Rights and duties of citizens” which stipulates that the state shall facilitate the provision of job opportunities to every able person and the states should enact laws that protect employees and employers.⁶⁹⁵ The Basic Law 1992 did not discriminate between genders and has afforded each person the right to work as long as that person is able. Furthermore, under Labour Law 2005, there are no legal restrictions for women to enter the workforce apart from an obligation on the employer to ensure that the employee’s health and safety are protected.⁶⁹⁶ In fact, the Saudi Labour Law 2005 dedicated an entire chapter on the employment of women. Article 149 of the Saudi Labour Law grants the right for women to work in all fields suitable to their nature. However, the labour law only prohibits women from working in hazardous jobs or industries that are deemed too detrimental to their health or likely to expose women to specific risks.⁶⁹⁷ Going back to Mtango’s claims that the key issue is not with the Saudi law but with the interpretation of Sharia by the council of senior Ulama (Religious scholars) who are tasked with the conformity of Saudi laws with the principles of Sharia. This raises some concerns on the method of interpreting such laws and sometimes can limit the promotion of women participation in the Saudi workforce.⁶⁹⁸

Nevertheless, the position in Saudi Arabia saw a shift in 2012, where the then King Abdullah issued a royal order permitted women to enter the Consultative Council (Shura Council) and provided women with the right to stand in municipal elections. King Abdullah was regarded as the main driver for the promotion of women rights in Saudi Arabia.⁶⁹⁹ King Abdullah Said in a ceremony where 30 women have taken their seats in the Saudi consultative council for the first time in the country’s history “we refuse to marginalise women’s role in Saudi Society”.⁷⁰⁰ King Abdullah revealed that the promotion of women’s representation is a process that requires time and that “the developments we are working at must be gradual”.⁷⁰¹ Furthermore, the

⁶⁹⁵ Basic Law of Governance 1992, Article 28.

⁶⁹⁶ Saudi Labour Law 2005 Royal Decree No. M/51. 23 Sha’ban 1426H / 27 September 2005G

⁶⁹⁷ *Ibid*

⁶⁹⁸ Hill, B., Lunn, M. and Morrison, W. (2015). Saudi Arabia: An Overview of Executive Compensation, Board Structure, and Sustainability. *Drake Management Review*, [online] 4(1\2), p.2. Available at: <http://faculty.cbpa.drake.edu/dmr/0412/DMR041205R.pdf> [Accessed 13 Oct. 2017].

⁶⁹⁸ MCSI, Governance Issue Report 2014 Survey of Women on Boards. (2014). *ESG research*, [online] p.2. Available at: <http://Governance Issue Report: 2014 Survey of Women on Boards> [Accessed 10 Nov. 2017].

⁶⁹⁹ Rajkhan, S. (2014). Women in Saudi Arabia, Status, Right and limitation. *University of Washington Bothell*, [online] p.21. Available at: <https://digital.lib.washington.edu/researchworks/bitstream/handle/1773/25576/Rajkhan%20-%20Capstone.pdf?sequence=1> [Accessed 10 Oct. 2017].

⁷⁰⁰ Aljazeera.com. (2018). *Saudi women take seats in Shura Council*. [online] Available at: <https://www.aljazeera.com/news/middleeast/2013/02/2013219201637132278.html> [Accessed 9 Oct. 2017].

⁷⁰¹ *Ibid*.

royal order stipulated that the Consultative Council must have 20% female participation at all times.

7.4.4 Impact of vision 2030 on the role of women in companies

According to the 2016 Global Board Diversity Report conducted by Egon Zehnder, Saudi Arabia was found to be one of the worst performing countries in terms of women participation in boards and in leadership positions.⁷⁰² The report was based on a sample of the biggest listed Saudi companies in the stock exchange it was revealed that only 29% of boards had any female board members and an average of 0.4 seats per board held by women and no significant growth in the percentage of women on boards from 2012-2016.⁷⁰³ However, due to the implementation of the National Transformation Plan (Vision 2030), there have been some steps in promoting more females in leadership roles. For instance, in February 2017, Rana Nashar became the chief executive officer of Samba Financial Group, becoming the first female CEO of a listed commercial bank on the Saudi Exchange. This appointment was in line with the Saudi governments economic and social reforms for achieving vision 2030.⁷⁰⁴ The week prior to the appointment of Rania Nashar as the CEO of Samba financial group, the Saudi stock exchange named Sarah Al Suhaimi as its first female chair.⁷⁰⁵ However, despite the recent high-profile positions afforded to Ms AlSuhaimi and Ms Nashar, Saudi Arabia remains far off the desired level of gender diversity in companies.

7.5 Board Sub-Committees

In order to provide assistance with the board to engage and perform its responsibilities in an effective and efficient manner, the company needs to establish a number of committees in accordance with its requirements.⁷⁰⁶ These committees play a major role, in particular where there in situations where there is a potential for conflicts of interest, can increase the ability of the company in tackling such issues in an object and independent manner, as well as increase

⁷⁰² Zehnder, E. (2016). Global Board Diversity Analysis. [online] p.16. Available at: http://www.gbda.online/assets/EZ_2016GBDA_DIGITAL.pdf [Accessed 10 Oct. 2017].

⁷⁰³ *Ibid*

⁷⁰⁴swad, C. (2017). *Nashar named Saudi Arabia's first female commercial bank CEO*. [online] U.S. Available at: <https://www.reuters.com/article/us-samba-financial-ceo-idUSKBN15Z0Z2> [Accessed 14 Apr. 2017].

⁷⁰⁵ Martin, M. and Nereim, V. (2017). *Bloomberg - Are you a robot?*. [online] Bloomberg.com. Available at: <https://www.bloomberg.com/news/articles/2017-02-19/sarah-al-suhaimi-will-become-first-woman-to-head-saudi-bourse> [Accessed 8 Sep. 2017].

⁷⁰⁶ Saudi CGR 2017, Article 50.

the observance to the law and any other bylaws and policy. However, these committees will not reduce the individual and collective accountability of the board of directors and its members.⁷⁰⁷

According to the Saudi law, it is compulsory for a joint stock company to set up three key committees; namely, the audit committee,⁷⁰⁸ the nomination committee and the remuneration committee.⁷⁰⁹ The next section will discuss the role of these committees in light of the Saudi and the UK standards in corporate governance.

7.5.1 Audit Committee

The audit committee oversees the internal and external auditing process of the company and is considered to be the most significant of all board sub-committees. The primary objective of the audit committee is to review the financial statements of the company and to make sure that it has effective internal controls, accounting procedures, and external auditors. Baruch states that the primary role of the audit committee is to observe the consistency of the company's procedures on accounting and auditing, thus safeguarding shareholders' interests.⁷¹⁰ This can be seen in the Smith Report (2003), which states "while all directors have a duty to act in the best interest of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of the shareholders are properly protected in relation to the financial reporting and internal control".⁷¹¹ The audit committee plays a key role in corporate governance as its oversight and conduit role between the management and the internal and the external auditors allow it to ensure the credibility of the company's financial reports.

Horon et al. summarise the importance of the audit committee through its three main responsibilities⁷¹²:

- 1- Assisting the board to perform their duties in relation to financial reporting and internal control.
- 2-Oversight of the managements' actions and applying best practices and procedures.

⁷⁰⁷ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI/e, at 57-58.

⁷⁰⁸ Saudi CL 2015, Article 104

⁷⁰⁹ Saudi CGR 2017, Articles 61 and 64.

⁷¹⁰ Baruch, H. (1980). The audit committee: A guide for directors. *Harvard Business Review* 58 (May/June), p.174-176.

⁷¹¹ Smith, R. (2013). Audit committees combined code guidance. *Financial Reporting Council*, [online] p.3. Available at: http://www.ecgi.org/codes/documents/ac_report.pdf [Accessed 14 Oct. 2017].

⁷¹² Horton, T. R., C. H. Le Grand, W. H. Murray, T. R. Ozier, and D. B. Parker. (2000). *Information Security Management and Assurance: A Call to Action for Corporate Governance*. Altamonte Springs, FL: The Institute of Internal Auditors p.7.

3- To objectively address issues of the management and the company.

The UK Corporate Governance Code states that “the board should establish an audit committee of three, in case of smaller companies two, independent non-executive directors” and that “the board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience”.⁷¹³

The Saudi legislator recognised the important role of the audit committee, even before the publication of the country’s first corporate governance regulations in 2006, by incorporating a piece of legislation that strongly encouraged companies to establish an audit committee amongst the boards sub-committees.⁷¹⁴

CGR 2017 has outlined specific roles for the formation of the audit committee. It should be formed by a resolution of the ordinary general assembly and its membership must include the following:

- 1- At least three members.
- 2- No executive directors; only non-executive and independent members are permitted to join.
- 3- At least one of its members must specialise in finance and accounting.
- 4- The chairman of the audit committee must be an independent director.
- 5- Members of the audit committee must not have any direct or indirect interest in the company’s transactions or contracts.
- 6- Any person who works or has worked for the company’s finance department, the executive management, or the company’s external auditors in the past two years is prohibited from membership.

The independence of the audit committee members is highly regarded by the Saudi regulator, as the terms of membership are clearly designed to ensure its integrity and the impartiality. Notwithstanding the efforts of the Saudi regulator in maintaining the impartiality of the audit committee, several Saudi listed companies have violated the provisions regarding this matter. For instance, Salama Cooperative Insurance has recently been fined \$7,999 for not setting up an audit committee which is free of any executive directors.⁷¹⁵

Another case concerning the existence of independent members on the audit committee is that of Banque Saudi Fransi. The bank was found not to have any independent members on the audit committee; in fact, Banque Saudi Fransi did not have any independent members on its

⁷¹³ UK Corporate Governance Code C.3.1

⁷¹⁴ Ministry of commerce and industry, Royal decree issued on 23/1/1994.

⁷¹⁵ Gov.uk. (2018). *Announcements - GOV.UK*. [online] Available at: <https://www.gov.uk/government/announcements?departments%5B%5D=competition-and-markets-authority> [Accessed 8 Oct. 2017].

entire board. This was a clear violation of article 12 (E) of the CGR 2006 which states that “the independent member of the board of directors and audit committee shall not be less than two members, or one-third of the members, whichever is greater”.⁷¹⁶ This violation resulted in Banque Saudi Fransi being fined \$13,333.⁷¹⁷

Returning to the point regarding the independence of the audit committee, Monks argues that having an audit committee composed only of independent or non-executive members can make it harder to achieve its objectives, mainly due to the part-time work arrangements of these directors.⁷¹⁸ Monk also argues that independent or non-executive members will not have a strong relationship with the company’s employees, compared with the relationship of the executive board members, who work on a full-time basis and thus have more direct contact with company employees.⁷¹⁹

Evidence suggests that a considerable number of Saudi listed companies have a cynical disregard for audit committees and have failed with one or more provisions of the CGR 2006. For instance, a common violation involves the nominating and appointing of audit committee members without prior approval from the general assembly.⁷²⁰ This occurred in both the Tabuk Cement company and the Basic Chemical Industry company, and both companies were fined \$13,333 for their violation of article 14 B CGR 2006. These penalties were in line with article 14 B of CGR 2006, which states that “the general meeting of shareholders shall be based on the recommendation of the board of directors, issue rules for appointing the members of the audit committee and define the terms of their office and the procedure to be followed by the committee”.⁷²¹

7.5.2 Remuneration Committee

Directors’ remuneration remains a contentious topic in the field of corporate governance, and the remuneration committee plays a significant role in avoiding potential conflicts of interests between senior executives and shareholders. If the remuneration committee does not perform its functions adequately within the company, senior executives may arrange a higher level of

⁷¹⁶ CGR 2006 Article 12 (E)

⁷¹⁷ CMA decision number 6-36-2011 Dated 11/12/2011.

⁷¹⁸ Robert Monks, (2001), ‘Redesigning Corporate Governance Structures and Systems for the Twenty First Century’, *Corporate Governance: An International Review*, 9 (3), p.146

⁷¹⁹ *Ibid*

⁷²⁰ CGR 2006, Article, 14 (B)

⁷²¹ *Ibid*

remuneration for their personal interests, which may not be in the best interests of the shareholders.⁷²²

The Greenbury Report in 1995 was focused on making sure that executive remuneration was linked to the company's performance; the level of pay was not of concern, as long as the remuneration was justified by the performance of the company.⁷²³ The Greenbury Report was the first report which recommended that certain aspects of directors' remunerations should be dependent on the performance of the company, thus aiming to align the interests of the directors with those of the shareholders. According to the Greenbury Report "to avoid potential conflicts of interests, boards of directors should set up remuneration committees of non-executive directors to determine on their behalf, and on the behalf of the shareholders, within agreed terms of reference the company's policy on executive remuneration and specific remuneration packages for each of the executive directors, including pension rights and any compensation payments".⁷²⁴

The main purpose of the Greenbury Report was to strike a balance between the remuneration of the directors and the performance of the directors; however, a number of academic researchers have shown that director's pay is only weakly correlated with the performance of the company.⁷²⁵ The UK code of corporate governance outline the remuneration level that directors should receive, stating that the level of directors remuneration should be sufficient to attract, retain, and motivate directors of necessary quality as required to run the company successfully, but that a company should avoid paying more than necessary to achieve this purpose, and a significant portion of directors' remuneration should be designed to link remuneration to corporate and individual performances.⁷²⁶

Furthermore, one of the main principles under the UK Corporate Governance Code recommends that the remuneration received by the executive director should be designed as to promote the long-term success of the company, but clarifying that "performance-related elements should be transparent, stretching and rigorously applied".⁷²⁷ The UK Corporate Governance Code also states that the remuneration committee should be composed of three

⁷²² Martin Conyon and Simon Peck, "Board Control, Remuneration Committees, and Top Management Compensation", *Academy of Management Journal*, 1998 (41), 145.

⁷²³ Greenbury, R. (1995). *Directors' remuneration: report of a study group chaired*. London: Gee Publishing Paragraph 6.36

⁷²⁴ *Ibid*, A.1

⁷²⁵ See Buck, T., Bruce, A., Main, B.G. and Udueni, H. (2003), Long term incentive plans, executive pay and UK company performance, *Journal of Management Studies*, 40(7), pp-1709-1727

⁷²⁶ UK CGC 2016, D.1

⁷²⁷ *Ibid*, D.1

independent non-executive directors, and the committee should be delegated the necessary powers to set remuneration for all executive directors and the chairman, including any pension rights and any forms of compensation.⁷²⁸

Similarly, the Saudi regulator states that the board of directors should form a remuneration committee and, based on the board's recommendation, the ordinary general assembly should appoint members of such a committee. Members should include at least one independent director, whilst the remaining members should be non-executive, and no executive director is allowed a seat on the remuneration committee.⁷²⁹

The CGR 2017 also set out what information must be included in the remuneration policy, whereby it stated that it must be in-line with the company's strategy and objectives, provide remuneration with the aim of encouraging the board member and the executive management to achieve "the success of the company and its long-term development",⁷³⁰ and take into consideration the remuneration of board members in other companies. However, the committee must avoid the risk of such comparison in leading to unwarranted increases in remuneration and compensation. The remuneration policy must also aim to attract talented professionals and retain and motivate them 'without exaggeration'. The new regulations award power to the remuneration committee to reclaim any unwarranted remuneration handed to the director and recommend that mechanisms be put in place to deal with situations that may warrant a suspension or a reclamation of remuneration, if it appears that such remuneration was based on inaccurate information that was provided by members of the board or the executive management.⁷³¹

Despite the similarities of the Saudi and UK code of corporate governance, the fact remains that the sub-committees, remain subordinate to the board of directors and it holds the final say on all matters. This is evident from the wording of article 21 in CGR 2017 which affirms that the final responsibility lays with the board of directors, even if it delegates some of its powers to other committees or persons.⁷³²

⁷²⁸ *Ibid*, D.2.2

⁷²⁹ CGR 2017 Article 60.

⁷³⁰ *Ibid*, Article 62.

⁷³¹ *Ibid*

⁷³² *Ibid*, Article 21.

7.5.3 Nomination committee

The existence of a nomination committee is generally viewed to better safeguard shareholders' interests, in contrast with companies without such a committee. Therefore, nomination committees can be seen to prevent – or at least limit – the nomination and eventual appointment of weak and ineffective directors.⁷³³ The procedure for the appointment of board directors is one that carries a great deal of significance as the procedure will ultimately lead to the appointment of the director who will be trusted to lead the company.⁷³⁴

Furthermore, to reflect the importance of such a procedure, the nomination committee must be made up of independent directors. The UK CGC 2016 states that the majority of members in the nomination committee should be independent non-executive directors⁷³⁵ and that the committee should ensure that there is a balance of qualifications, skills, and expertise in the board.

Under the previous Saudi Corporate Governance Regulations 2006, the importance of the nomination committee appeared not to have been fully appreciated. This is clear from the fact that the Saudi regulator recommended the establishment of the nomination committee alongside the remuneration committee, and both carried identical provisions. However, the Saudi regulator appears to have realised the benefits of separating the two committees, and this is made clear under CGR 2017. In addition to this, the Saudi regulator has assigned each committee with its own responsibilities in a clear and precise way. CGR 2017 states that the nomination committee must suggest clear policies and standards for membership of the board of directors and the executive management.⁷³⁶ The committee should also ensure the continued autonomy of the independent directors on an annual basis, and ensure the absence of any conflicts of interest if a board member is also acting as the board member of another company.⁷³⁷ The nomination committee is also required to annually review the skill and expertise of the board members, as well as of the executive management.

Furthermore, the new regulations require the company to publish nomination announcements on its website and on the website of the CMA and invite persons who wish to be nominated for the membership of the board. Such announcements must remain on both websites for at least one month.⁷³⁸ However, the Saudi regulator does not set out the procedure by which sub-

⁷³³ B.D Baysinger and H.N Butler (1985) "Corporate governance and the board of directors: Performance effects of changes in board composition" *Journal of law, economic and organization*. 11, P.101-124.

⁷³⁴ UK CGC 2016, B.2

⁷³⁵ UK CGC 2016, B.2.1

⁷³⁶ GCR 2017, Article 64.

⁷³⁷ GCR 2017, Article 65 (7).

⁷³⁸ Article 68.

committee members should be remunerated; it is therefore recommended that amendments are made to CGR 2017, addressing this point. The CMA should follow similar recommendations set out in the Greenbury Report, namely that remuneration committee members should typically be remunerated by way of a fixed fee set by the board of directors. The fee should be within the limits provided in the company's articles and should reflect the amount of time the committee member has dedicated to the company. This method should be considered and applied to all sub-committee members.⁷³⁹

7.6 Board of directors' remuneration

The UK code of governance does not explicitly set the pay of the directors; however, it does outline remuneration levels. The UK's CGC 2016 states that executive remuneration should be designed to promote the long-term success of the company.⁷⁴⁰ This principle emphasises the importance of linking directors pay with the company's performance, as it is presumed that the link is weak between the pay on one hand and the performance on the other. Nonetheless, in determining such remuneration, the committee should be aware of the company's position relative to other companies. However, that comparison should be used with caution, to avoid the risk of "an upward ratchet of remuneration levels with no corresponding improvement in corporate and individual performance".⁷⁴¹ Moreover, companies should avoid excessive pay for executives and should aim to be sensitive to pay and employment conditions elsewhere in the company.⁷⁴² Executive remuneration is expected to be structured in such a way as to be linked to corporate and personal performance.

The Saudi regulator appears to have adopted a similar approach as the UK, whereby it recommends that the remuneration of directors receive should be sufficient to attract skilled professionals and take into account paid practices of other relevant companies, without falling into the trap of unjustifiable increases in remuneration and compensation.⁷⁴³ Furthermore, and for the first time, the CGR 2017 appears to have linked the remuneration of a board member and the executive management to the long-term performance of the company. This is a considerable change in approach, as, under CGR 2006, there were no articles dedicated to the linking of the remuneration of board members and executives to the long-term performance of the company.

⁷³⁹ Greenbury, R. (1995). *Directors' remuneration: report of a study group chaired*. London: Gee Publishing, p.23.

⁷⁴⁰ UK CGC 2016, D.1

⁷⁴¹ *Ibid*

⁷⁴² *ibid*

⁷⁴³ CGR 2017 Article 62.

There is one marked difference between the position in Saudi Companies Law and that in the UK. While the Saudi CGR 2017 expresses the same principle as the UK CGC 2016, the Saudi CGC 2017 must be read subject to the provisions in Article 76 of the CL 2015 which states: “The company’s articles of association shall specify the manner of remunerating the members of the board of directors. Such remunerations may consist of a specified salary, a fee for attending the meetings, in taking benefits, a certain percentage of the profits, or a combination of two or more of these benefits. If, however, such remuneration represents a certain percentage of the company’s profits, it must not exceed 10% of the net profits after deduction of such reserves determined by the general assembly pursuant to the provisions of this Law or the company’s articles of association, and after distribution of a dividend of not less than 5% of the company’s capital to the stockholders, provided that the eligibility of such remuneration shall suit the number of sessions attended by the member. Any determination of remuneration made in violation of this provision shall be null and void. In all cases, the total remuneration, whether cash or in kind one, to be received by the member of the board of directors shall not exceed SAR 500,000 per annum as per the regulations set by the Competent authority”

In a bold move, the Saudi legislator stated that the maximum remuneration that a director may receive, whether in cash or in kind, must not exceed 500,000SAR (\$133,300). The decision of the Saudi legislator to fix a maximum amount for directors’ pay was based on a review of such payment by the Saudi consultative council, which has legislative power over commercial and corporate law.⁷⁴⁴ The reason for this review was due to a previous ministerial resolution, which set the maximum amount that non-executive directors and independent directors could receive in compensation. The ministerial resolution stated that the maximum remuneration that non-executive and independent directors should be capped at 200,000SAR (\$53,333) annually. Building on this, the Consultative Council recommended that the total amount of compensation for any director should not exceed 500,000SAR (\$133,300). It is evident that the approach of the Saudi legislator is different to that of the UK legislator; whilst the latter insists that director’s remuneration is a matter for the market and the shareholders, and it would not get involved in setting directors pay, the former favour a more hands-on approach, believing that it is within the Saudi legislator’s powers to set the maximum levels of director’s remuneration.

⁷⁴⁴ Saudi Consultative council establishment act 1992, Article 67.

It is reasonable to assume those harsh penalties, including imprisonment for breaching any provisions of the Company's Law 2015 work as a strong deterrent and ensure compliance of companies to the provisions on the law.⁷⁴⁵ Article 213 in the CL 2015 states that any company or director who fails to abide by the laws and resolutions relating to the company's business and fails to comply with instructions, circulars or directives issued by the competent authority, shall be punishable by a fine of 5 million Riyals and 5 years imprisonment.⁷⁴⁶ Additionally, the Saudi CGR 2017, as a part of its disclosure and transparency requirements, requires that the annual board report should include the remuneration policy and the procedure by which remuneration of the board and executive management is decided. The annual board report should disclose detailed information of all remunerations granted to board members and members of executive management in the company, without any omissions or misleading information. Furthermore, the pay of the top five senior executives – those who have received the highest remuneration the CEO and CFO must also be included in the report. However, there a need for clarification in the Saudi CL 2015. The CL 2015 does not expressly state which types of directors are limited to this figure as it is unclear in CEOs and other members of the executive management team who have additional responsibilities in the daily management of the company than NEDs or independent directors. Therefore, for the sake of clarity, the legislator should issue some guidance on the applicability of this article.

On a different note, the UK CA 2006 adopts a “Corrective” approach in relation to directors pay. The CA 2006 does not make any provisions that stipulate how directors should be remunerated instead the Act makes provisions on how the shareholders should act if they feel that the director's pay is excessive.⁷⁴⁷ This is a demonstration of the stance of the UK legislator whereby, it does not want to get involved in settings directors remuneration, as it believes that it is an internal matter and should be handled by the company's management. This can be seen as a contradiction on the part of the UK legislator, in other words, if the UK legislator believes that directors pay is a matter for the company's management, why did the CA 2006 get involved in the first place. The position of the CA 2006 on directors pay can be traced back to the case of *Hutton V. West cork railway Co.*⁷⁴⁸ In that case, directors by default had no lawful entitlement to remuneration unless it was stipulated in the company's articles or in a separate

⁷⁴⁵ CL 2015, Article 213.

⁷⁴⁶ CL 2015, Article 213 (R).

⁷⁴⁷ Ernestine Ndzi, (2016) Directors' pay regulation: “one goal two approaches”, *International Journal of Law and Management*, 58(3), pp.337-352.

⁷⁴⁸ 1883, 23 Ch D 654.

contract.⁷⁴⁹ However, by early 1990s, the UK legislator began to take interest in the executive remuneration, especially when in 1994 the CEO of British Gas received a 70% pay rise which led to public outcry and attracted headlines in the press. The huge amount of negative press was not only because of the huge pay rise of the CEO of British Gas but because at that time British Gas was implementing voluntary redundancies towards the company's employees. The Chief executive at that time Mr Brown was required to appear in front of the house of commons employment committee to defend his pay. This was a shift in the position of the UK legislator whereby previously it stated that the director's remuneration was a matter for the market and the shareholders. From this moment onwards, the law made several provisions on director's compensation which was intended to increase transparency and accountability to director's compensation, however it did not have the intention to curb executive pay.

The Companies Act 1985 saw two major provisions which required listed companies to disclose directors' remuneration and provide shareholders with a non-binding vote on the remuneration report.⁷⁵⁰ Greater disclosure requirements have also been introduced into the 2006 Companies Act by the Enterprise and Regulatory Reform Act 2013 (ERA 2013), all aimed at increasing transparency and accountability in the pay procedure and the quality of the disclosed information⁷⁵¹. Therefore shareholders had been granted greater access to directors remuneration and this would surely lead to shareholders making a more informed decision when voting on directors remuneration report at the general assembly.⁷⁵² Previously, section 439 CA 2006 allowed shareholders a non-binding vote on the remuneration report, however, as the vote was non-binding if the shareholders decided to vote down the remuneration policy, the company was not forced to act in accordance with that vote. The Enterprise and Regulatory reform act 2013 inserted section 439A into the companies act and made it a requirement for the remuneration policy to be approved by the members of the company by way of an ordinary resolution. Listed companies were required to produce a remuneration report which must be separated into three sections. Firstly, a statement from the chair of the remuneration committee. Secondly, the remuneration report and thirdly, the implementation report. Specifically, the statement from the chair of the remuneration committee must contain a summary of the major decisions that were taken on directors remunerations, any major changes that occurred during

⁷⁴⁹ Villiers, C. (2010), "Controlling executive pay: institutional investors or distributive justice?", *Journal of Corporate Law Studies*, 10(2), pp. 3029-3342.

⁷⁵⁰ Ernestine Ndzi, (2016) Directors' pay regulation: "one goal two approaches", *International Journal of Law and Management*, 58(3), pp.337-352.

⁷⁵¹ Maber, D. and Ferri, F. (2012). Say on Pay Votes and CEO Compensation: Evidence from the UK. *review of finance*, 17(2), pp.527-563.

⁷⁵² CA 2006, s.412

the company's fiscal year regarding directors remunerations and what context these decisions were taken on and the context that those decisions were taken.⁷⁵³ The policy report must set out the proposed future remuneration policy which the shareholders must approve in abiding vote once every three years. The policy report however only indicates the terms in which executive directors are remunerated and does not include the specific amount paid to executive directors. The implementation report must be put to an annual non-binding vote by the shareholders.⁷⁵⁴

The shareholders binding vote alongside other powers given to shareholders under the 2006 act, such as the requirement for the approval of the shareholders for directors' service contracts that exceeds two years⁷⁵⁵, the ability for the shareholders to remove a director from office by an ordinary resolution⁷⁵⁶ and the approval of certain payments for loss of office⁷⁵⁷, all these powers represent the significance of the voice of the shareholders in the UK. However, the fact remains that the average shareholder lacks the expertise and the time to fully comprehend the complex nature of the reports, excluding institutional shareholders who can afford to hire outside expertise to interpret such reports. Roach argued that shareholders that hold a relevantly small percentage of the shares will have to incur additional costs by hiring experts to interpret the remuneration reports for them to make an informed decision when voting on the remuneration policy. Therefore, it is likely that these shareholders would decide to abstain from voting.⁷⁵⁸

Whilst Ndzi argues that shareholders are not familiar with the remuneration process of the company and would only base their decisions on the payout of dividends and cast their vote for or against the remuneration report. Adding to Ndzi's argument even though disclosure requirements were introduced as early as 2002, only a small number of companies have their remuneration report rejected by shareholders with the majority number of shareholders preferring to abstain from such voting⁷⁵⁹. The situation is very similar in Saudi listed companies, whereby, to the author's knowledge not a single remuneration report has been voted down by the shareholders in the general assembly. This may be due to the lack of shareholder's knowledge to interpret the remuneration report.

⁷⁵³ *Ibid.*

⁷⁵⁴ Large and medium size companies group accounts and report regulation 2008.

⁷⁵⁵ Section 188 CA 2006.

⁷⁵⁶ Section 168 CA 2006.

⁷⁵⁷ Section 217 CA 2006.

⁷⁵⁸ Roach, L. (2004), The directors' remuneration report regulation 2002 and the disclosure of executive remuneration", *Company Lawyer*, 25(5), pp. 141-148.

⁷⁵⁹ Ndzi, E. (2016) Directors' pay regulation: "one goal two approaches", *International Journal of Law and Management*, 58(3), pp.337-352.

A study conducted by Clark et al 2011 of 342 company chairman listed on London Stock Exchange found that the effect of disclosing director's remuneration actually led to an increase of the levels of executive pay. Half of the 342 UK respondents believed the disclosure of executive pay had resulted in a significant increase in pay levels⁷⁶⁰. This was since executive directors used the disclosure requirements to their advantage whereby, executive directors used the disclosure requirement to compare their pay levels to that of their peers. Therefore, instead of risking the departure of the executive directors, companies tend to offer the dissatisfied directors a pay package similar, if not better to their peers⁷⁶¹. Nzdi concluded that there is several challenges facing the CA 2006 on director's remunerations, chiefly, the CA 2006 did not intend to get involved in the setting of directors pay and it was of the view that it was an internal matter for the company. Thus, the law cannot make provisions as to the appropriate levels of remunerations that a director should receive or the aspects that make up their pay package. The "non-use" of shareholders voting rights to review and monitor directors pay appears to have contradicted the law's approach to set director's pay. Thus, rendering the role of CA 2006 companies act in this area ineffective which is clearly seen by the continued increase of directors pay in the UK.⁷⁶²

Although shareholder votes are aimed to indirectly influence the remuneration process, the effect of their influence is minimal, to say the least. Therefore, there is a need to enact certain clear provisions in the CA 2006 such as, who should determine the pay of the directors. Therefore, as a matter of law, directors set their own remuneration, and this may lead to potential conflicts of interests.⁷⁶³

Moving back to the Saudi position, board member remuneration in Saudi listed companies has been associated with negative headlines in recent history. In April 2017 a headline in Al Eqtisadiya newspaper was titled "Five Companies on the brink of liquidation pays out 16.6 million SAR in remunerations". The article questioned whether these payments to board members and senior executives were justified despite the company's suffering huge losses and being faced with impending liquidation.⁷⁶⁴ The five companies were: Bisha Agriculture

⁷⁶⁰ Clarke, M. (2011), "Banks remuneration report highlights failure of institutional investors", available at: www.freshbusinessstinking.com/news.php?NID11106 [accessed 30 December 2016]

⁷⁶¹ *Ibid.*

⁷⁶² Nzdi, E (2016) Directors' pay regulation: "one goal two approaches", *International Journal of Law and Management*, 58(3), pp.339

⁷⁶³ *Ibid.*

⁷⁶⁴ For more information see Al Eqtisadiya newspaper, available at: www.aleqt.com/2017/04/16/article1170991. Last [accessed April 29, 2017]

Development Company, Al Baha Company, Nema Petrochemical Company, Sanad Cooperative Insurance and the Saudi Fishery Company. Sanad Cooperative Insurance's annual report (2016) showed that the company paid out SAR 5.86 million to senior executives, and SAR 1.91 million in allowances for board members, even though it had recently suffered losses amounting to 91% of its capital.

In a similar case, the Saudi Fishery Company remunerated its senior executives and board members 3.2 million SAR in salaries and allowances to two of its executive directors, whilst making a loss of 72%. This company is considered to be one of the worst performing companies in the Saudi exchange, yet it has continued to pay relatively high remunerations to senior directors and board members over the past four years,⁷⁶⁵ leading to the question of how the remuneration committees of how it has managed to design its executive and board members remuneration policy with total disregard to corporate and individual performances.

7.7 conclusion

This chapter debated the main thesis question, namely whether the Saudi Arabian corporate governance standards meet international standards by using the UK best practices as exemplar in relation to directors' duties, the board structures, directors remuneration and gender diversity. The chapter discussed the duties of directors in the Saudi legislation and proceeded to compare it to the duties stated in the UK legislation. It was observed that the Saudi Companies law fails to explicitly refer to the two essential fiduciary duties: the duty of loyalty and the duty of care. The analysis revealed that these duties need to be clarified in the primary companies legislation rather than depend on the uncodified principles of Sharia law which are subject to interpretation. The chapter also reviewed the structure and the composition and structure of the board of directors in Saudi Arabia in light of the UK and international standards of corporate governance. It was shown that the both systems share many similarity in structure and composition of the board. It was also discussed the diversity of the board of directors and the roles of Executive, non-executive and independent directors and the issue of gender. The issue of directors remuneration was also discussed in detail and it was revealed that the Saudi position is considered more strict and set a limit on the remuneration a director whilst the UK position is less strict and sets no limit on directors pay. However, it was argued that there needs to be a review of the limitation set by Saudi law of the overall amount a director would receive

⁷⁶⁵ *Ibid*

as it was not explicitly mentioned if the remuneration limit includes executive directors who undeniably have more responsibilities.

Chapter 8

Conclusion and recommendations

8.1 Conclusion

The aim of this research is to analyse and assess the current Saudi corporate governance framework to determine if it attains international standards by using the UK best practices as an exemplar. The thesis is set out to examine the current corporate governance practices in Saudi Arabia in relation to directors' duties, the board of directors' practices, gender diversity and director's remuneration which are all key issues and controversial features of corporate governance. In order to achieve the stated research aim, this thesis assessed the compatibility of the Saudi legislation in respect to English law. This has been achieved through a comparative law approach. In adopting such approach, the research seeks to clarify the Saudi local political, legal and cultural environments that impact the development and the application of corporate governance in Saudi Arabia and to identify deficiencies in the Saudi law in relation to the board of directors in listed companies. The objective of this study is to propose certain recommendations to improve the respective laws by suggesting more clarity, certainty, transparency and accountability. In achieving this the following chapters were reviewed and analysed where appropriate.

The thesis first discussed a detailed review of the definitions, importance and concepts of corporate governance. It then explored the popular theories and models of corporate governance that affect the role of directors such as the agency and stakeholder theory. This will help extend the knowledge and understanding of the role of directors and their relationship with the company's shareholders and stakeholders. This was followed by investigating the most extensively followed models of corporate governance that affect the role of directors and the extent those models are followed in Saudi Arabia. It was noted that the several corporate governance models and theories have levitated from different theoretical viewpoints whether they be social, cultural political or economic. Upon evaluation of the different theories explored, it was apparent that each has its own merits, and some have practical elements that can be applied in different environments that can contribute to the development of corporate governance.⁷⁶⁶ In addition, this chapter concluded that The Saudi and UK legislation consider the company (not the shareholders) as the principal and the board of directors as autonomous fiduciaries who act on behalf of the interest of the whole company. It was found that Both countries recognise various stakeholder as part of the

⁷⁶⁶ Kiel, G., and Nicholson, G. (2003). Board Composition and Corporate Performance: How the Australian experience informs contrasting theories of corporate governance. *Corporate Governance: An International Review*, 11(3), p. 201.

company who have needs, rights and claims.⁷⁶⁷ Thus the relationship between the board of directors and the company is quite unique where it never can be described as an exclusive agent-principle relationship between the board of directors and the shareholders.⁷⁶⁸ It was also reported that the two most renowned models of corporate governance were the Anglo-American and the Continental European models. The research then explained the huge differences between the two models which led to recognize that these differences were due to a host of legal, cultural and institutional reasons.⁷⁶⁹

Consequently, The Saudi model of corporate governance is regarded to be much closer and more in harmony with the Anglo-American model and its shareholder ordained approach. The Saudi legislator adopts a unitary board and does not allow for a two-tier model. The Saudi legislator does not provide an option for any form of employee participation or representation in the decision-making process. Furthermore, the Saudi model does not support the bank orientated system nor any form of long-term dominate ownership. However, this system relies on the advanced nature of the capital markets and strict regulation on discourse and reporting as well as the legal infrastructure in the country. Such system requirements might be difficult to implement in a country such as Saudi Arabia. On the other hand, The corporate governance system in continental European countries was built on civil law and is considered quite distinct from the Anglo-American system of the corporate governance these continental European countries tend to be more focused on certain stakeholder groups offering their interests and rights wider legal protection than to shareholders.⁷⁷⁰ The main features of this model can be described as being bank focused, insider-dominated and stakeholder oriented.⁷⁷¹ In contrast to the one-tier structure found in the Anglo-American model, continental European countries opted for two-tier board: the board of directors and the supervisory board. The continental European model highlights and promotes the labour related aspects and employee involvement and participation, it also allows them to contribute to the strategic management decision. Therefore, it was concluded

⁷⁶⁷ UK CA 2006, s.172 and Saudi CGR 2017, Article 85.

⁷⁶⁸ Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), p.231.

⁷⁶⁹ Goergen, M., Manjon, M., and Renneboog, C. (2008). Is the German system of corporate governance converging towards the Anglo-American model?. *Journal of Management and Governance*, 12(1), p. 65

⁷⁷⁰ Mullineux, A. (2010). Is There an Anglo-American Corporate Governance Model? *International Economics and Economic Policy*, 7(4), pp. 437- 443.

⁷⁷¹ Weil, G., and Manges, L. (2002). Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States, European Commission, Final report and Annexes, *Weil, Gotshal and Manges*, p. 32.

that there is no system of corporate governance should be imitated blindly. Each system of governance explored has its merits and must be viewed in the light of local and legal settings, the characteristics of the capital market and the ownership structure.⁷⁷²

The thesis then discussed the background and the legal structure of Saudi Arabia, it then underlined the local environment in Saudi Arabia in relation to the political, legal and judicial settings which is considered key issues that affect corporate governance practices in the country. The discussion was proposed to highlight some of the more unique characteristics of the Saudi legal structure. The research has clarified the role of Sharia as the foundation of all laws in the country and the considerable influence of Sharia judges was noted in matters relating to corporate governance such as the quasi-judicial committee and commercial courts.

Consequently, the discussion in chapter three acts as a crucial base to the upcoming chapters as an understanding of corporate governance in Saudi Arabia it critically depends on the understanding of the legal system and its underlying structure.

Subsequently, the fourth chapter then analysed the development of the Saudi corporate governance framework. The discussion focused on the first set of corporate governance regulation issued in Saudi Arabia in 2006. It was observed that the Saudi corporate governance regime adopted the Anglo-American model with the emphasis placed on the rights of shareholders. This was further proven by the fact the CGR closely reflected the recommendation of the Cadbury Report, such as the as the voluntary nature of compliance i.e., “comply or explain” approach suggested in the Report and opting for the unitary-style board as well. The ‘comply or explain’ nature of the regulation was viewed as not appropriate as the Saudi legislator adopted the approach without considering the local environment such as ownership concentration and social and hierarchical that is prevalent in Saudi companies.

The discussion then moved to the UK companies law and corporate governance framework, this was due to the decision to use the UK as a benchmark for possible recommendations in relation to director’s duties and the development of corporate governance in Saudi Arabia. The position of the law on directors’ duties prior to the enactment of the Companies Act 2006 was explored. It was noted that directors’ duties were governed mainly by common law rules and equitable principles and to some extent by statutes. The need for reforming the

⁷⁷² Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 22.

Companies Act and codifying the duties of directors was presented. The UK company act needed to be reformed as directors' duties were fragmented and there were demands for the full or partial codification of the law. The 'new' general duties were also examined. Further, the research then reviewed the long experience of corporate governance, spanning over 30 years and the constant process of review and development that was led by the Financial Reporting Council.

The thesis then turned its focus on the Saudi Companies Law and corporate governance framework it also reviewed the changes between the 1965 Companies law and the updated Companies Law 2015. It was evident that the new law contains several provisions that deal with corporate governance, the law also removed barriers that aim to reduce the cost and the procedure required to establish a firm. It was noted that one of the most important additions to the new law was to provide the audit committee with increased independence and powers. Furthermore, the new law stipulated harsher punishments for violation of the provisions, including imprisonment heavy fines. However, it was observed that there was no explicit mention of any of the fiduciary duties in the Saudi Companies. Although the fiduciary duties of loyalty and care have established in Islam, these duties were not clearly specified or defined in the current Saudi Companies Law 2015. In fact, it was suggested that these duties need to be clarified and clearly specified in the companies law, rather than depending on the scattered range of rules and principles outside the legislation which will only add to the current uncertainty.

The new corporate governance regulations 2017 was also reviewed in light of current economic environment, in particular, Vision 2030 which aims to have a huge impact on the diversification of the Saudi economy, increasing foreign direct investment and restructuring state-owned enterprises. The new regulations were in response to the issuance of the new Saudi Companies law to harmonise their rules. Numerous provisions were added, and many shortcomings have been tackled in the new regulations. Unlike its predecessor, the new corporate governance regulation is compulsory on all listed companies, except for a limited number of articles which indicates that the new Regulations have been customised with the local business environment.

In the final chapter, the thesis discussed the board of directors in Saudi corporate governance as compared to the UK. It was identified that the Saudi corporate governance has some deficiencies in relation to director's duties and gender diversity. However, in relation in

relation to director's remuneration, it was revealed that Saudi Arabia adopts a completely different position to the UK, whereby the Saudi legislator set a limit on the maximum remunerations a director receives, although it is not expressly stated if the provision applies to all directors including executive directors.

8.2 Summary of findings and recommendations

8.2.1 Recommendations in relation to Saudi corporate governance and company law

One of the most important issues that were addressed in this research is the Capital Market Authority and its competent authority for handling disputes relating to Saudi listed companies. The disputes of listed companies in Saudi Arabia are dealt with by the Committee for the Resolution of Securities Disputes (CRSD) disputes which work outside the jurisdiction of the courts. This is also the case with the appeal panel of these disputes. The CRSD was established by the CMA which is the sole authority that issues regulations and rules concerning the capital markets. The CMA has the power to determine infringements in the capital market as well as being the authority that issued the regulations relating to such infringements. This gives the CMA the power to set the rules that determine the practices and acts that would constitute fraud and insider trading as well as stipulating and defining related terms.⁷⁷³ This means that the CMA in these cases plays the role of the lawmaker, claimant, investigator, judge and jury at the same time.

Although the CRSD and ACRSC carry out judicial functions and have authority to do so. However, according to the Saudi law, the members of these committees are not viewed as judges and their verdicts are not deemed judicial, but they consider as administrative decisions.⁷⁷⁴ Furthermore, the CRSD and ACRSC exercise their judicial duties outside the remits of the courts and have the power to issue fines, suspensions and even imprisonment even though they have no legal qualification or independence as is the case of members of the judiciary.

⁷⁷³ CML 2003. Articles 25 (c), 49 and 50.

⁷⁷⁴ CML 2003. Article 25 (b)

A noteworthy example of the deficiencies in the Saudi securities market was the recent case of Al Mojil Group. The CRSD in the final resolution handed down a fine of 1.6 billion Riyals (\$427 million) to be deposited in the CMA accounts and imposed a five years prison sentence for the chairmen Mohammed Al Mojil and his deputy for irregularities related to the company's initial public offering (IPO).⁷⁷⁵ It should be noted that to appeal a decision by the CRSD, permission must first be granted by the Appeal Committee for the Resolution of Securities Conflicts (ACRSC) which has the discretion to decline to review the decision by the CRSD, affirm the decision or reconsider the lawsuit. In this case, the ACRSC declined to hear the case deemed final with no legal recourse to the Board of Grievance or any other court for that matter.⁷⁷⁶

It was also noted that the decision of this committee is considered final without any opportunity for judicial review for the aggrieved party. This situation was considered unacceptable and may have serious negative consequences not only on the Saudi companies and their directors but also on the integrity of litigation in the capital market which may deter foreign investors from entering such a market. It was also pointed out that this situation hinders the role of the corporate sector which goes against the goals of Vision 2030. Saudi Arabia is heading towards intensive privatization. Thus, the Saudi legislator must improve the regulation and the judicial system to create a welcoming and secure environment for all parties. The cause of this current dilemma is the long-term disagreement between Sharia scholars and Saudi legislators about enacting laws that tend towards dealing with the need of modern times.

Recommendation

To ensure fairness in the justice system, it is recommended that CRSD and ACRSC be transformed into authentic courts. Such authentic courts would be divided into two levels; the court of the first instance and an appeals court. This would necessitate the legal system in Saudi Arabia to recognise these committees as part of the judiciary and afford its members the same power, protection and independence currently afforded to members of the judiciary authority. This would also apply to the process of appointment, tenures and the nature of decisions taken by the members of these committees.

⁷⁷⁵ The Capital Market Authority. (2018). *The CMA Announcement on The Issuance of a Final Decision by The Committee for the Resolution of Securities Disputes Convicting Violators of the Capital Market Law and Its Implementing Regulations*. [online] Available at: https://cma.org.sa/en/market/news/pages/cma_n_2182.aspx [Accessed 2 Aug. 2018].

⁷⁷⁶ CML 2003. Article 25 (g)

Furthermore, the fact that the decisions of the committees are considered final would considerably lessen the attractiveness of the Saudi market. Under Article 25 (g), the CML provide that the decision of the ACRSC shall be deemed final. Thus, the litigant has no legal recourse available in the form of a judicial review on the decision of these committees. Therefore, it is recommended that the Saudi legislature to remove Article 25 (g) and replace it with an appropriate article to ensure that the aggrieved party has legal recourse before the Board of Grievances as is the case in the UK legal system.

In addition, the lack of committee sittings outside the capital city presents an obstacle that might discourage (both in terms of cost and location) aggrieved parties from bringing an action before the CRSD. It is recommended that Saudi Arabia could benefit from the experience of the UK regarding this issue, for example, the High court in the UK has many sittings around key locations in the country.

Recommendation for an Independent body for corporate governance

In the UK, the development of corporate governance can be seen to have begun early in the 20th century when public companies took the significant step of being listed on the stock exchange, widening the dispersion of shareholders and thus weakening the shareholder-management link.

Behind the increasing numbers of measures taken in the UK to regulate corporate governance lie a number of factors, including concern arising from several instances of corporate financial collapse 1990s and 2000s. A strengthened awareness of corporate governance practices has also arisen from the greater investment of pension funds, insurance companies and other institutional investors in the shares of public companies and the consequent increase in their concern regarding their exposure to the risks inherent in these shareholdings. At the same time, companies have increasingly sought and expected to obtain external funding, giving rise to the increasing importance of corporate governance and its role in reassuring prospective investors that their money is in safe hands.

The Financial Reporting Council (FRC) was established as an independent organisation, that “officially took over the role of review and updating the UK corporate governance code”⁷⁷⁷ this was to promote high standards of corporate governance and reporting with the objective of fostering investment. The health and growth financial market contribute directly to the overall development of an economy and ensuring the that the UK financial market function in an efficient way there is an inherent need for investors to have the confidence to invest

The FRC is the UK’s independent regulator and is responsible for setting and promoting high-quality corporate governance standards in listed companies. Some of its functions are maintaining and reviews the UK Corporate Governance Code, implementing and monitoring the standards of corporate reports, encouraging companies to publish reports in a fair, balanced and understandable way and operating a Financial Reporting Lab that connects companies and investors together to participate in the improvement of company reporting.

On the other hand, The CMA is the sole authority that supervises and regulates the conduct of all listed companies in Saudi Arabia. The weakness of the present regime is that the CMA reports directly to the Council of Ministers. It acts as an agency of the government, which directly appoints the board members making its independence restricted by excessive government interventions that compromise its ability to monitor and regulate corporate practices.⁷⁷⁸ This was confirmed by The World Bank’s report on the observance of standards and codes relating to corporate governance practices in Saudi Arabia which suggested that there was a lack of managerial independence among the regulatory authorities, unnecessary political interference and a shallow market where corporate legislation is weakly implemented and enforced.

Recommendation

It is recommended for Saudi Arabia to create a separate independent body for corporate governance, a similar organisation like the UK Financial Reporting Council to be in charge of maintaining and reviewing the Saudi Corporate Governance Regulations, monitoring the standards of corporate reports and to engage with stakeholders on regular basis and respond to any concerns they might have. The body should also hold conferences, workshops, publish

⁷⁷⁷ Yeoh, P. (2018). Corporate Governance in the UK: A Time for Reflection. *Business Law Review*, 36(4), p.130.

⁷⁷⁸ Al-Matari, A. Al-Swidi, K. and Fadzil, B. (2012). Corporate Governance and Performance of Saudi Arabia Listed Companies, *British Journal of Arts & Social Sciences*, 9(1), pp.1-30.

consultations to increase awareness of corporate governance and ensure that regulations are harmonized with the local business environment so that it would serve its purpose.

8.2.2 Recommendation in relation to the role of Sharia in corporate governance.

Since the foundation of the Saudi nation, Sharia has been recognised as the official legal code. The research, therefore, considers it is significant that the analysis of the issues on director's duties is expanded to include the viewpoint of Sharia. Furthermore, the duties and responsibilities of directors in relation to the rules and rights afforded by Sharia may provide useful suggestions. These suggestions include increased effectiveness when dealing with the misconduct of directors. The recommendations provided by Sharia law may be used to improve the efficacy of certain regulations in Saudi company law which will subsequently have a positive impact on corporate governance.

This thesis has shown that several director's duties have been acknowledged by Sharia scholars. To ascertain the origins of these duties, several primary and secondary sources have been analysed to confirm this claim. The thesis has also proven that the origins of the fiduciary duties were Sharia law.⁷⁷⁹ Moreover, the duty of care, the duty to act within powers, the duty to avoid conflicts of interest and other duties have been proven to have its origins in Sharia law and have been acknowledged by Sharia courts. Sharia scholars categorise the director (Mudharib) as a trustee and therefore, must act in a certain manner and within the agreement between him and the shareholders. As a trustee, the director is not authorised to undertake risks that are harmful to the people that placed their trust in them and must only act in their best interest. From a Sharia perspective, a trustee is personally held liable in cases of negligence or aggression. The concept of negligence is recognised as the absence of care in the maintenance and the protection of commodities or money that have been placed in the care of a trustee. In relation to the level of care expected from a trustee, Islamic scholars have clarified this position by stating that the adequate level of diligence that experts consider is acceptable under normal circumstances.⁷⁸⁰ Breaching the duty of care was demonstrated in the case of the chairman of ABDAR company where he was sued on the grounds of negligence when the chairman failed to arrange the required loan of \$13 million which caused huge losses to the

⁷⁷⁹ See Chapter 6.

⁷⁸⁰ Siraj, M, (1993). *liability of aggression in Islamic jurisprudence compare to tort liability in Law*, Dar Alddirasat Aljame'eiah, Beirut, pp.251-257

company. The Commercial court at the Board of Grievances ruled that the chairman was negligent and was liable to the company for the damages by breaching his duty of care.⁷⁸¹

Despite Sharia recognition of the duty of care, the Saudi companies Law 2015 has no specific mention of the fiduciary duties of directors.⁷⁸² for instance, The Saudi legislator has failed to clearly define the duty of care in the CL 2015 which makes it difficult to hold directors accountable for their breach under Saudi law.

Recommendation

It is recommended that the Saudi legislator should clarify the fiduciary duties in the Saudi Companies Law 2015. The fiduciary duties of directors are not well defined in the Saudi legislation, although Sharia law has recognised these fiduciary duties and through this recognition exerts its influence in the country and is applied by Sharia courts. However, this recognition is achieved through scattered Sharia rules and principles which can create a sense of legal uncertainty. Therefore, given that other duties are generally codified in the Saudi Companies Law 2015, it recommended that this is applied in relation to directors fiduciary duties. This will be beneficial to directors and will clarify Saudi Arabia legal stance regarding fiduciary duties. For example, the Saudi legislator will benefit from the UK companies Act 2006 s.174 which offers a clear definition of the duty of care and provides the standards that directors are required to meet

8.2.3 Recommendations in relation to the cultural and political environment.

The new trend of vision 2030 is a key factor that can greatly affected corporate governance in Saudi Arabia. Vision 2030 outlined the proposed new economic blueprint for the kingdom of Saudi Arabia. This could be a turning point in the history of the nation and may have a huge impact on the diversification of the economy in Saudi, promoting the culture of work and corporate governance practices. The new vision in Saudi involves a comprehensive privatization programme of state-owned companies and government agencies which aim to increase transparency, tackle any form of corruption and reduce unemployment by encouraging

⁷⁸¹ The Board of Grievances the Commercial court, Judgment Number. 10421/1 in 2011.

⁷⁸² Al Rimawi,L, (1999), “Emerging Markets of the Middle East: A Critique of Selected Issues in Arab Securities Regulation”, *Journal of Financial Regulation and Compliance*, 7 (2),p. 160.

the private sector to employ most of the labour force. all these factors together and linked to the current legal environment raises questions about the ability to achieve the targets of vision 2030 whilst protecting the rights of shareholder and stakeholders.

Recommendation

In light of Vision 2030, good governance and the protection of stakeholders interest would be more significant than ever before. The research has shown that there is no equivalent of s.172 CA 2006 in the Saudi Companies Law. Indeed, the Saudi corporate governance framework would benefit greatly from adopting a similar provision to the duty set out in s.172. The essence of the duty is to make directors base their decision, on the long-term success of the company and take into account the interests of stakeholders. The director will have to think harder about making decisions, this shouldn't be viewed as an impendent on the directors, rather should ensure that the decision would entail stability and sustainability. Further to the discussion in chapter two, the principle of Sharia law recognises the need to take into account the effect on the other stakeholders of the board of directors' decisions. The importance of consulting stakeholder can be found in Sharia, the following text from the Quran affirms this. Allah declares: "And consult them on affair [of the moment] then, when you have decided put your faith in Allah"⁷⁸³ Also "Those who respond to their Lord and establish regular prayers who [conduct] their affairs by mutual consultation who spend out what we bestow on them".⁷⁸⁴

This confirms the importance of consulting with stakeholders especially in areas where they are likely to be affected by the decision of the director. It is therefore recommended that the law is made more certain by codifying the Sharia principle in a similar manner to that of section 172 CA 2006. The proposed provision was found to be a good tool for corporate governance and is being fully compliant with Sharia law.

Female participation

The representation of women on board of directors has recently gained global attention and considered as a key topic in corporate governance.⁷⁸⁵ Despite the recent progress towards gender balance in the labour force of many countries women are still largely underrepresented in leadership positions and particularly in executive positions.

⁷⁸³The Holy Quran, Surrah Al Amran:3:159

⁷⁸⁴ Ibid, AL Shura 38.

⁷⁸⁵ Hill, B., Lunn, M. and Morrison, W. (2015). Saudi Arabia: An Overview of Executive Compensation, Board Structure, and Sustainability. *Drake Management Review*, [online] 4(1\2), p.2. Available at: <http://faculty.cbpa.drake.edu/dmr/0412/DMR041205R.pdf> [Accessed 13 Oct. 2017].

However, it was revealed that Saudi Arabia was one of the worst performing countries in terms of women representation. In the 2014 Catalyst Report which studied the board composition of 44 countries found that Saudi Arabia was ranked 44 out of the 44 countries chosen for the study with only 0.1% of board seats occupied by women in 2014.⁷⁸⁶ Many European countries have opted to adopt quotas to increase female participation on company boards. For instance, Norway, Italy, Belgium and France have all decided to enact binding quotas whilst countries like Greece, Denmark, Austria and Slovakia have placed quota requirements for state-owned companies.⁷⁸⁷

In the United Kingdom, the Government Equalities Office of Statistics revealed that in the FTSE 100 female directors hold 23.5% of board seats and that statistics that there were no all-male boards in any of the FTSE 100 companies. This represented an increase of 11% since 2012 in female representation on company boards. The increase has been attributed to government campaigns, voluntary initiatives and legal disclosure requirements.⁷⁸⁸ In 2011 the Davies Review into women on boardrooms made several recommendations, including; all FTSE 100 companies should aim for at least 25% female representation on boards by 2015. (A target that was reached six months ahead of schedule)⁷⁸⁹, All FTSE 350 should set aspirational targets for the percentage for women on their boards, quoted companies should disclose of the number of women on the percentage of women on the board, in senior executive positions and the overall proportion of women in the company and Amending the UK Corporate Governance Code to require listed companies to establish a policy that addresses the issue of diversity in the boardroom.

The recommendations of the Davies Review work well together with the gender diversity disclosure requirements are set out in the UK CA 2006 and the UK Corporate governance code. Section 414 (8)(c) of the CA 2006 requires quoted companies to include in the annual strategic

⁷⁸⁶ Catalyst. (2014). Catalyst Census: Women Board Directors. [online] Available at: <http://www.catalyst.org/knowledge/2014-catalyst-census-women-board-directors> Last accessed 22 January 2016

⁷⁸⁷ Valsan, R (2016), 'Board gender diversity and the enlightened shareholder value principle' *The Company Lawyer*, 27(6), pp. 171-177.

⁷⁸⁸ Davies. Lord Mervyn. 2011. *Women on boards*. London: Department for Business, Innovation and Skills. Available at: <http://www.bis.gov.uk/assets/biscore/businesslaw/docs/w/11745womenonboards>. [accessed 23 August 2016]

⁷⁸⁹ Davis. Lord Mervyn. 2015. *Women on boards Davis Review five year summary*. . London: Department for Business, Innovation and Skills. Available at: <https://www.gov.uk/government/publications/women-on-boards-5-year-summary-davies-review>.

report a breakdown at the end of each year showing the number of each sex who were employed by the company including directors and senior managers.⁷⁹⁰

The UK corporate governance code also recommends that the directors should be appointed on merit and “With due regard for the benefit of diversity on the board, including gender”.⁷⁹¹ The UK CGC also states that a separate section of the annual report must include a description of “The boards' policy on diversity, including gender, any measurable objectives that it has set out for the implementation of the policy, and progress on achieving the objectives”.⁷⁹²

It was noted that one of the benefits of the gender diverse board was the promotion of dialogue which essential for a board to function effectively. The dialogue should be both constructive and challenging to avoid issues that may arise from “Groupthink”. The presence of a more diverse board would help avoid instances of “Group-think” which is the phenomenon where the desire for harmony and conformity in a group may lead to irrational decision making.⁷⁹³ Groupthink has been uncovered as one of the reasons for the financial crises in the United Kingdom.⁷⁹⁴ One of the methods to ensure against issues arising from groupthink is to ensure that there is a constructive debate in the boardroom. Having a diverse board is one of the ways to avoid such a problem.

Diversity in the composition of the board promotes different approaches and experiences. According to the UK corporate governance code, diversity is also a very important tool for ensuring effective engagement with key stakeholders and help achieve the company's strategy.⁷⁹⁵ Furthermore, according to the Catalyst Research Series “the bottom line”, boards with more female participants achieve better financial results than boards with fewer women participants. The research also found that companies with more women on boards had an average of 16% higher Return On Sales and 26% higher Return On Investment.⁷⁹⁶ However, the research also confirmed that in order to gain the benefits of gender diversity on boards, at least 3 or more women are needed on each boardroom this is to create a “critical mass”⁷⁹⁷ of

⁷⁹⁰ CA 2006 414A (8)(c)

⁷⁹¹ UK Corporate Governance Code, 2016, Principle B.2.

⁷⁹² *Ibid*, B.2.4

⁷⁹³ Al-Janadi, Y., Rahman, R. A., Omar, N. H. (2013) Corporate Governance Mechanisms and Voluntary Disclosure in Saudi Arabia. *Research Journal of Finance and Accounting*, 4 (4), 25-35.

⁷⁹⁴ *Ibid*

⁷⁹⁵ *Ibid*.

⁷⁹⁶ Catalyst. (2014). Catalyst Census: Women Board Directors. [online] Available at: <http://www.catalyst.org/knowledge/2014-catalyst-census-women-board-directors> Last accessed 22 January 2016

⁷⁹⁷ Kanter, R. M. (1977a) ‘Some Effects of Proportions on Group Life’, *American Journal of Sociology*, 82 (5), 965–90.

women and thus leading to higher financial performances⁷⁹⁸. It was argued by Linda Eling et al that the presence of 3 or more women on boards can change the dynamics of the boardroom and “enhances the likelihood that women’s voices and ideas are heard”⁷⁹⁹.

One of the main goals of vision 2030 is providing equal opportunities for both genders. This goal can be used as a catalyst for the promotion of gender diversity on company boards. The increase of Saudi women’s representation on boards can bring many benefits as discussed above. Furthermore, the benefits of a more gender diverse board can broaden the perspective of the board and make use of interpersonal skills to promote collaboration which can widen the context of discussions in the board.

Recommendation

It is recommended that the Saudi legislators adopt mandatory quota legislation requiring every board to have at least 20% female representation. Saudi women are a great asset that has been neglected for a long time.⁸⁰⁰ However, with vision 2030 and under the wisdom of the King and the vision of the crown prince, Saudi women have more rights than ever before. Therefore, adopting mandatory quota legislation will ensure the increase of female representation in corporate boards.

Finally, if these recommendations are adopted they will certainly enhance Saudi corporate governance to a level that is comparable to the United Kingdom and of global best practice. This in turn will enhance the flow of foreign investment into the kingdom and ensure the success of vision 2030.

⁷⁹⁸Eling, L, Marshall.R, Rallis A, and Moscardi.M. (2015). MSCI, Women on Boards: Global Trends in Gender Diversity on Corporate Boards.” Available at: <https://www.msci.com/documents/10199/04b6f646-d638-4878-9c61-4eb91748a82b> [accessed 22 January 2016]

⁷⁹⁹ *Ibid.*

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Appendices

CAPITAL MARKET AUTHORITY

CORPORATE GOVERNANCE REGULATIONS IN THE KINGDOM OF SAUDI ARABIA

Issued by the Board of Capital Market Authority Pursuant to
Resolution No. 1/212/2006 dated 21/10/1427AH (corresponding to
12/11/2006)

based on the Capital Market Law
issued by Royal Decree No. M/30
dated 2/6/1424AH

**Amended by Resolution of the Board
of the Capital Market Authority Number 1-1-2009
Dated 8/1/1430H Corresponding to 5/1/2009G**

English Translation of the Official Arabic Text

Arabic is the official language of the Capital Market Authority

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