



Good Corporate Governance: Observations and Recommendations for the MENA Zone

Soulef Zekri

Contractual Assistant at the Faculty of Economics and Management of Nabeul

Abstract

Embodying good corporate governance is now both a concern and an ambition for the different countries to ensure an effective protection of the shareholders, the financial investors and also the different partners of the firm (employees, customers, suppliers). However, as suggested by Cannac and Godet (2001), having a good system of corporate governance would end up by developing and complying with the regulations that are designed to make sure, as far as possible, that the actions of the company's leaders are in accordance with the will of the shareholders and their interests. This governance may lead, according to Godet (2001), to a set of mechanisms to ensure that the objectives pursued by the leaders are "legitimate and the means implemented to achieve these objectives are powerful or efficient, which means that they better contribute to the objectives at the least cost." Nowadays, the concept of corporate governance has evolved into a theoretical framework that has reached a certain degree of stability through two basic approaches: the first is a shareholding approach which focuses on the relationship between the managers and the shareholders, and the second is a partnership approach that integrates all the stakeholders in the relationship with the leaders. If several authors are concerned about corporate governance at a micro-economic level, many others are more interested in the macro-economic aspects in questioning the effectiveness of the institutional, legal and regulatory framework as well as their ability to contribute to a better performance of the firms. In this research, we carried out a survey next to firms in the MENA region and we tried to answer the following question: "What are the main shortcomings of the system of corporate governance for the small and medium enterprises (SMEs)? The aim of this research is, firstly, to examine the context of corporate governance in the MENA zone and, secondly, to check whether the main actors and corporate governance mechanisms have worked well in this area.

Key Words: Corporate governance, MENA, performance.

1. The concept of corporate governance and its context in the MENA zone

The economic policy developed by the MENA zone since the eighties is formalized under the program of the structural adjustment program proposed by the World Trade Organization for Economic Cooperation and Development (OECD). It was centered on three fundamental pillars:

- The stabilization or control of the indicators of the macroeconomic equilibrium, including the reduction of the budget deficit to less than 4% and the control of inflation in foreign assets below 2%.

- The development of a liberal framework through a range of reforms and legal and regulatory initiatives including: the corporate laws and the commercial code, the banking reforms and the financial market reforms, the liberalization of foreign trade and, finally, the development of a competitive environment. These reforms are intended to promote the rule of the law and an environment conducive to the development of the private initiatives.
- The support of the private initiative, through incentives, contained in the old codes and transferred to the investment charter. This has led to the global fund support and the establishment of supportive and supervision structures such as the Regional Investment Centers and the National Agency for the Small and Medium Enterprises.

The system of corporate governance in the MENA zone can be said to be intermediary: the corporate governance structure inspired by the Anglo-Saxon system is of "monistic" type which means that the functions of management and control are not separated. However, we find non-executive and executive directors. These are expected to carry out their duties of loyalty, protection and good judgment of the business as well as their main responsibility and that of the shareholders (Lorsch and MacIver, 1989). The executive and non-executive directors are appointed and dismissed by the General Meeting of the shareholders.

As in the German context, ownership structure is relatively concentrated in the MENA zone. This explains, in part, the state of the market control. The more this structure is concentrated, the more there are mechanisms used by the shareholders to impose their strategies on the leaders and the less the option of last resort (the hostile takeover) is sometimes used.

Ownership structure explains the low volume of transactions in the control market:

- Ownership concentration is relatively high in the MENA zone. The percentage of shares held by the 5 top shareholders exceeds 50% in the MENA countries.
- In the MENA zone, most of the companies are controlled by families.

The cultural contingencies that characterize some local models and determine the nature of the obligations of the parties and sometimes the execution protocol of the contracts cannot easily falter. As suggested by Meisel (Meisel, 2005, p. 14), "It is important not to analyze the governance institutions regardless of the culture in which they are embedded." Indeed, the cultural dimension is predominant in the MENA zone. One of the dominant cultural features is the concept of the "family." This explains the need to reach a consensus. Furthermore, a little attention is paid to disputes (ICMG1, 1995).

All these measures, namely combining the functions of management and control, ownership concentration and the cultural contingencies, are essential components of the "marketing policy" designed to attract and promote local and foreign investors.

2. Questioning research conducted next to the SMEs

Is the assessment of the situation of the MSEs on corporate governance in the MENA area approached through the main mechanisms for large enterprises as published in the codes of good practices?

- The Takeover Bid recommended by GROSMAN and Hart (1980)) as well as the anti-takeover measures outlined in the work of GOMPERS et al. (2003),
- The presence of a particular block of shareholders mentioned by Demsetz and Lehn (1985), Demsetz and Villalonga (2001),
- The control carried out by the significant creditors or banks mentioned by Diamond (1984)),
- The composition of the board of directors used in the work of Yermack (1996), Eisenberg et al. (1998), Hermalin and Weisbach (1991) and Bhagat and Black (2002).

It appears from these studies that good practices concern the essential variables ensuring an inclusive environment for businesses as well as investments and a very considerable growth, which deserve an analysis suitable for our situation on the ground in order to define the specific features of this MENA zone.

3. The survey methodology

Providing answers to these questions lies in assessing the current status of corporate governance practices in the context of the MENA zone. To achieve this, we will use a qualitative approach which helps explore this research field. Since the targeted actions which help develop an efficient governance system can vary from one context to another, the adoption of a qualitative approach might be interesting. This approach was advocated by Lambert and Sponem (2005) and Graham, Harvey and Rajgopal (2005). This analysis would enable us to explore new behavior and explanations for good corporate governance. Moreover, the most common criticisms addressed to the quantitative approach deal with the level of confidence of the governance measures. These criticisms are generally made by McNochols, 2003; Durtschi and Easton, 2005, which have motivated us to adopt a qualitative approach.

Finally, assessing the state of corporate governance in the MENA zone is evaluating the country compliance with the principles of the OECD or the good practices within the firms. We could conduct a questionnaire next to 250 listed companies of the MENA zone covering the following features:

The shareholders' rights in the following dimensions: the shareholders' fundamental rights, the right to take part in the decision making related to the fundamental changes within the company, the right to have enough information and attend and vote in the OGAs, the disclosure of the capital structure and the mechanisms enabling a disproportionate control to the amount of the contribution, the institutional investors' exercise of their rights in a complete, objective and transparent way.

- The equitable treatment of the shareholders is based on the following variables: the shareholders' equality within the same category and the disclosure of transactions by the directors and officers for their own accounts.
- The role of the stakeholders in corporate governance is to identify the following relationships: the commercial credit relationships, the relationships with individuals and the bank-SME relationship.
- Transparency and information disclosure in its following aspects: disclosure of the relevant information, annual checking of accounts by independent auditors and the tools necessary for information disclosure that can be equally accessed to by the users.
- The board of directors' responsibility through the assessment of the following functions : dealing equally with every category of shareholders, appointing, remunerating and evaluating the management of the directors and the senior leaders, an objective and independent judgment in conducting the company's activities and the access by the directors to accurate and relevant information available at the right time.

The study of the state of affairs led to a questionnaire mailed to the 'targeted' companies. These companies include the firms where the rights of the minority shareholders are poorly protected and where ownership structure is concentrated in firms that are mainly family-dominated. These selection criteria are derived from the Euro-continental literature and more precisely from the classification of La Porta et al. (1998), and the work of Claessens et al. 2000, Bebchuk et al. 2000, Faccio and Lang 2002. Many authors consider that governance mechanisms change when ownership is concentrated and the firms' structure is family-based. Finally, we could obtain 97 responses of the interviewed companies of which 90 were usable. We therefore had a response rate of about (90/250) 36%.

The topic of this research could help show up the inadequacies or the gaps compared to the standards adopted by the OECD (see appendix 1). To achieve this, we suggest a qualitative assessment scale measured in the following way:

- Observed: all the essential criteria are met without significant deficiencies.
- Widely observed: minor shortcomings are observed.
- Partially observed: divergence between practice and application.

- Not materially observed: shortcomings are sufficient to raise doubts about the compliance of the authorities.
- Unobserved: no substantial progress towards the authority compliance.

This qualitative scale close to those of Likert, may be interpreted as a ranking of responses where the topic shows to what extent it is in agreement with, and well suited to our analysis. Moreover, it was used by Kidder, L. and C. Judd (1986) and by Lehmann D. (1985) in similar contexts such as the research in managerial and social sciences.

4. Result presentation

Based on the variables outlined above, we will present the most significant results and since the history weight remains notable in the practices of governance in the MENA zone, we will have an analysis compared to the principles of OECD on corporate governance.

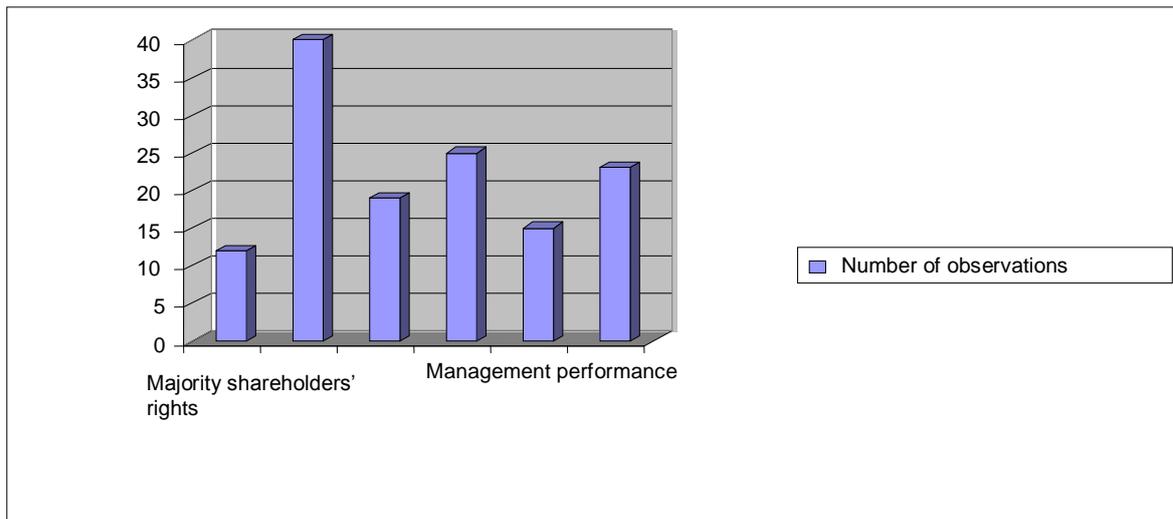
4.1. Shareholder – executives’ relationship

The SME shareholder – executives’ relationship cannot be thought of in the same way as in large businesses mainly because of the capital homestead and the non-separation of the leadership and ownership power. Even in the limited SMEs, the role of the board of directors is symbolic and dominated by the family power. This situation carries high risks of non-governance, abuse of power, wealth confusion sometimes at the expense of the company and its stakeholders. The SME is not usually listed on the stock market, the rights of the minority shareholders (if any) is greatly reduced to the goodwill of the majority, the financial market regulator has no role. Regarding the rights of the shareholders, the main aspect covers the corporate governance; the efforts are made at this level so that the new developed system allows security as shown in graph 1. The settlement and the delivery of the shares are now incidental. Similarly, thanks to a good coding, there is neither confusion nor suspense regarding the outstanding amounts of the shareholders’ contributions. The issue of double voice calls, however, for better regulation: The double voting rights, the possibility of issuing shares with full voting rights without immediate payment or the ability to repay the shares are anti-takeover measures enabling the management team to evade its responsibilities. The financial markets should be able to operate efficiently and transparently regarding corporate control. The capital structures and arrangements that enable some shareholders to exercise disproportionate control over a company in relation to the amounts of their equity ownership should lead to advertising. The following table clearly shows that the protective rights of the various stakeholders of the company are relatively guaranteed. The board does not assume liability only in 23 companies of our sample; that is 26% of the cases. Transparency and information disclosure are checked only in 25 companies.

Table 1: Aspects of corporate governance in the MENA zone.

	Number of observations	Rate
Majority shareholders’ rights	12	13%
Shareholders’ rights in general	40	45%
All the partners’ right (salaries, customers, suppliers, environment...)	19	21%
Transparency and information disclosure	25	28%
Management performance	15	17%
Duties of the board of directors	23	26%
Total	90	

GRAPH 1: Distribution histogram of the corporate governance aspects in the MENA zone.



4.2. The equitable treatment of shareholders

In terms of equitable treatment of the shareholders, the voting rights should be exercised by custodians or the authorized signatories with the consent of the security owner. The conditions for exercising the shareholders' voting rights require that foreign shareholders may vote either directly or via email. In fact, proxy voting is not allowed according to the responses made by the companies of our sample. Table 3 illustrates this result. We can witness the development of a monitoring service that has improved the follow-up of the actors. The new law now gives more power to regulate and enforce possible sanctions. The following table clearly shows that 78% of foreign investors vote directly and the others via email. Voting by proxy does not exist in the companies of our sample.

Table 2: Foreign shareholders' voting.

	Number of observations	Rate
Directly	70	78%
By proxy	0	0%
By mail	20	22%
Total observations	90	100%

5. The MSE- foreign shareholders' relationships

Corporate governance can be assessed mainly through:

- Contracts and commitment honoring with the customers, suppliers and other partners. In particular, business to business (B2B) commercial credit relationships appear to compel the leaders of SMEs and SMIs more strongly. The weak governance of the SMEs in the Maghreb area seems to be of great concern and of highly value destroying. It leads to the assessment of the governance of the judicial system (commercial courts), in its relationship with the litigants, which determines its effectiveness for the benefit or the expense of the whole economic tissue.

- The SME-bank relationship seems to convey strong binding disciplinary mechanisms for the owner-managers of the SMEs/SMIs. The analysis of governance in these relationships must examine their optimality under the divergent interests of the creditors and owner-managers of the SMEs. This raises the question of parallel governance within subdivisions, including local banking institutions in their dealings with the customers.

- Finally, we may wonder about the specificity of the GE of the SMEs in their relations with the other external stakeholders.

In our study, this specificity is reflected by weak governance arising from the following points:

- The SME-Public Administration and local communities’ relationships in granting and managing public contracts;

- The SME-Tax Administration relationships concerning the tax reporting, the management of tax audits and credit recoveries;

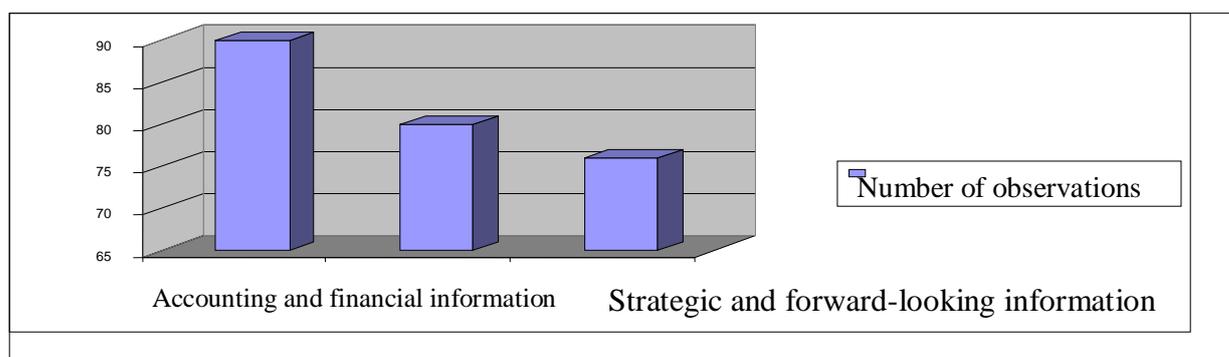
- The SME-societal environment relationships: Transparency and disclosure of economic, financial and social information of the SMEs: the generally limited transparency is a constraint: transparency analysis and information disclosure show that only a little retrospective accounting information is published by companies.

In support of our observations, Table 4 summarizes this information and clearly shows that the SMEs continue to disclose accounting and financial information, that is 100% of the firms in our sample, and that the retrospective, strategic and forward-looking information is of minimal importance.

Table 3: Typology of published information.

	Number of observations	Rate
Accounting and financial information	90	100%
Other retrospective information	80	89%
Strategic and forward-looking information	76	84%
total	90	

GRAPH 2: Typology of published information.

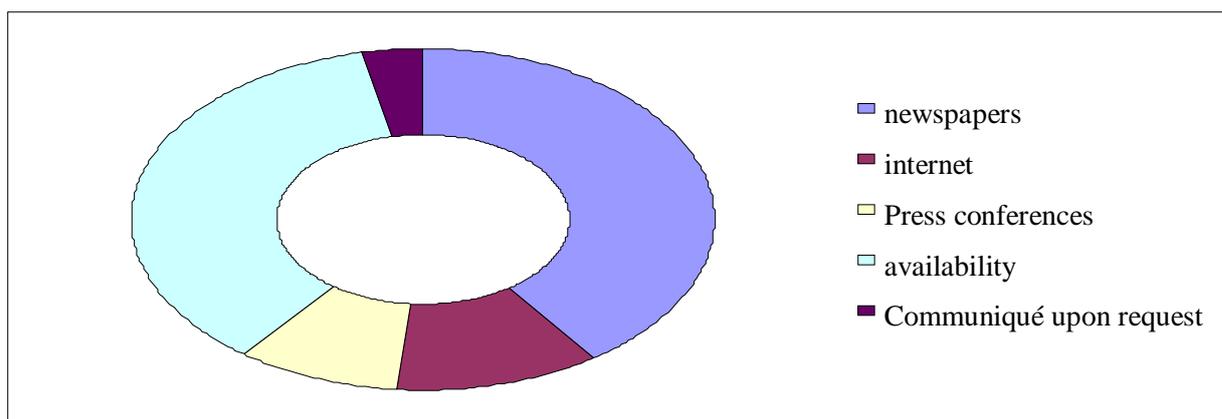


Different networking provides access to information primarily the newspapers at 78% of the access methods. Table 4 presents these different methods.

Table 4: methods of access to information

	Number of observations	Rate
Newspapers	70	78%
Internet	20	22%
Press conferences	16	18%
Availability of information	63	70%
Conveying information upon request	6	7%
total	90	

GRAPH 3: Methods of access to information



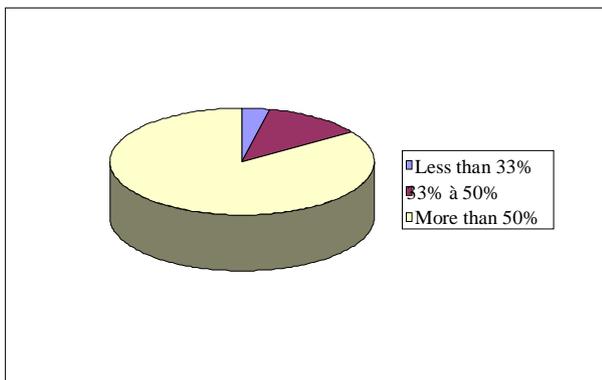
In the MENA zone, and contrary to what happens abroad, there are few companies that have developed a system communication with the market. The adoption of international standards of accounting information is still not applied. However, and despite their resort to a world class audit firms to audit their financial statements, several large private companies still establish their financial statements according to local accounting standards (not the IFRS). The current trend is the convergence towards the international standards, including the IFRS. In France, listed companies have been applying these standards since 2005. The Association of Chartered Accountants supports this development and it is recommended to activate the texts dealing with consolidation with the General S The role of the various stakeholders in corporate governance has some shortcomings: the slowness of the judicial procedures, of the progress of the commercial courts and of the training of the judges. We can also mention that the current legislative system does not sufficiently protect the witnesses of abusive, illegal or unethical practices, on the one hand, by the main leaders, and on the other hand, by the creditors in case of bankruptcy. The business climate will take advantage by establishing of an atmosphere of confidence through:

- Awareness and training
- The application of texts
- Job professionalization

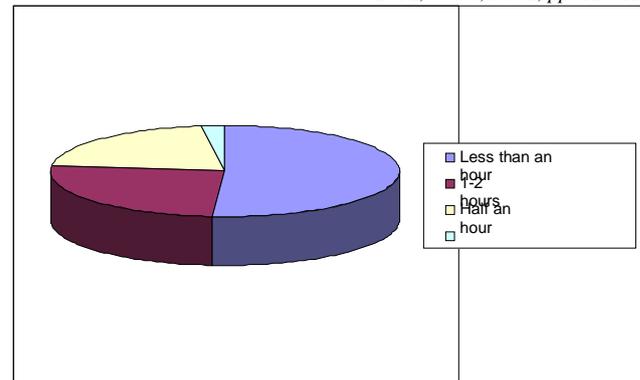
The media have to play an important role, however, they need training in the field of corporate governance. They need to be independent, like the experts, so that they will not be exponents to particular interests. Finally, concerning the responsibility of the Board of Directors, it is still difficult to get information on any possible transactions between the directors and the related parties: we rarely have answers to our questions about the subject. The board is a closed circle of large shareholders who have dominate the board directly and indirectly. It is also an issue of lack of a nomination committee that appoints the members that is why competence is not taken as a criterion for recruiting directors. An aging board that no longer plays its role becomes a recording chamber. The report of the auditor at the AGM should include this aspect, a charge for him charge to get written information from the Chairman. However, the use of annual reports of these companies provides us with information about the presence or absence of the Board of Directors, the attendance rate at the Board and length of the Board meetings:

Table 5: Features of the board of directors in the MENA zone.

Existence of a board of directors	Number of observations	%
Yes	80	89%
No	10	11%
Total observations	90	100%
BOARD EXISTENCE	Number of observations	%
Less than 33 %	3	3.5 %
33 % à 50 %	11	12.5 %
More than 50 %	76	84 %
Total observations	90	100 %
Length of the board meetings	Number of observations	%
Less than an hour	46	51%
1-2 hours	23	26%
Half a day	19	21%
More than half a day	2	2 %
Total observations	90	100 %



GRAPH 4: Existence of the board



GRAPH 5: Length of the board meetings

6. Improving corporate governance in the MENA zone

The study of the situation of the governance practice in the MENA zone has helped identify the deficiencies or shortcomings in relation to the standards adopted by the OECD. However, it was recognized that strictly adopting the recommendations of the OECD in this area is not easy in the context of MENA and does not necessarily guarantee the desired efficiency. Actually, the recommendations based on the OECD principles are neither a miracle cure nor a predefined pattern or even a roadmap but simply a way to provide a structure for discussion. We should notice that the online discussion forum which was initiated by the World Bank in the second quarter of 2004 under the theme: « How is Corporate Governance Relevant in Low-income Countries » clearly demonstrated, according to the majority of experts who participated in this discussion, that the brutal and indiscriminate application of the OECD principles is not necessarily a good thing in the developing countries which do not have a tradition in the business world. The MENA countries are recommended to apply a methodical approach structured around targeted actions to develop an efficient system of corporate governance by taking into account the local specific features. Thus, the preliminary results suggest that we consider the following issues:

- It is important to invest more in the knowledge of the system of governance of small and medium industries (systematically expanding the scope of the studies about the PMI) which are actually very important in the economic tissue.
- It has become also necessary to evaluate the possible correlation between the LEs and the SMEs regarding the performance approach. Subsequently, evaluate the contributions of the GE in upgrading the SMEs / SMIs in MENA.
- It would be also relevant to identify the relationship between the good governance models proposed by experts and the integrated approaches identified in the SMEs that we studied, and where substantial differences were observed.

CONCLUSION

The lack of governance in the studied SMEs can be explained primarily by both the diverging interests between the stakeholders and the family nature of the group. The power misuse by the CEO and (or) by the family leaders have caused differences with the standards recommended by the OECD experts in managerial practices and corporate governance. This finding casts doubt about the theoretical paradox borrowed from the big business according to which the goals and objectives of the SMEs are different from the objective of maximizing that we are supposed to retrieve in the managerial companies. Using a sample of 250 firms, we have studied 90 companies in a significant way. Our work leads to the following empirical paradox: The concentration of family ownership has as a result the trivialization of the governance legislative framework. This trivialization occurs in favor of informal structures and monitoring

mechanisms that we have identified and that literature is generally ignored. Finally, the literature review faced with in this investigation leads us to believe that the theory of corporate governance cannot be used or collected in the SME / SMI in the same way as it would be in a great company.

References

- Abdannadher Nacef, Bellalah Mondher et Hergli Moncef (2006) « la gouvernance d'entreprise, une nécessité pour les PVD : cas de la Tunisie, Euro-Mediterranean Economics and Review. Vol.1, N°4, Septembre 2006.
- Aldahdah Edouard (2005), « gouvernance et développement au Maghreb », Note présentée à l'occasion de la table ronde organisée à Tunis par la Banque Mondiale les 24 et 25 Mai 2005.
- Al-turki Khaled Hamed (2006): corporate governance in Saudi Arabia: Overview and Empirical Investigation; Victoria University.
- Banque Mondiale(2003), « vers une meilleure gouvernance au Moyen-Orient et en Afrique du Nord », Rapport sur le développement au Moyen-Orient et en Afrique du Nord.
- Belkahia Rachid (2005), « la gouvernance d'entreprise au Maroc : Etat de l'art et perspectives », Ministère des affaires générales-CGEM Rabat-14/15Septembre 2005.
- Cannac Y., et Godet M., "La bonne gouvernance", Futurible, n°265, juin, 2001, pp. 41-50.
- Ellen Kerrigan Dry (2003): Corporate governance in the Sultanate of Oman; Richmond Journal of Global Law and Business; vol3; pp.45-82.
- Franks J.-R. and Mayer C., « Capital markets and corporate control, a study of France, Germany and the UK. » *Economic Policy*, vol. 5, 1990, p. 191-231.
- Lorsch J.W. and MacIver E., « Pawns or potentates: The reality of the America's corporate board », *Havard Business School Press*, Boston, 1989.
- Madani Wassel (2009) : les pratiques de gouvernance d'entreprise manquent encore en maturité ; Fitch ratings.
- Oman CH., Fries S. et Bruiter W., 2003, "la gouvernance d'entreprise dans les pays en développement, en transition et les économies émergentes", centre de développement de l'OCDE, cahier de politique économique n° 23.
- Rainer Geiger (2008) : stratégie pour améliorer la gouvernance d'entreprises au MENA ; programme MENA –OCDE pour l'investissement.
- Rajeev Pillay (2008): implementing corporate governance codes in MENA. Lessons learned series.
- Saidi Nasser (2004): corporate governance in MENA Countries: improving transparency and disclosure; the Second Middle East and North Africa Regional Corporate Governance Forum.

Appendix1: The situation of corporate governance practice in the MENA zone.

Corporate Governance Principles	Observations				
	Tunisia	Saudi Arabia	Morocco	Jordan	Sultanate of Oman
I. The shareholders' rights					
I.1 The fundamental shareholders' rights * securing the methods of ownership recording * transmit and transfer the stock * obtain relevant information about the company on an ad hoc and regular basis	Largely noticed				
I.2. The right to participate in the decision making concerning the fundamental corporate changes	Largely noticed				
I.3. The right to be sufficiently informed to participate and vote at the AGM	Largely noticed	Largely noticed	noticed	Largely noticed	Largely noticed
I.4. The disclosure of capital structures and mechanisms for a disproportionate control related to the amount of contribution	Partly noticed				
I.5 institutional investors exercise their rights in all objectivity and transparency	Partly noticed	Partially noticed	Partially noticed	Partially noticed	Partially noticed
II. Fair treatment of shareholders					
II.1 equality of shareholders of all categories	Partially noticed				
II.2 disclosure of transactions by directors and officers for their own interests	Partially noticed	Largely noticed	Largely noticed	Largely noticed	Largely noticed

III. The role of stakeholders in corporate governance					
III.1 respecting the legal rights of stakeholders	Largely noticed	Largely noticed	Largely noticed	noticed	Largely noticed
III.2 mechanisms of the employees' contribution for a better performance	noticed	noticed	noticed	noticed	Noticed
III.3 Claims of the stakeholders to the Board of Directors	Largely noticed	noticed	Materially not observed	noticed	Noticed
IV. Transparency and information disclosure					
IV.1. Disclosure of the relevant information	Largely noticed	Largely noticed	Largely noticed	Largely noticed	Largely noticed
IV.2. Performing annual auditing by independent auditors	Largely noticed	noticed	noticed	Largely noticed	Observé
IV.3. Means for a fair access to disclosed information at the right time and at the best price for the users	noticed	noticed	noticed	noticed	Noticed
V. The duty of the board of directors					
V.1. Acting according to experience, in good faith and with due diligence, in the interest of the company and the shareholders	Largely noticed	Largely noticed	Largely noticed	Largely noticed	Largely noticed
V.2. Treating the shareholders of each category fairly	Partially noticed	Partially noticed	Partially noticed	Partially noticed	Largely noticed
V.3. compliance with the legal rules by taking into account the interests of the shareholders	Partially noticed	Largely noticed	Partially noticed	Largely noticed	Largely noticed
V.4. The board of directors' main functions	Largement observé	Largely noticed	Largely noticed	Largely noticed	Largely noticed
V.5. Appointing, remunerating and evaluating the management of the board members and key executives	Partially noticed	Largely noticed	Partially noticed	Largely noticed	Largely noticed
V.6. The directors' responsibility concerning the quality and integrity of the disclosed information	Largely noticed	Largely noticed	Largely noticed	Largely noticed	Largely noticed
V.7. Objective and independent judgment on the running of the company's business	Materially unnoticed	Materially unnoticed	Materially unnoticed	Materially unnoticed	Materially unnoticed
V.8 The administrators' access to accurate, relevant and available information at the right moment	Largely noticed	noticed	Largely noticed	noticed	Noticed