Framework for success

TREATING CORPORATE GOVERNANCE AS A COMPLIANCE EXERCISE IS NO ROUTE OUT OF THE FINANCIAL CRISIS. IT MUST BE UNDERSTOOD AS A STRATEGIC IMPERATIVE TO BE EFFECTIVE, SAYS **AFSHAR MONSEF**.

The global financial crisis and post-crisis corporate turbulence may seem unparalleled, but asset bubbles, lax accountability and greed are not new. We have seen the debate on corporate governance dominate the political and business agenda across the world, with an increased call for additional regulation and compliance enforcement by experts and lawmakers presented as the panacea. However, recent experience of Sarbanes-Oxley has demonstrated that regulation and governance as regulatory compliance are not effective.

Corporate governance is more than controlling and directing or the distribution of rights and responsibilities among different participants in the organisation. The essence of any system of good corporate governance is to allow management the freedom to drive the company forward but to exercise that freedom within a framework of effective accountability set by the board.

It is the system by which organisations are directed and managed. It influences how the objectives of the organisations are set and achieved, how risk is monitored and assessed, and how performance is optimised. Good governance structures encourage companies to create value and provide accountability and control systems commensurate with the risks involved.

It is also about how the culture and tone of the organisation is set at the very top. The financial crisis has clearly shown that even if boards were exemplars of best practice and had ticked all the boxes for compliance, their governance structures and compliance regimes counted for little where the organisation's culture wasn't right or where the board and senior management turned a blind eye to excessive risk taking.

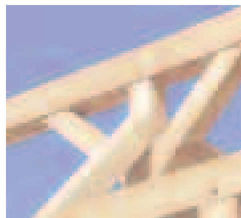
The prime responsibility for good governance must lie within the organisation rather than outside it.

The board and senior management must consider corporate governance as a strategic imperative/value proposition rather than a compliance exercise. It's about effective integration of corporate governance, enterprise risk management and compliance programmes and the alignment of accountability, corporate control and transparency under the board's stewardship (see Figure 1).

In the UAE the Securities and Commodities Authority (SCA) started the corporate governance regulation journey in 2007, with Decision No. R/32, Corporate Governance Regulations for Joint-Stock Companies and Institutional Discipline Criteria. The R/32 regulation broadly set the corporate governance framework, principles and standards for listed entities. In general these are in alignment with and incorporate the elements of good corporate governance accepted internationally (see box).

Box: 10 elements of good corporate governance

1. Lay solid foundation for management and oversight (accountability)
2. Structure the board to add value (accountability)
3. Promote ethical and responsible decision-making (accountability)
4. Safeguard integrity in financial reporting (transparency)
5. Make timely and balanced disclosure (transparency)
6. Respect the rights of shareholders (transparency)
7. Recognise and manage risk (includes assurance on internal controls) (corporate control)
8. Encourage enhanced performance (corporate control)
9. Renumerate fairly and responsibly (corporate control)
10. Recognise the legitimate interest of stakeholders (corporate control)



The SCA has been leading corporate governance reform in the GCC region and has seen the corporate governance rating of UAE-listed entities improve since 2007. Independent studies by The National Investor (TNI), Hawkamah (Institute for Corporate Governance) and IOD Mudara (Institute of Directors) – Basic I and II in 2008 and 2009 – demonstrate that although some companies in the region have embraced corporate governance and fast-tracked implementation, the GCC average is at a basic level and more than ever needs to improve considerably to compete globally for investor funding and confidence (see Figure 2).

There are a number of key challenges that the GCC needs to address to facilitate better implementation of corporate governance and to ensure that the focus moves from form to substance:

- proper disclosure of dealings with related parties;
- minority shareholder interest must be addressed;
- compulsory rotation of external auditors every three to five years;
- requirement for truly independent directors must be imposed;
- strong enforcement regime needed to incentivise companies to do the right thing;
- minimum external governance reporting needs to be standardised to ensure consistency in disclosure;
- need for greater guidance on a number of key contentious areas that are open to interpretation, such as disclosure of elements compensation packages of the board and executive management; and
- boards should provide certification of the elements of corporate governance and provide explanations on areas not implemented.

Importantly, the implementation of corporate governance in the GCC also needs to overcome sensitivities faced by boards across the world with respect to the following:

- board performance and evaluation;
- selection of director appointments to board;
- fiduciary obligations and duty of care to all shareholders;
- conflicts of interests and interlink between related private interests;
- ensuring adequate time can be devoted to stewardship of the company;
- annual general meetings providing an adequate forum for shareholders to raise issues; and
- an appreciation that directors are appointed as stewards rather than executives to run the company.

For corporate governance to be effective, companies and organisations around the world need to adopt the mindset that implementation of governance is not a burden to be tolerated, but a positive force to help businesses become and stay competitive and ensure sustainability. Corporate governance is no guarantee against corporate failure, but it will provide a company with the information, systems, processes and understanding of risks to better deal with predicaments.

In conclusion, corporate governance need not stifle innovation, growth or agility because without taking risk, business cannot make money. Rather, governance requires the board to allow management the autonomy to manage the company to create shareholder value with an understanding of the risks within a framework of appropriate accountability, control and transparency.

Figure 1: Corporate governance

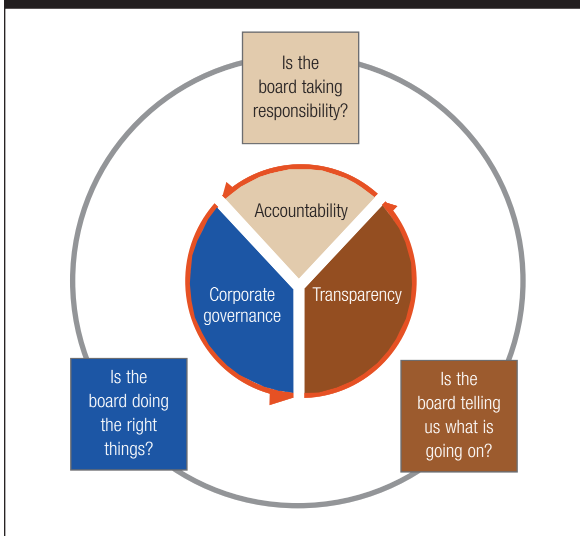
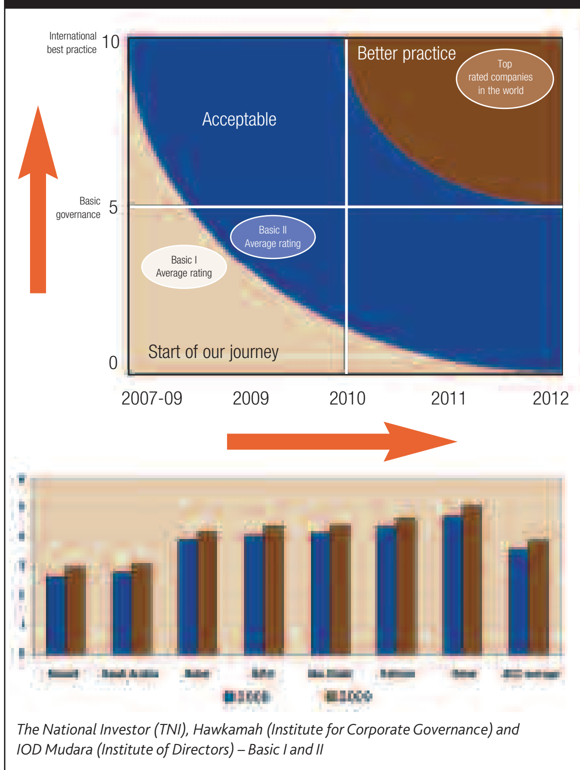


Figure 2: Benchmark to MENA and international best practice



The National Investor (TNI), Hawkamah (Institute for Corporate Governance) and IOD Mudara (Institute of Directors) – Basic I and II

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