Corporate Governance Standards in Saudi Financial Sector: Achievements and Challenges

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Abstract

Corporate governance is a relatively novel in Saudi Arabia. It has just been recognized following the market crash that hit the Saudi financial sector in 2006 and resulted in heavy losses of many Saudi people wealth. Following the recent challenges showed after the establishment of the Capital Market Authority (CMA), this article examined corporate governance mechanisms based on the recent reforms involved in enacting Corporate Governance Regulations (CGR), Capital Market Law (CML) and new Company Law (CL), as well as it identified the strengths and shortcomings points associated with the early developments in the Saudi legal system. When looking at the Saudi financial sector, the report issued by the World Bank on the observance of standards and codes across Saudi Arabia in 1990 can be seen as a central to analysing the Corporate Governance Regulations (CGR) in Saudi Arabia. This article discovered that governance mechanisms applied in Saudi Arabia are extensive and cover a broad area of corporate governance principles. Furthermore, because of negligence and dearth of studies in this area, it is expected that this article would contribute to enhance literature on corporate governance studies in Saudi Arabian library.

Keywords: Corporate governance; Company law; Capital Market Authority; Listing rules; Corporate Governance Regulations; Board of directors; Shareholders activism.

1. Introduction

The 1987 market crash and the subsequent collapse of many corporations resulted in a more comprehensive reform of corporate governance mechanisms around the world (Standards Australia 2003). Similarly, the financial crisis in East Asia has affected the economies of countries such as Malaysia, the Philippines, Thailand, Indonesia, and South Korea. Importantly, the weakness of institutions in these economies is attributed to a lack of, or weak, corporate governance mechanisms. These corporate scandals revealed not only gaps in corporate governance (Dallas and N. Bradley 2002), but also the need for more effective corporate governance mechanisms (M. Mobius 2002). Other countries such as the US have also witnessed various forms of corporate scandals. For instance, the massive failures in companies, such as Enron and MCI Inc. (formerly WorldCom), AOL, Tyco and Arthur Andersen have led to political interest in corporate governance and specifically the passage of the Sarbanes-Oxley Act in 2002 by the US federal government, whose main aim was to restore public confidence in corporate governance (G. Farrell 2005). According to Edwards and Burns, these scandals have undermined confidence in the US business system and raised questions about the effectiveness of corporate governance in the US (F.R. Edwards and A.F. Burns 2003).

Importantly, “in the wake of these scandals, many of these companies saw their equity values plummet dramatically and experienced a decline in the credit ratings of their debt issues, often to junk status” (A. Agrawal and S. Chadha 2005). The lack of corporate governance regulations in financial sector has been blamed for the depth of the economic crisis (E. Wyatt 2000). The evidence above suggests that corporate fraud is associated with weak corporate governance and can undermine the trust of investors in the security market, weaken the value of firms and banks, disrupt regular operations, produce changes in key personnel and even threaten the survival of related financial institutions (D.B. Farber 2005). The phenomenon above continues to baffle scholars and practitioners across the global.

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The 1990s were a landmark in the field of corporate governance and saw many laws being enacted to address the issues of corporate scandals and restore public confidence in the security market. Thus, the Cadbury Report in the UK (Cadbury Committee 1992), the OECD Principles of Corporate Governance of 1999, and the Sarbanes-Oxley Act of 2002 were born.

In Saudi Arabia, applying corporate governance principles in the listed corporations, including banks has increased dramatically, particularly in the wake of the economic crisis of 2006. Specifically, this awful financial crisis hit the Saudi stock market and made the price index plummet by approximately 13,000 points within one month (65% of its maximum level) (A.A. Al-Twaijry 2007). This resulted in heavy losses to many Saudi people, especially the minority shareholders, who are yet to recover their losses or obtain fair compensation following the collapse. Specifically, when looking at the Saudi financial sector, the report issued by the World Bank on the observance of standards and codes across Saudi Arabia can be seen as central to analysing the Corporate Governance Regulations (CGR) in Saudi Arabia. Detailed consideration in this article will, therefore, be given to the OECD Principles of Corporate Governance (which are six principles) to measure the extent of the compliance of the Saudi financial institutions with these global principles.

To achieve the purposes of this article, several objectives will be focused upon. Firstly, it is necessary to consider the way in which corporate governance works in Saudi Arabia and the relevant legal and regulatory structures that are present in the Saudi legal system. The research evaluates the corporate governance structure in Saudi Arabia, including the general principles, as well as laws and regulations that currently exist. Secondly, it will determine the extent to which the Saudi financial sector can effectively apply the mechanisms being laid out by Capital Market Authority (CMA) and also to discuss the key drawbacks that may occur in Saudi legal system, and to reveal whether there is a need for greater harmonisation with the global standards of corporate governance.

2.General Overview of Corporate Governane in Saudi Arabia:

Corporate governance in Saudi Arabia has gained considerable attention, in recent years, culminating in a report by the World Bank on the observance of standards and codes across Saudi Arabia, in 2009 (Walid Al-Ajlan, 2005). As part of the report, discussed here, the way in which Saudi Arabia has implemented the principles of corporate governance, as stated by the Organisation for Economic Co-operation and Development (OECD), was analysed with reference to whether or not Saudi Arabia follows solid international practices (McGraw- Hill, 1990). On the whole, it was felt that Saudi Arabia is following solid corporate governance practices; this could largely be attributed to the market correction that occurred, in 2006, and creation of market regulators to deal with the further issues associated with corporate governance. As a result of this report, greater effort towards securing strong corporate governance has been put in place, particularly in relation to listed companies, including banks, through the use of the Corporate Governance Regulations (CGR). CGR was aimed specifically at the way in which the financial sector was supervised and was put in place by the Capital Market Authority (CMA) in 2003 (Capital Market Law, 2003). It has the power to investigate and regulate those involved in securities exchange. The report did, however, note that although there are structures in place to establish very strong corporate governance, in all aspects of Saudi business, at times, implementation has been very much in its infancy, creating some weaknesses (Oxford Business Group 2010).

The report also noted that the recommendations are being made to Saudi Arabia, so that it can bring its current national standards more in line with international standards. Typically, the recommendations focused on improving the implementation of the established rules and regulations they were practically applied across all regions but, in particular, in relation to the financial sector. The corporate governance structure within Saudi Arabia is under constant scrutiny and the CMA is following a three stage process, in order to improve corporate governance within the financial sector. The first phase has been completed through the publication of the CGR; the second phase is now underway, looking at ways of revising these rules, as well as how they have been practically applied. There are expectations that, in the third phase when the CGR is being revised again, the CMA will consider whether the regulation should become mandatory, in part or in full, as this is not currently the case (S Ingves and M Khan, 2004). Although it was noted by the report that corporate governance is relatively strong, nonetheless there were also some inherent weaknesses in the system, which were identified, particularly in relation to the financial sector. As a result, the report not only looks at how corporate governance is being applied, today, but also offers recommendations for the future (RK Morck, 2007).

Broadly speaking, these recommendations include making adjustments to the CGR to ensure better processes are put in place and also to create greater emphasis on disclosure practices. There is particular concern that the disclosure of issues, such as beneficial ownership and qualifications of board members, were not always being followed by those within the financial sector and, whilst the rules may be present, they were not being practically applied by the individual entities (M Cihak and A Tieman, 2008).

From the positive point of view, it was noted that the Saudi stock market was beginning to publish information on shareholder's ownership of listed companies. Shareholders were also shown to have reasonably strong protection, despite that fact that there was a widespread acceptance that factors, such as insider trading and market manipulation were widespread problems. Given these concerns, the CMA has looked towards improving the position and has issued a Market Conduct Regulation which focuses specifically on the insider trading provisions that were already touched upon by Capital Market Law (Capital Market Authority, 2006). The CMA has enforcement and investigatory powers in place that can be used to monitor parties, as well as to regulate those associated with the securities' exchange. The report found that the CMA had been working continuously in a consultative way, in order to ensure that there was greater interaction between the various different entities, particularly when it came to developing new regulations that need to be applied in specific circumstances, such as in relation to the financial services to ensure that they work as a coherent whole.

In the report, it was found that one clear division of responsibility was between the CMA and the Saudi Arabian Monetary Agency (SAMA); the two entities were seen to be working together very well to ensure that the regulatory provisions that related to the financial sector were looked at as a coherent whole, regardless of which entity was responsible for the provisions. Concerns have been raised, however, that despite the very strong structure that has been put in place by the various authorities, it has not always been seen to travel down to the front line, so that it can be practically applied by organisations (Rifki Ismal, 2010).

3. Analysing the Legal and Regulatory Framework in Saudi Arabia (the External Mechanisms)

The Saudi Arabian legal system is built upon a duality method with the Shariah principles on the one hand and the civil law principles on the other hand. The inconsistency in the Saudi legal and judicial setting may be attributed to the variation in the views on maintaining the Islamic traditions, in which the State was built upon, and accepting the contemporary laws. the Saudi Arabian laws are divided into two categories (Macgorine A. Cassell and Rebecca J. Blake 2011): one is based on the rules of Islamic law (the Shariah), in particular personal status law, criminal law and property law; and another is based on the modern laws, in particular those which depend on international conventions or global standards. The oil discovery in 1938 showed the need to enact a set of modern statutory laws and regulations to regulate and govern the state's relations with other countries, especially the Western countries. Consequently, between the periods of 1957 and 2006, the Saudi government have made considerable progress in reforming parts of its laws and regulations. Specifically, since 1965, statutory laws in Saudi Arabia have played a vital role in activities such as commerce, the banking sector, business, labour, taxation, arbitration and the settlement of commercial and securities disputes. The contemporary legal system in Saudi Arabia has been affected by the model of civil law countries, particularly in commercial law, company law, securities law and administrative law. As a result, the concept of company, as an independent legal, personal, as well as the legal provisions has been transplanted into the Saudi Company Law from the Western European laws (Fahad, M. Almajid, 2008). Listed companies are subject to quite considerable governance under Company Law, as well as Listing Rules and Capital Markets Law. Several regulations have been issued by the CMA and need to be followed closely by listed companies. Supplementary regulations have also been issued to deal with specific issues. For example, the Saudi Arabia Monetary Agency (SAMA) has issued information on the types of responsibilities that directors within the commercial banks are expected to comply with, in particular the types of internal controls that are expected to be in place and the role of the audit committee, all of which are seen to add to the corporate governance structure within the region (Adnan M Abdeen and DN Shook, 1984).

3.1 Company Law (CL)

Despite the early emergence of business and economic activities in Saudi Arabia, following the discovery of oil in the year 1938, there were no laws to regulate companies' activities until the year 1965 (Abdullah Alkahtani 2015). The paradigm shift occurred in 1965, when the Saudi regulator issued company law (CL) in 1965 (Abdullah ALkahtani 2015). Since that time, CL has been considered the main legislative body and the key reference for all types of commercial business activities in Saudi Arabia.

However, the Saudi regulator recently undertook a comprehensive reform to the CL that has been taken a long time to updating. The new updating Law will entirely replace the old one, and will override such rules conflict with the new Company Law. The existing corporations are required to comply with the new developments in this law within a one year period from the date of publication in the official gazette. The main advantage of the new CL is that it comes in the line with global standards of corporate governance. The new CL issued on 9 November 2015 and contains 227 Articles which extensively cover five forms of business entities, which are classified as follows: (1) general partnership; (2) limited partnership; (3) joint venture company; (4) joint stock company; and (5) limited liability company.

The new CL contains a set of provisions related to corporate governance rules, such as the responsibilities of the board of directors, the civil liability of directors, the duties of the general assembly, the procedures of the annual general and extraordinary meetings, shareholders' rights and remedies, the discloser requirements and other relevant issues. To engorge the effective application of corporate governance, the new CL has involved new governance mechanisms, since it states on the separation between the function of chairman and CEO, the audit committee is required to oversee a joint stock company, cumulative voting is available for electing the board members and the modern technology means are used now for conducting general meetings and voting process.

3.2 Capital Market Law (CML)

The Saudi stock market witnessed a paradigm shift when the Saudi government issued the Capital Market Law (CML) in 2003 (the Royal Decree No. M/30 dated 2/6/1424 H (31 July 2003). This was in response to a boost in the Saudi economy, which led the Saudi government to take decisive measures to enact a bundle of laws and regulations to deal with stock market issues and other financial matters facing its economy. The Capital Market Law contains 67 Articles, which became enforceable at the beginning of 2004. The CML is a legislative framework for all miscellaneous security matters in Saudi Arabia. According to the CML, the Capital Market Authority (CMA) has issued eleven key implementing regulations (Saudi Implementing Regulations), namely: (1) prudential rules; (2) listing rules; (3) anti-money laundering and counter-terrorist financing rules; (4) authorised persons regulations; (5) merger and acquisition regulations; (6) real estate investment funds regulations; (7) securities business regulations; (7) market conduct regulations; (8) corporate governance regulations; (9) offers of securities regulations; (10) investment funds regulations; (11) the resolution of securities disputes proceedings regulations. The aims of the CML are to produce an appropriate investment environment, to protect investors and guarantee accountability, fairness and efficiency in the stock market (Capital Market Law 2003).

3.3 Capital Market Authority (CMA)

The CMA was established to govern and supervise the issues facing the Saudi securities market. The CMA is an independent government authority and is directly linked to the president of the Saudi Council of Ministries (Capital Market Law 2003). By the law, the Capital Market Authority is deemed as a legal personality and enjoyed with financial and administrative autonomy. Furthermore, it is responsible for issuing regulations, rules and instructions for implementing the provisions of the Capital Market Law. According to the CML, the CMA must be governed by a board known as the Capital Market Authority Board (CMAB). The CMAB comprises of five members, who must be Saudi Arabian citizens working on a full-time basis, and they must be professionally qualified. The board members must be appointed and their salaries and financial benefits determined by the Royal Order. Among the board members, the Royal Order shall specify the chairman and deputy chairman (who will replace the chairman in his absence) (CML, 2003). The CML has paved the way for the CMA to create new rules, make decisions and place appropriate procedures, which contribute to addressing all matters affecting the market, including challenges and stockholders demands. Evidence in support of this is contained in the CML provision, which defines the function of the CMA as follows: 'the Authority shall be the agency responsible for issuing regulations, rules and instructions, and for applying the provisions of this Law' (CML, 2003).

To protect shareholders' rights, the CML has stated that one of the objectives of the establishment of the CMA is to provide a statutory protection for dealers in the Saudi stock market. Consequently, the CMA must do the following roles, (CML, 2003):

1. Regulate and develop the exchange, seek to develop and improve methods of systems and entities trading in securities and develop the procedures that will reduce the risks related to securities transactions.
2. Regulate the issuance of securities and monitor securities and dealing in securities.

3. Regulate and monitor the works and activities of parties, subject to the control and supervision of the authority.
4. Protect citizens and investors in securities from unfair and unsound practices or practices involving fraud, deceit, cheating or manipulation.
5. Seek to achieve fairness, efficiency and transparency in securities transactions.
6. Regulate and monitor the full disclosure of information regarding securities and their issuers, the dealings of informed persons, major shareholders and investors, and define and make available information which the participants in the market should provide and disclose to shareholders and the public.
7. Regulate proxy and purchase requests and public offers of shares.

3.4 Stock Exchange (Tadawul)

The Saudi stock exchange (Tadawul) is one of the most significant institutions established by the Capital Market Law (CML). The key objective of Tadawul is to maintain market integrity, operate the market effectively and efficiently, present a quality services for investors, brokers, issuers, vendors and others. Moreover, it aims to increase investors' education and awareness efforts and develop the exchange's capabilities and competencies, (Tadawul Saudi Share Index). According to the CML, Tadawul shall be '...the sole entity authorised to carry out trading in securities in the Kingdom' (CML, 2003). The establishment of Tadawul reveals the seriousness of the Saudi regulator, since concentrated the function of market monitoring into a single exchange so that it facilitates the task of regulatory oversight over the shares trading operations.

3.5 Corporate Governance Regulations (CGR)

The shift occurred in 2003, when the CMA was established and much of the regulatory role associated with the SAMA was transferred across, on the whole however it was shown that the two entities work well together, in order to establish an integrated approach to corporate governance. One of the most notable additions, in recent years, has been that of the CGR, which works on a "comply or explain" basis, meaning that listed entities need to comply with the regulations laid out, or they need to explain why they have deviated. However, the World Bank report in 2009 did show that, on the whole, there was a relatively low level of compliance across the financial sector and, as a result, the SAMA is working on producing a corporate governance manual specifically aimed at banks. Since 2000, the Saudi government has had a genuine desire to restore the reputation of the Saudi economy and attract foreign investments.

There was a serious work aimed at improving the national economic performance. These efforts have culminated into establishing several institutions and enacting sophisticated laws and regulations. Without going into details, perhaps the most significance of these institutions is the Capital Market Authority in 2003. In the aftermath of the collapse of the stock market, the Saudi government (represented in the Board of Capital Market Authority) decided to establish a good legal framework in order to provide sufficient protection for all participants and practitioners in the securities market. As a consequence, the Corporate Governance Regulations (CGR) issued in November 2006 and covered all elements existing in the global standards of corporate governance, which are divided into four parts, as follows: part 1 covers preliminary provisions; part 2 covers rights of shareholders and the general assembly; part 3 covers disclosure and transparency; and part 4 covers the board of directors. The CGR aim to ensure that the listed corporations comply with the best governance practices. This assurance is clearly reflected as follows: "these Regulations include the rules and standards that regulate the management of joint stock companies listed in the exchange to ensure their compliance with the best governance practices that would ensure the protection of shareholders' rights as well as the rights of stakeholders" (CGR, 2006).

The CGR have asserted since the beginning that self-regulation is a general norm, so that they work as the guiding principles for all corporations listed in the stock exchange, and they are not obligatory, except as provided for in Article 1b), where these regulations stated that: '....a company must disclose in the Board of Directors` report, the provisions that have been implemented and the provisions that have not been implemented as well as the reasons for not implementing them' (CGR, 2006). This challenged the board of directors to effectively act in order, to reflect a good picture for their corporations. Despite the fact that these regulations are distinguished as non-binding, they reflect the position and performance of the company positively among its counterparts in the stock market. In effect, obtaining accurate statistics on the number of the listed corporations that apply the self-regulation of corporate governance in the Saudi stock exchange is extremely difficult.

Nevertheless, there has been a study which showed that about 57.1% of the number of listed corporations sufficiently apply corporate governance policy since these companies have established independent departments to ensure the implementation of the CGR. However, on the other hand, other studies have revealed that the number of the listed companies that recognised self-regulatory corporate governance do not exceed 25 corporations, out of 150 corporations listed in the stock exchange (Faleh AL-Kahtani 2013). In fact, these results present a negative picture regarding the extent of the effective application of the corporate governance regulations, on the corporations operating in the Saudi stock market.

3.6 Listing Rules (LR)

The Listing Rules are great initiatives issued by the Capital Market Authority Board (CMAB) upon its Resolution Number 3-11-2004 Dated 20/8/1425H Corresponding to 4/10/2004 G based on the Capital Market Law. Also, the Listing Rules were amended by Resolution of the Board of the CMA, No. 2-128-2006, dated 22/12/1426H (22/1/2006). These rules were enacted as standards to disclose and monitor publicly listed companies' behaviours. They have been defined as one of the best ways to assist stock market authorities in overseeing the performance of listed corporations (Du Plessis, J. J., McConvill, J. and Bagaric, M. 2005). The main purpose of the LR is to regulate the public offerings of securitises and register and incorporate these securities in its official list (LR, 2004). These rules are distinguished as they are strictly obligatory, as companies must either declare their commitment to these rules or explain any deviation from them (Steven Tankiso Moloi 2008). The compliance with these rules is a condition to invest in the Saudi stock market as stipulated in Article 20 of these rules 'Issuers must comply with the listing rules and must provide to the authority without delay all information, explanations, books and records that the authority may require'(LR, 2004).

To strengthen the protection of the stock market and its stakeholders, the LR gave the CMA absolute rights to intervene directly, to suspend the shares of listed corporations that are trying to manipulate the market or the shareholders' interests (LR, 2004). Previous literature shows that these rules are intended to protect existing and potential shareholders by ensuring full disclosure of financial material and other information, and giving investors all the rights to vote on certain matters (Padraig Cronin and Frances Murphy, Slaughter and May 2012). In protecting shareholders' rights, the LRs have included a number of provisions, such as access to information, disclosure of financial information, board of directors' reports, its duties, notification relating to substantial shareholdings and continuing obligations. According to the LR, or 'continuing obligations', listed corporations must be committed to notify the CMA and shareholders, without delay, of any major developments in their field of activity, which are not public knowledge and which may have an effect on the issuer's assets and liabilities, the financial position, the general course of its business, or any major developments as mentioned in Article 25a) of the LR. The LR have come to affirm on the value of protecting shareholders' rights. Thus, these rules have stated clearly that the issuer must ensure equality of treatment for all shareholders who hold the same class, in respect of all rights attaching to such equities (LR, 2004). Thus, it is suitable to say that the LR have introduced, at least in theory, a number of rules that can help protect the rights shareholders against the abuse of power by management and boards of directors. These rules have paved the way before the CMA to exercise power and competences in order to protect the stock market and investors against manipulation of management or directors.

4. Appraising the Internal Corporate Governance Mechanisms in Saudi Financial Sector

Corporate governance is often made up of the internal and external mechanisms. The internal mechanisms are share ownership structure, board of directors, transparency and disclosure, whereas the external structure are often takeover market, legal and judicial system (Denis and Mc Connell, 2002; Cremers and Naim, 2004). Harmonization between the internal and external tools of corporate governance is required to creating a solid corporate governance system. The external mechanisms can be applied as a consequence of the defeat of the internal mechanisms to resolve the company's issues (Jensen, 1986, 1988, 1989, 1993). Most collapse of giant corporations was baked to the weak of company's management, dispersed ownership and control, board of directors was ineffective in carrying out their responsibilities.

The following elements will discuss the practices of the internal mechanisms of corporate governance in the Saudi financial sector based on Corporate Governance Regulations (CGR) and the World Bank Report on Corporate Governance in Saudi Arabia. Thus, this article would concentrate on analyzing share ownership structure, the composition of board of directors and board's duties, its committees and disclosure requirements.

4.1 Share Ownership Structure

Generally speaking, the type of ownership can be seen from separated ownership and concentrated ownership perspectives. The differences in legal, political and economic factors have generated the various patterns of ownership structure across countries. A dilution of the ownership structure is prevalent in some countries and absent in others. The common law countries, for example, the US and UK are characterized by a separation of ownership and control, whereas the concentration of the ownership structure is still high in many countries, especially in continental European countries, Latin American countries, East Asia, and Arab countries including Saudi Arabia (Aguilera, R.V, Castro, L.R.K, Lee, J.H and You, J., 2011).

Corporate ownership in the US and the UK, for instance, are based on the “outsider system”, a large shares market, an active market and a dispersed ownership structure. In turn, corporate ownership in some continental European countries depend on the method of “insider system”, low levels of takeover activity, and a concentration of ownership in the hands of wealthy families, state-controlled companies and financial institutions (Franks, F., and Mayer, C., 2001). These models are different in terms of efficiency of corporate governance rules and the ability to provide good protection of minority shareholders' rights. Thus, the civil model is characterized by weak protection of minority shareholders' rights and poor corporate governance practice (La Porta, R.F., Lopes-de-Silanes, A. Shleifer, and R., Vishny, 1998). In contrast, the common model is usually provide an active corporate governance and strong protection of minority shareholders rights ((La Porta, R.F., Lopes-de-Silanes, A. Shleifer, and R., Vishny, 1998).

As far as Saudi Arabia is concerned, share ownership is characterized by a high concentrated ownership and control in the hands of wealthy families and the State (the World Bank Report, 2009). The prevalence of the family ownership structure in the Saudi Stock Market can be attributed to that Saudi Arabia is characterized by absolute monarchy and the nature of the political system has a large impact on the life of its trade and economy (P. Gourevitch and J. Shinn, 2007). Thus, Saudi stock market dominates by a relatively small network of prevalent business leaders. Banks still plays a vital role in the Saudi securities market. They work as stockbrokers and prefer to deal with large investors instead of smaller ones (A. Awwad, 2000). Literature showed that concentrated ownership empowers the controlling shareholders to expropriate minority shareholders’ rights (R. La Porta et al, 2000).

Concentrated ownership and control in the hands of single families in Saudi Arabia has resulted, in many cases, in the failure of some family corporations. A recent example is the Saudi Arabian construction company Mohammed Al-Mojil Groups (MMG), which was hit by heavy losses and accumulated debts amounting to $107 million in November 2012. The collapse of the MMG was attributed to the mismanagement and misuse of power by the board of directors (Aleqtisadiah newspaper, 2012). Some Saudi scholars commented that the failure of MMG suggests that most family-owned businesses that have recently moved to a joint-stock company in the Saudi securities market do not exercise a positive role, either to the Saudi economy in general or to the Saudi community in particular (Aleqtisadiah newspaper, 2012).

Ownership of Saudi listed corporations shows that one-third of the stock market's aggregate capital is dominated by the Saudi government, and another one-third is controlled by founding families (Economist Intelligence Unit). The remaining shares which represent about 30% are in the hands of Saudi retail investors, who are in charge of 93% of the trading activities in Saudi marketplace (the World Bank Report, 2009). Specifically, the Saudi stock market has been closed to foreign ownership and institutional investors (the World Bank, 2009). It has argued that foreign companies do not have regular access to shares in Saudi companies (Eric Herring and Glen Rangwala, 2005). Lately, Saudi government determined opening the market to institutional and foreign investors. Financial institutions from the Gulf States and foreign legal residents are now permitted to purchase shares directly in Saudi stock market (alriyadh newspaper, 2016). Yet, the influence of this measures remains limited, since the foreign investment remains less than 2% of the overall (the World Bank, 2009). The recent Saudi governance reform has stressed on the significance of institutional ownership and foreign investors while limiting the individual and family ownership.

The Saudi Market Authority began opening up the market to foreign investors to access to the biggest bourse in the region which is estimated $530 billion (Leone Lakhani and Alanna Petroff, 2014). In 2015, the Board of the Capital Market Authority issued Rules for Qualified Foreign Financial Institutions Investment in Listed Shares.

The aims of opening the Saudi stock market to qualified foreign financial institutions are to (Rules for Qualified Foreign Financial Institutions Investment in Listed Shares, 2015): (1) boost institutional ownership in the Saudi Capital Market; (2) increase the knowledge and experiment of the financial institutions; (3) contribute to market stability and mitigate high volatility in shares prices, and (4) enhance the Capital market to be a leading market, improve the level of research, studies on the market in order to provide more information and more assessments.

4.2 Board of Directors

Board of directors is appointed in order to ensure the alignment of the company activities with its specified objectives. The board is in charge of making sure that the top management are behaving in a way that will improve the performance of the company and the shareholders' value (Coles et. al, 2001). According to the CL, joint company should be directed and managed by board of directors and the board members should be identified by the articles of association, provided that the board size is not less than three and not exceeding eleven members (Company Law, 2015). The Saudi Corporate Governance Regulations (CGR) has come in the line with the CL, since it states the same conditions as for the board size (CGR, 2006

4.2.1 Board Structure

the Saudi’s board system is characterised by a single-board or unitary system composed of non-executive directors and executive directors. It is quite similar to the single-board model that operates in the US and the UK systems. The boardrooms of the Saudi listed corporations shill consist of both independent non-executive directors and executive directors. Non-executive directors have lately become one of the most important foundations of the sound corporate governance practice in any State (J. Cotter and M. Silvester, 2000). The importance of separating the duties of non-executive directors and executive directors is increasingly being recognised as a crucial factor in reforming listed corporations in many jurisdictions. This importance has reflected in the Principles of Corporate Governance, which state that: "Independent board members can contribute significantly to the decision-making of the board" (the OECD Principles of Corporate Governance, 2004). Non-executive directors are responsible for identifying the appropriate compensation of executive directors and they also have an absolute power to appoint and fire executive directors (J. Cotter and M. Silvester, 2000).

The Company Law of 1965 and the new amended Company Law of 2015 did not give room for division of board members. Indeed, this represents a problem in good corporate governance in Saudi Arabia, the presence of independent directors can reduce information asymmetry (M. Allegrini and G. Greco, 2013) mitigate the conflict of interest between agents and principals (L. Bebchuk and M. Weisbach, 2010) and improve board decisions (S. Chen et al., 2011). By not giving room for a division of board members, many Saudi firms will be saddled with agency problems, which may adversely affect the protection shareholders’ rights. The CGR in 2006 stated the need to divide the board into three categories. It defined three types of the board members as follows: executive members, independent members and non-executive members. The executive director is a person who works in a full- time capacity with the company and obtains a monthly wage (CGR, 2006). The non-executive member is a director who does not hold a full-time management position in the firm, or receive a monthly or yearly salary. To increase the effectiveness of the non-executive directors, the CGR require all listed corporations to ensure that the majority of board members are appointed as non-executive directors (CGR, 2009). The CGR emphasized the need to appoint independent non-executive members of the board who should enjoy complete independence.

However, the problem is that the CGR are still optional rather than binding. The listed companies are no bound to follow this rule, and thus most listed corporations' boards still act under the control of government's members, founder or family members. Moreover, there is an ambiguity regarding the function of the independent director and the non-executive director in Saudi law. For instance, it is very uncertain that non-executive members and executive members would not challenge the strategies and decisions made by the chief executive officer (CEO) (J. Westphal and E. Zajac, 1998). To comply with sound corporate governance standards, the contract of the executive director should run for three years, which can only be renewed following endorsement of shareholders. Furthermore, the executive members’ income should be subjected to full transparency and disclosure (A. Cadbury Repotr, 1992). However, the CGR in Saudi Arabia have not provided this in the legislation, thus there is a need for amendment in the legislation to accommodate this requirement.

Despite the number of non-executive directors, particularly in Saudi banks are composed of a large percentage of the board members (Fahad. Al Majed, 2008). For instance, the board members of the Aljazeera Bank are consisting largely of non-executive directors. In the Saudi SAMBA Bank board, 8/10 members are non-executive directors. All the 9 board members of the Saudi Investment Bank are non-executive directors and for Saudi Hollandi Bank, 9/12 members are non-executive directors (Fahad. Al Majed, 2008).

However, the presence of non-executive directors in the board of the Saudi family-owned corporations and other listed corporations are virtually non-existent. Previous research suggests this is due to an increased concentration of ownership in listed companies (Fahad. Al Majed, 2008). The CGR stipulate that the board of directors, including non-executive directors, must be appointed by the general assembly (CGR, 2006). In addition, the CGR also provide that the nomination committee should recommend all appointments for the membership of the board, to the board of directors in accordance with the approved policies and standards. The non-executive directors are appointed and dismissed by the nomination committee under the UK law, for example, but in Saudi Arabia, the appointments and dismissals are done at the discretion of the general assembly. As a result, non-executive members may act under the influence of controlling shareholders or majority shareholders and this may weaken their status of independence.

4.2.2 Chairman and CEO

Management structure of a company may combine leadership structure and separated structure (Coles et. al, 2001). Enhancing monitoring management can be apply through the separation between CEO and Chairman, while Haniffa and Cooke, 2000 suggests that a single person in the position of Chairman and CEO simultaneously may less contracting and reduce information asymmetry.

However, it has been found that cost-efficiency and return on assets are lower when the CEO is also the chairman (Pi and Timme, 1983). Jensen (1993) found out that the combined structure is inadequate to draw critical power relationships in the company. The duties of the chairman and the CEO are sometimes combined as one, suggesting that one person can serve as the chairman of the board as well as the chief executive officer of the company (Company Law, 1965). It has been argued that the function of the chairman and the CEO should be separated and should not be filled by only one person (UK Company Law, 2009). In Saudi legislation, it advocated that the role of the chairman and that of the CEO should be inseparable. Yet, this view has changed following the enactment of the CGR in 2006 and the new CL in 2015. This new regulation has recognized the importance of separation between the functions of the chairman and the CEO. The CGR not only recommended that the functions of the chairman and the CEO in listed corporations should be separated, but that it should also be considered a serious offence if any corporation violates this provision. The New CL of 2015 has supported this trend by stating that it does not allow combining between the function of chairman and CEO.

Yet, although the Saudi legislations stated and recommended the separation of the two functions, most listed corporations, particularly the State and the family-owned corporations, do not apply this rule. In fact, it is not a surprise that some corporations fail to implement the Saudi security laws when it comes to separation of the office of the chairman and the CEO. This is because the CL granted the board members the right to elect the chairman and the CEO (Company Law, 1965). As a result, the State and rich families exert considerable influence in the selection of the chairman and the CEO of their companies. For instance, the chairman of the SABAC Company is appointed by the Saudi State and the post of the chairman and the CEO of the Al Rajhi Bank are held by a single individual, who in this case is the son of Suleiman Al Rajhi (Mr. Abdullah bin Suleiman Al Rajhi Chairman).

In fact, most obstacles facing the effectiveness of corporate governance in the Saudi securities market are that there is clear duplication between the rules of the CL and the CGR, as well as the appointment of the chairman and the CEO being subject to social ties and business relationships. Thus, the appointments of most chairmen and CEOs in the Saudi listed corporations are largely based on friendship ties rather than on skills, qualifications and experiences.

4.2.3 Board Members' Qualifications and Expertise

Having qualified directors will help the company adopting innovative activities and improving its performance (Hambrick and Mason, 1984). Wallace and Cooke (1990) indicate that improving education in any state play a crucial role in developing political awareness and corporate accountability.

The existence of qualified and well-educated personnel with solid backgrounds in the field of law, finance, economy, and other scientific majors are fundamental prerequisites for developing sophisticated laws to deal with capital market issues, in particular protecting investors' rights and interests. This view is consistent with the recommendation made by the International Organisation of Securities Commission (IOSCO). According to the IOSCO, securities regulators should be equipped with sufficient skills, experience and qualifications that are appropriate to the private sector (International Organization of Securities Commission (IOSCO), 2003). Moreover, the IOSCO also proposed that security market staff should receive constant training as required.

Investment in the securities either markets directly or indirectly, via mutual funds, is growing rapidly (C. N. Katsoris, 2001). Furthermore, lawsuits between the securities market and its participants, as well as between investors have also increased. With an increase in the size of the market and widening scope of internet trading, causes related to security dealings have continued to rise steadily (C. N. Katsoris, 2001). The cases of the securities market are complicated and not easy to resolve. Thus, perfect knowledge in the science of law and other sciences is required. In particular, the appointment of a member of the board of directors should take into account the legal, financial and economic qualifications and experiences of the candidates.

In Saudi Arabia, CGR requires all directors of listed companies to undergo continuous training programs of suitable skills for membership of the Board of Directors and "the preparation of a description of the required capabilities and qualifications for such membership" (CGR, 2006). The World Bank report of 2009 criticized and recommended that CMA and SAMA should encourage roll out a corporate governance awareness raising campaign. The campaign should involve a bundle of seminars, workshops, conferences and training courses targeting directors and senior management (the World Bank, 2009). Moreover, board professionalism is a fundamental to improving corporate governance practices and to a firm's long-term success. Thus, resources are required to put in place suitable programs, which can develop and train board members and enhance their skills, as well as raise their realization regarding the importance of good corporate governance (the World Bank, 2009).

4.2.4 Board Committees

The boards' committees are becoming a fundamental prerequisite for the effective application of corporate governance practice worldwide. It helps the company's boards to achieve their goals and objectives efficiently. Klein (1998) suggested that the board committees may affect the company's performance. Specifically, it was seen that having the proportion of insiders on the finance committee is positively reflect on company value. Despite this view, however, Weir et. al. (2001) argued that the independence of the company's committee and merit of its members has an impact on the company's performance. Vafeas and Theodorou (1998) have also supported this opinion and found out that the structure of board sub committees has no a significantly affect on the performance.

The board committees differ in terms of the nature and size of the corporation. However, establishing a good corporate governance system requires at least three major sub-committees. As an example, in the UK experience, the Higgs Review suggested that most public companies should have two types of sub-committees, namely the audit committee and the remuneration committee (R. Hampel, 1998). Similarly, the Cadbury Report recommended that the board of directors should have two official committees: the audit committee and the remuneration committee (Cadbury Report, 1992). The Cadbury Report also stated that the nomination committee is a very important device to ensure the board of directors' designation process is made more explicit (C.A. Mallin, 2007).

The audit committee is the most significant board committee that oversees the internal and external audit process of the company. Basically, the objective of an audit committee is to review the company's financial data and ensure that the corporation has efficient internal controls, suitable accounting standards and external auditors who can prevent scams, manipulation and enhance the company's quality. Literature suggests that the audit committee helps the board in monitoring and ensuring the efficient implementation of the internal control mechanisms, overseeing and concentrating on all aspects of risk management, especially financial risk (W. Willekens and P. Sercu, 2005). Under the Saudi legislation, the audit committee has constituted a paradigm shift in the field of transparency and disclosure in the Saudi stock market, particularly in the wake of enacting the CGR in 2006. The new regulations strongly recommend that each board of directors in listed corporations set up an audit committee (CGR, 2006).

Its members should not be less than three, involving professional persons in the domains of financial and accounting matters. Furthermore, the CGR recommended that the members of the audit committee should be selected from non-executive directors.

To ensure integrity and neutrality, the audit committee should not have any direct or indirect engagement in any interest linked to the company's dealings or transactions. Another duty is reviewing the interim and annual financial reports and conducting suitable recommendations prior to presentation to the board of directors (CGR, 2006). In spite of the Saudi regulator's efforts in this regard, evidence suggests that most Saudi listed corporations have a cynical disregard of the activities of this committee and thus some of them have failed to comply with the provisions of the CGRs. The main problem emerges when the board of the listed corporations nominate the audit committee members without seeking approval from the general meeting of shareholders. For instance, the Basic Chemicals Industries Company recently paid a fine of $13,333 due to the failure of the company's board to seek approval of the general assembly when selecting the members of the audit committee (BCMA, Decision No. 7-1-2012). In addition, Tabuk Cement Company also received the same penalty because it breached the provisions of Article 14b) of the CGR (BCMA, Decision No. 8-1-2012).

Although the new CL of 2015 ahs stated that general assembly shill set up an audit committee within listed companies. However, the problem is that both the CGR and CL conditions in relation to setting up the audit committee is still voluntary rather than obligatory. The World Bank report of 2009 had criticized the accounting standards of listed companies, as it stated that accounting standards in Saudi Arabia does not intend to converge with International Financial Reporting Standards (IFRS) (the World Bank, 2009). It added that convergence with the national standards is reportedly high, yet there is need to converge with internationally acceptable accounting and auditing standards to improve the financial statement and give further trust investors (the World Bank, 2009).

The compensation committee (remuneration) remains a contentious topic in the field of corporate governance. It plays a vital role in preventing potential conflicts of interests between managers and shareholders, as executive directors may set up private remunerations for their personality interests. This committee has taken an advanced position under UK legislation as it was one of the issues that led to the agency theory problem. Therefore, it has received special attention in UK legislative reform. The UK CGC of 2012 states that the level of directors' remuneration should be sufficient in order to attract, keep and encourage the professional directors to run the firm efficiently but that a corporation should avoid paying more than is necessary for this objective (UK Corporate Governance Code, 2012). The UK Combined Code (2006) provided that: 'the remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration' (UK Combined Code, 2006).

In Saudi Arabia, the CGR were very obvious when they state that: '… the ultimate responsibility for the company rests with the board, even if it sets up committees or delegates, some of its powers to a third party'. Consequently, this committee and other board committees cannot replace the board of directors' responsibilities, which has the absolute power to manage the company with the appropriate method. Controlling shareholders in Saudi listed companies can abuse the company and the rest of shareholders by approving high remuneration for themselves (S. Johnson et al., 2000). This has a negative impact on shareholders' rights, especially if we take into account that the controlling shareholders hold an executive position in most listed corporations in the Saudi securities market.

4.3 Transparency and Disclosure Requirements

It was also found that when it came to ensuring transparency of enforceable legal requirements, Saudi Arabia had implemented this relatively strongly, but only moderate transparency has been achieved within the capital market. Therefore, the theme, here, seems to be that although the rules are in place, there is a variety of success levels in terms of getting the rules and regulations implemented (Saeed Al-Muharrami, 2009). A notable weakness was identified when it came to disclosure of non-financial information, due to the lack of foreign competition. Therefore, at times, it was seen to be inadequate practical protection from insider trading. Although concerns have been raised in relation to certain aspects of disclosure, the institutional structures that have been put in place and the capital markets are relatively strong, having gone through a large transformation in the previous few years. There seems to be a general level of support towards ensuring that corporate governance disclosure requirements are met and market integrity is improved, both on a regional and international basis (Abul Hassan, 2009).

However, the World Bank report of 2009 found out that the disclosure requirements associated with stakeholders could not be suitably analysed, as it was too new to be meaningfully considered. Where other aspects of disclosure are concerned, there were substantial weaknesses identified, particularly in relation to non-financial disclosure and issues such as conflict of interest by brokers and rating agencies has not been implemented at all. The reason for this is identified as being the fact that the core principles associated with the authorised persons' regulations did not require such disclosure and, therefore, has not been brought into general corporate governance structures (A Demirgüç-Kunt, E Detragiache and T Tressel, 2008). In the context of public disclosure, it is the listed companies that are controlled in a much stronger way, although there were still certain areas that were left out, such as disclosures relating to beneficial ownership (the World Bank, 2009). Furthermore, the Listing Rules of 2004 have completed and required significant disclosure. Yet, the compliance with it by market participants regarding the disclosure requirements have been criticised by the World Bank report, as it stated that this compliance is weak in particular with respect to corporate governance related information. In addition, ownership information does not seem to be made publicly available on a methodical basis. Hence, the World Bank recommended CMA to publish ownership information of listed corporations, and should follow up with firms that have not published their ownership reports.

4.7 Conclusion

In conclusion, the article presented a descriptive analysis on the corporate governance mechanisms in Saudi financial sector. It discussed the Saudi government efforts in the wake of the financial crisis in 2006 that necessitate for the comprehensive reforms of corporate governance mechanisms on its financial sector. The article analyzed the reforms tools contained in the Corporate Governance Regulations, Capital Market Law, and new Company Law. The World Bank report in 1990 has been taken as a fundamental benchmark to assess the status of corporate governance in Saudi financial sector. It has found that the corporate governance structure in Saudi Arabia, particularly in relation to the financial sector, has strong corporate governance frameworks. However, it is noted that these frameworks are relatively new, and therefore the application of the rules have not yet been seen in reality.

The article identifies some of the significant mechanisms implemented in the reforms of the Saudi corporate governance, and discovered that the mechanisms that have been made are extensive and covers a broad spectrum of corporate governance whether as respect to the internal mechanisms or the external mechanisms.

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