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THE DEVELOPMENT OF CORPORATE
GOVERNANCE PRACTICES IN THE MIDDLE
EAST SPECIFICALLY IN SAUDI ARABIA AND
YEMEN

BY

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ABSTRACT

The concern of corporate governance system has been driven in recent years primarily as a result of a series of corporate scandals and failures in a number of countries. This concern is to protect not only shareholders but stakeholders as well. Investors believe that better corporate governance will bring them higher rewards and they are more confident and consider that a company which implements corporate governance is a safe place to provide them with an appropriate return on their invested capital. In addition, creditors will trust that their rights are protected. In the Middle East there is a great concern to attract as large amounts as possible of domestic and international investments, and in order to achieve this aim, corporate governance system should be adopted. This study aims to examine the current developments of corporate governance in two countries of the Middle East which are Saudi Arabia and Yemen comparing them with international corporate governance principles of best practice such as the OECD principles. Additionally, it makes a comparison between the two countries. The study used primary data which was a questionnaire distributed to 58 listed companies in Saudi Arabia and the 52 largest companies in Yemen. To fulfill the objectives of the study, seven important factors of corporate governance were employed as the measures, namely, board of directors, Duality of CEO and Chairman, Second Man (Deputy CEO\GM), Audit Committee, Internal Auditing, Risk Management and Disclosure and Transparency. The results generally showed that corporate governance practices do to some extent exist in both countries. However, some aspects of corporate governance are implemented to a higher degree while some other aspects are practiced at a lower degree. Furthermore, there is a difference of implementation of corporate governance principles between the two countries and generally, Saudi companies look better than Yemen companies in terms of corporate governance practices.

ملخص البحث

لقد زاد الإندفاع كثيرا بالاهتمام بنظام الإجراءات الحاكمة للشركات في السنوات الحالية وذلك نتيجة لوجود انهيارات مالية وافلاس في عدد من كبرى الشركات العالمية. هذا الاهتمام الزائد لغرض حماية المساهمين وجميع أطراف المصالح في الشركة. يعتقد المستثمرون بأن التطبيق السليم لنظام الإجراءات الحاكمة للشركات يمنحهم عائدا أكثر ويشعرون أيضا بالارتياح. بالإضافة إلى أن الشركات التي تطبق هذا النظام تعتبر مكانا آمنا للإستثمار لأنها تقوم بتزويد المستثمرين بعائد مالي مناسب علاوة على ذلك فإن الدائنين يكونون على ثقة تامة بأن أموالهم محمية. هناك حاليا الرغبة الكبيرة في الشرق الأوسط باستقطاب أكبر عدد من السمتثمرين المحليين والدوليين، ولكي يتم انجاز هذا الهدف فإنه يتطلب تطبيق نظام الاجراءات الحاكمة للشركات. إن هذه الدراسة تهدف إلى دراسة التطور الحالي لتطبيق نظام الإجراءات الحاكمة للشركات في دولتين من دول الشرق الأوسط وهما المملكة العربية السعودية واليمن بالمقارنة مع المفاهيم الدولية لنظام الإجراءات الحاكمة للشركات. أيضا تهدف هذه الدراسة إلى عمل مقارنة بين الدولتين المملكة العربية السعودية واليمن من حيث تطبيق نظام الإجراءات الحاكمة للشركات. لقد تم في هذه الدراسة استخدام الإستبانة من أجل جمع البيانات من الدولتين. وتم توزيع الإستبانة على 58 شركة سعودية من شركات سوق البورصة السعودي للأوراق المالية و 52 شركة يمنية من كبرى الشركات اليمنية. ومن أجل تحقيق أهداف هذه الدراسة تم اختبار سبعة عناصر مهمة من عناصر نظام الإجراءات الحاكمة للشركات وهذه العناصر هي مجلس الإدارة، الفصل بين مناصبي رئيس مجلس الإدارة والمدير التنفيذي في الشركة، وجود الرجل الثاني في الشركة، لجنة المراجعة المنبثقة من مجلس الإدارة، المراجعة الداخلية، تحليل المخاطر، الشفافية والإفصاح. تشير نتائج الدراسة إلى

أن تطبيق الإجراءات الحاكمة للشركات موجودا الى حدٍ ما في الدولتين ومع هذا فهناك اختلاف في مدى التطبيق بين الدولتين ويبدو أن الشركات السعودية أفضل قليلا من الشركات اليمنية في مدى تطبيق الإجراءات الحاكمة للشركات .

APPROVAL PAGE

I certify that I have supervised and read this study and in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

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Hafiz Majdi Abdul Rashid
Supervisor

I certify that I have supervised and read this study and in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

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Co-Supervisor

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Master of Science in Accounting.

Jamil Osman
Dean, Kulliyah of Economics
and Management Sciences

DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Yaseen Ahmed Mohammed Al-Janadi

Signature:

Date:

INTERNATONAL ISLAMIC UNIVERSITY MALAYSIA

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**THE DEVELOPMENT OF CORPORATE GOVERNANCE PRACTICES IN
THE MIDDLE EAST SPECIFICALLY IN SAUDI ARABIA AND YEMEN**

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LIST OF ABBREVIATIONS

AGM	Annual General Meeting
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CG	Corporate Governance
CPA	Chartered Public Accountant
GDP	Gross Domestic Product
GNP	Gross National Product
GM	General Manager
MENA	Middle East and North Africa
OECD	Organization for Economic Cooperation and Development
TADAWUL	Saudi Arabian Stock Exchange

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

A concern of corporate governance system has been recently exposed as a result of a series of corporate scandals and failures in a number of countries. This concern is to protect not only shareholders but stakeholders as well. Investors believe that better corporate governance will bring them higher rewards making them more confident, considering that the companies which implement corporate governance can safely provide them with an appropriate return on their invested capital. In addition, creditors trust that their rights will be protected. The first part of this chapter will discuss the strategic position and economic background of the Middle East, with specific focus on the selected countries which are Saudi Arabia and Yemen. The second part will discuss the motivation of the study. The third part will discuss the objectives of the study. The fourth part will discuss the scope of the study and lastly this chapter will discuss the structure of this dissertation.

1.1 Background of the Study

The Middle East is located in the heart of the world. It has a unique geographical location. It has a strategic position in the world. It connects three continents: Asia, Africa and Europe. It has a diverse environmental system including a wide range of climatic conditions like alpine, tropical, coastal and desert regions. This environmental diversity creates great, valuable and diverse raw minerals such as oil and gold. Despite the main income in most of the Middle East countries depending on oil, for example, in Saudi Arabia and Yemen which comprise the sample of this study, the oil export revenue in these two countries makes up around 70 percent of state revenue (Energy Information Administration, 2004). But in the last decade there has been an increase in the orientation of economic reforms and development. Some of these reforms and developments are based on establishing free trade zones such as in United Arab Emirates and Yemen, in order to attract international investments and diversify their economic income. Additionally, many countries such as the countries of the Gulf Cooperation Council were not willing to allow foreign investments in their markets but, in the last decade they have allowed many foreign investors to gain access to their markets. Morgan Stanley Capital International (MSCI), as quoted by El-Ansary (2004) states that the Middle East represents approximately 6% of the MSCI Emerging

Markets Index. Furthermore, most of the Middle East countries tend to privatize many public sector organizations in order to increase profitability and reduce its costs. However, not all Middle East countries are convergent economically, but there is diversity from country to country. For example, in Saudi Arabia the real GDP growth was 5.2 percent in 2004 while in Yemen the GDP growth was 2.7 percent. Additionally, some developing countries like Lebanon are in need of capital accumulation whereas other countries which are rich in oil such as Saudi Arabia and Kuwait have enough capital to invest, but they need to diversify and to develop their economies. Thus, all these countries in order to diversify and develop their economies, they need to develop their stock markets and implement a corporate governance system. Shalan, (2005) declared that the stock exchanges have typically been the focal point for corporate governance reform in the developed countries. The stock exchanges in the Middle East countries are not fully developed. The stock exchanges in the Middle East region are government or quasi-government bodies and are supervised by government security regulators. Most of the Middle East countries have a stock exchange market, while Yemen and Syria are in the planning stage of establishing a stock exchange.

Corporate governance has started to take a strong root in the Middle East's markets. Additionally, it is supported also by several international organizations which are interested in corporate governance. Miteva (2005) declared that the OECD has embarked on improving the corporate governance initiative with the Middle East and North Africa (MENA). The OECD – MENA initiative is aimed at modernizing the government structures and proceeding with corporate governance practices in MENA countries. Additionally, it aimed at improving the policies and environment for investment in the region.

1.2 Motivation of the Study

There are several motivational factors to conduct this study. The first motivation is that recently, in the Middle East, the economic development and reform strategy have become the main goal in the region. This development and reform, in order to be successful, need to implement corporate governance principles. Shalan (2005) declared that in order to have effective and efficient reforms and economic development both in the private and public sectors in the Middle East and North Africa there must be awareness of the benefits of the sound corporate governance. Thus, the researcher has

a strong motivation to study corporate governance in the Middle East in order to contribute to the economic development and reform strategy in this region.

Secondly, the majority of the Middle East countries are moving towards privatization. Hessel (1995) declared that for privatization, in order to contribute to economic growth investors must be convinced that the money they invest in a newly-privatized company will be handled reliably by the company's decision-makers. Thus, private investment depends heavily on the promotion of good corporate governance practices.

Thirdly, the Middle East countries have recently allowed foreign investments.

In order to attract a huge amount of domestic and international investments they need to have a strong management system which can give protection to the investors and provide confidence for them to invest. A corporate governance system, if well implemented, can provide this protection. Consequently, this study is looking forward to giving investors a clear picture of the current application of corporate governance practices in the Middle East especially in the selected countries, namely, Saudi Arabia and Yemen.

Finally, with the lack of a comprehensive study on corporate governance practices in the Middle East, especially in the selected countries, the researcher strongly hopes that this study will be a part of his contribution towards his region.

1.3 Objectives of the Study

In this research there are three objectives, which are expected to be fulfilled. The first objective of the study is to examine the current developments in corporate governance practices in the Middle East, especially in Saudi Arabia and Yemen.

Secondly, it aims at examining the extent to which this development exists in the two countries.

The third objective of this research is to compare the current developments in corporate governance between Saudi Arabia and Yemen.

1.4 Scope and research method

The research method adopted in this study is an empirical analysis of primary data which is the questionnaire. The sample chosen by the researcher is to look into all listed companies in Saudi Arabia and the 60 largest companies in Yemen. The study will focus on examining the current developments in corporate governance in the two

countries. In order to fulfill this objective, the study prepares a questionnaire that examines the important elements of corporate governance which are board of directors, audit committee, internal auditing, risk management and disclosure and transparency.

1.5 Contribution of the Study

Due to the importance of corporate governance of companies which encourages people to invest their money, the researcher feels that it will be necessary to conduct research on corporate governance in Yemen and Saudi Arabia. This study chiefly aims to contribute in the development of corporate governance in the two countries, and presents an overview of the extent to which corporate governance exists in these countries in comparison to international corporate governance practices. Moreover, it also assists in giving the investors a clear picture of the protection system that would encourage them to invest and recognize the safe area in which they may invest. The result of the study will hopefully make a useful contribution that enables the future research to enhance corporate governance practices and helps the regulators to develop effective corporate governance procedures and codes.

1.6 Structure of the Dissertation

This research is organized into six chapters which are as follows:

1. Chapter one gives a brief background to the Middle East. It explores the unique location, the important characteristics, the economic development and corporate governance of the Middle East. This chapter also explains briefly the motivation, objectives, contribution and research methodology of this study.
2. Chapter two will discuss the background of corporate governance. It will discuss the definition, the importance and the basic principles of corporate governance internationally. Additionally, this chapter will discuss corporate governance in the Middle East, particularly the selected countries which are Saudi Arabia and Yemen.
3. Chapter three presents the empirical evidence on corporate governance both internationally and in the Middle East.
4. Chapter four will discuss the research method adopted in this research. This chapter includes population and sample, research questions, data collection procedures, data structure and data analysis of this study.
5. Chapter five will present the discussion and analysis of the results of this study.

6. Chapter six will discuss the conclusion and limitations of this study.
Additionally, it will suggest areas for future research.

CHAPTER TWO

BACKGROUND OF CORPORATE GOVERNANCE

2.0 INTRODUCTION

The background will first discuss what corporate governance is and its importance, then it will discuss the basic principles of corporate governance for several regulatory agencies and committees around the world, especially in Malaysia as a sample of developing country. Secondly, the discussion will be on the background of corporate governance in the Middle East and focus more on the countries selected in this study, namely, Saudi Arabia and Yemen.

2.1 Corporate Governance Internationally

2.1.1 What is Corporate Governance?

In recent years, there has been a rapid development of corporate governance which has resulted in different perspectives. There are many different definitions of corporate governance, but all of them are based on three fundamental principles as follows:

- (i) the relationship between corporate managers, directors and shareholders;