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**An evaluation of the current rules and regulatory
framework of corporate governance in Saudi Arabia: a
critical study in order to promote an attractive business
environment**

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(November 2016)

Submitted for the Degree of Doctor of Philosophy

Declaration

I confirm that the thesis is my own work; that it has not been submitted in substantially the same form for the award of a higher degree elsewhere; and that all quotations have been distinguished and the sources of identification specifically acknowledged.

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Abstract

The importance of a good awareness of the corporate governance system nowadays, as a mechanism that is helping towards achieving a successful and reformed business environment, is self-evident, especially in the light of the crises, recessions and corporate failures that the world is currently facing. However, the legal and regulatory frameworks of any country are important factors that contribute towards the success of the corporate governance system based on principles of justice, accountability and transparency, so that market participants can trust the market to establish effective contractual relations. Developing countries in this context are more likely to suffer from a lack of accountability and transparency, and are more vulnerable to having problems with the business environment; Saudi Arabia is no exception. The pursuit of improved corporate governance practices needs to be combined with improvements to legal, regulatory and enforcement tools, as well as institutional reform, in order to balance the interests of all parties involved in a company's interests. Moreover, there are different levels of corporate governance frameworks, such as legal and regulatory, self-regulatory arrangements, and the history and tradition of the country which varies

from one place to another. Therefore, corporate governance codes and regulations as a form of soft law could be used to complement the legislative and regulatory framework of corporate governance to provide more flexibility. However, not every successful aspect can be copied from one country to another country, as it may not work effectively due to the context varying according to the country's specific circumstances.

Therefore, there is a very important need to review, reform, and adjust corporate governance framework provisions in order to ensure they are suitable and updated to meet the new surrounding circumstances, which will be reflected in the integrity of the market and the country's economic performance. Likewise, there is a need to benefit from supranational organisations through international dialogue, such as with the OECD and the World Bank to learn from their experiences and benchmarks. There are different levels of legalisation and institutional frameworks that are related to corporate governance in the Saudi Arabian case, and the corporate governance code has been adopted from other jurisdiction after a series of arrangements to make it suitable and applicable in Saudi. Thus, the adoption of a new concept in a challenging and different legal and cultural environment needs to be examined. Starting with Sharia, the capacity to accept and absorb a new concept such as corporate governance, with the different structure of institutional and legal frameworks, could present a challenge; as well as society and culture also playing a crucial role in this context. This study aims to evaluate and critically analyse the current rules and regulations of frameworks of corporate governance in Saudi Arabia in order to create an attractive business environment. So, in this context, the UK corporate governance system has been used an example to draw lessons from and examine the ability of the Saudi legal

system and its legal and regulatory frameworks to absorb and adapt to emerging concepts such as corporate governance as a Western concept.

There is flexibility within Sharia and the Saudi legal system to adapt to modern concepts, which has been proven by the compatibility of corporate governance- to some extent- with international standards, such as OECD and UK regulations. Considering the local business environment of Saudi Arabia (even more so when adopting new regulations) will reduce the weaknesses and any negative side effects. Setting up committees in Saudi Arabia that specialise in corporate governance like the UK will contribute towards improvement in corporate governance practices.

The importance of this research has become more apparent with the issuance of the new Saudi Companies Law in 2015, which will be enforced from May 2016. This Companies Law 2015 can be described as a new era in determining the functions and jurisdictions of the Ministry of Commerce and Industry, and the Capital Market Authority. Thus, this study could be the first attempt to examine the Saudi system of corporate governance with relation to Companies Law 2015.

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List of Abbreviations

CACG: Commonwealth Association for Corporate Governance

CBI: The Confederation of British Industry

CIPE: The Center for International Private Enterprise

CMA: Capital Market Authority

CML: Capital Market Law

CRSD: Committee of the Resolution of Securities Disputes

EU: The European Union

FCA: Financial Conduct Authority

FRC: The Financial Reporting Council

FSA: The Financial Services Authority

FSB: The Financial Stability Board

FTSE: The Financial Times Stock Exchange

GCC: Cooperation Council For The Arab States Of The Gulf

GCGF: Global Corporate Governance Forum

ICGN: International Corporate Governance Network

IFC: The International Finance Corporation

IIC: The Institutional Investors Committee

IIFA: International Islamic Fiqh Academy

IOSCO: The International Organisation of Securities Commissions

ISC:	The Institutional Shareholders Committee
KSA:	The Kingdom of Saudi Arabia
LSE:	London Stock Exchange
MENA:	Middle East and North Africa
MEPI:	The Middle East Partnership Initiative
OECD:	Organisation for Economic Co-operation and Development
PIF:	The Public Investment Fund
PRA:	Prudential Regulatory Authority
SAMA:	The Saudi Arabian Monetary Agency
SAGIA:	Saudi Arabian General Investment Authority
UAE:	United Arab Emirates
UK:	The United Kingdom
USA:	The United States of America

1. Introduction

Corporate governance is about safeguarding the rights of all parties involved in the company's affairs.¹ However, if corporate governance does not provide protection for the involved parties, this could lead to many risks and crises. This objective of corporate governance concerns not only developed countries - developing countries also need effective corporate governance, even more so, in order to ensure the safety of developments in business environments that have less effective legal and regulatory frameworks.

While corporate governance matters for all countries, it is extremely important for Saudi Arabia and the GCC –The Cooperation Council for the Arab States of the Gulf-countries as developing countries.² Despite the fact that corporate governance in every country has a different legal, cultural and political context, with a variety of business forms, the need for extra transparency and creating more confidence is the reason for the introduction of corporate governance codes.³ Many issues affecting Saudi Arabia could be taken to reflect the situation across the GCC countries as a GCC representative. From this viewpoint, the importance of corporate governance is reflected in the essential link between corporate governance on the one hand and

¹ That is including: shareholders, management, customers, suppliers, financiers, government and the community.

² Six full members are forming The Cooperation Council for the Arab States of the Gulf including: The Kingdom of Saudi Arabia, United Arab Emirates, The Kingdom of Bahrain, The Sultanate of Oman, Qatar and Kuwait.

³ C A. Mallin, *Corporate Governance* (3rd edn Oxford University Press, 2010) Page: 26.

development on the other. Moreover, corporate governance is possibly an effective solution to fixing many problems facing the world today.⁴

For example, the Eastern part of the world witnessed ‘the Asian financial crises’ during the late 1990s. Some researchers believe that weak corporate governance could have been one of the factors that led to these crises. Although weak corporate governance might not have started the East Asian crises, corporate governance practices might have made these countries more vulnerable to the crisis and may have aggravated it once it started.⁵

To some extent, corporate governance could be described as a new concept in the modern business world. Some researchers think that corporate governance as a term has appeared during the mid 1970s. However, corporate governance is practically there since the beginning of the nineteenth century when the limited liability corporations has emerged.⁶ For the evaluation of the current rules and regulations framework of corporate governance in Saudi Arabia, a successful Western style law that has a history of corporate governance, evolving judiciary and over ten centuries of legal revolution is very important in this context, although some aspects of the

⁴ CIPE, *Corporate Governance: The Intersection of Public and Private Reform* (Center for International Private Enterprise, 2009) Page: 7.

⁵ T Mitton, 'A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis' (2002) 64 *Journal of Financial Economics* 215.

⁶ S Ahmad and R Omar, 'Basic Corporate Governance Models: A Systematic Review' (2016) 58 *International Journal of Law and Management* 73.

comparison may be quite broad.⁷ However, some questions concerning the adoption of a new concept in a challenging and different legal and cultural environment need to be answered, starting with Sharia as the supreme law of Saudi Arabia and the capacity to accept and absorb a new concept such as corporate governance. Furthermore, the different structure of institutional and legal frameworks could present a challenge as well. In addition, society and culture also play a crucial role as well in this context.

A new era for corporate governance legal and regulatory frameworks in Saudi started with the introduction of Capital Market Law 2003, which reshaped the layout of the Saudi stock exchange. However, after three years of the establishment, the CMA's ability in terms of regulation and supervising has been questioned due to the Saudi stock market crises in 2006.⁸ Regardless of that, the establishment of the Capital Market Authority was a very significant event in 2003 and has changed the roles of the institutional frameworks of corporate governance as well. In fact, establishing the CMA and the issuance of CML by Royal Decree (M/30) in 2003 may be described as forming the backbone of the restructuring of the capital market environment and its legal frameworks.

⁷ N H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 European Business Organization Law Review 3.

⁸ A Baamir, 'Issues of Transparency and Disclosure in the Saudi Stock Market' (2008) 22 Arab Law Quarterly 63.

1.1 Research objective

This thesis aims mainly to provide a critical study by evaluating the current rules and regulations of frameworks of corporate governance in Saudi Arabia in order to create an attractive business environment. This research is seeking to illustrate and examine corporate governance regulations, and its legal and regulatory frameworks, in order to identify weaknesses and improve it. The Saudi business environment is currently witnessing rapid steps forward in the development and improvement of the legal environment, including establishing the Capital Market Authority, the issuance of Capital Market Law 2003, with this being crowned by the issuance of a new Companies Law in 2015.⁹ So, the main research question of this thesis is to what extent the current rules and regulatory framework of corporate governance are able to offer an effective matrix of frameworks that promote an attractive business environment. To what extent international norms are compatible, and whether they can help to improve the current corporate governance situation, as well as how to reform and improve corporate governance frameworks according to international standards, will be discussed. For example, what lessons can be learnt from the United Kingdom's corporate governance system, frameworks, history and developments to

⁹ *Companies Law 2015*. It should be mentioned here that the new law '*Companies Law 2015*' will be in force in the 2nd of May 2016. The new law with Royal Decree No. (M / 3) dated 01/28/1437 and the Council of Ministers resolution No. (30) dated 01/27/1437 contains 226 Articles and replaces the Companies Law 1965 that promulgated by Royal Decree No. (M / 6) dated 03/22/1385 AH, and eliminates all conflicts with its provisions. Unfortunately, the English translated version of the new law has not been published yet, however, the Arabic version is available at the official websites of the Ministry of Commerce and Industry and the Bureau of experts at the council of Ministers. See: <http://mci.gov.sa/Documents/cl2015.pdf> for the Arabic version of the *Companies law 2015*. Accessed at 7/3/2016.

improve the Saudi Arabian example; whether Sharia's influence has an effect on corporate governance regulations and the legal and regulatory frameworks of corporate governance in Saudi Arabia. In addition, to what extent the enforcement mechanism in corporate governance, could be improved under the current frameworks of corporate governance, and whether the current structure of authorities and institutional frameworks, such as Saudi legislative bodies and the Judicial Authority of corporate governance, has impacted on corporate governance and the business environment.

For this reason, this research objective is to critically analyse the current institutional and judicial bodies, as well as the legal and regulatory aspects that are related to corporate governance's legal and regulatory frameworks. Therefore, this research will address sources of law affecting corporate governance practices in Saudi Arabia, such as Sharia, Companies law, self-regulatory codes and stock market regulations. Moreover, the regulatory authorities, including the Capital Market Authority which has the power of supervising and overseeing the capital market, will be examined as well. In other word, to what extent the current framework of rules and regulations of corporate governance in Saudi Arabia are clear, effective and compatible to achieve the purpose of improving the current situation in the business environment.

Corporate governance is a good example of a Western concept, whose theories are dominating the business world nowadays. Therefore, a highly developed and stringent framework of corporate governance, such as the UK system, will be taken as an example to draw lessons from. The differences between the Saudi legal system, and other world legal systems, provides the motivation behind shedding light on the key aspects of a developed country with a different system in order to take lessons and

examine the ability of the Saudi legal system to absorb and adapt to emerging concepts. Thus, the effectiveness of the legal and regulatory frameworks should be examined to assess their strengths and weaknesses. Furthermore, examining one law alone might not be enough to show the weaknesses or strengths points of the law. The aim is to provide a successful example to learn from, with a good history of development and in-depth experience, taking into account the cultural and societal differences, as Cornelius and Kogut state: “what works in Kansas might not work in Beijing”.¹⁰ This in effect is the critique of legal transplants, which we will consider later. Therefore, this thesis will focus more comprehensively on the corporate governance framework in Saudi Arabia in order to gain lessons and make better recommendations.

So, it can be seen from this introduction that for the sake of evaluating the current Saudi system, there will be a survey of the UK system of corporate governance on the one hand and Sharia principles on the other hand. Both systems provide a good basis for evaluating the current Saudi system, and the reasons for this will be explained in the following paragraphs. Starting with Sharia, it is crucial in this context to look at the main aspects of Sharia as the Supreme law of Saudi Arabia to examine the harmonisation of such a new concept as corporate governance and other laws and regulations with regard to Sharia. Examining the new regulations and laws to check their compatibility with Sharia principles is an ongoing issue in Saudi Arabia, even after the application of new regulations, which may not have given enough consideration concerning compatibility with other legal frameworks. There is a recent

¹⁰ P Cornelius and B Kogut, *Corporate Governance and Capital Flows in a Global Economy* (Global Outlook Series, Oxford University Press, 2003) Page: 19.

example with Companies law 2015, which has been adjusted- to some extent- to be more in tune with Sharia principles.¹¹ Moreover, there is an influence from Sharia over many aspects of the Saudi legal system that will contribute towards the evaluation of the current Saudi system. In fact, the fundamental legislative texts state that any article of the law “must not prejudice against the requirements of Sharia” or must be “in accordance with Sharia”, and this is contained in many of the royal decrees and laws issued including Company law. Therefore, Sharia could be described as the fundamental foundation and a central pillar of the Saudi system, and so a survey of Sharia law will offer an important basis for evaluating the current Saudi system.

Furthermore, in evaluating the current Saudi system, examining the UK system of corporate governance is very important in order to provide a good basis for this research as well. First of all, the UK framework of corporate governance has been described as highly developed and stringent, which "has spurred reviews of corporate governance in markets around the world and has provided a yardstick against which investment frameworks in other countries are measured".¹² Additionally, the Cadbury report has played a crucial role in the UK as well as on a worldwide level, and has provided a foundation for corporate governance.¹³ Moreover, the Combined Code of Corporate Governance is seen as an international benchmark for good corporate

¹¹ See chapter five for more details.

¹² B R. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan Via Toronto' (1999) 10 Duke Journal of Comparative and International Law 5.

¹³ S Ahmad and R Omar, 'Basic Corporate Governance Models: A Systematic Review' (2016) 58 International Journal of Law and Management 73.

governance practice to a large extent.¹⁴ There is no doubt that there has been an influence from the UK legal system on corporate governance in many parts of the world, including the GCC countries such as Saudi Arabia. Moreover, the City of London is a hub for many aspects of business activities nowadays, and many branches of Saudi companies, and companies that have business and trade relations with Saudi Arabia, are located there. Aiming to boost the Islamic finance sector, the UK government is offering products and services which are compatible with the principles of Islamic finance such as issuing ‘sukuk’ - Islamic bonds- and the announcement of a new Islamic index by the London Stock Exchange Group which, in addition to the previous reforms, is making London the foremost Western centre for Islamic finance.¹⁵ On the other hand, some GCC cities such as Dubai, Abu Dhabi and Doha have established a new business solution that provides strong connections between the UK legal system and the GCC countries including Saudi Arabia - the biggest among the GCC countries. These cities have given the authority and autonomy to establish what could be seen as new jurisdictions and legal islands for alternative dispute resolution centres, which have the independency to adopt English common law, and this has attracted experienced judges from the UK.¹⁶ As discussed previously, there is

¹⁴ S Arcot, V Bruno and A Faure-Grimaud, 'Corporate Governance in the UK: Is the Comply or Explain Approach Working?' (2010) 30 *International Review of Law and Economics* 193.

¹⁵ F Manjoo, 'Is London Ready to Become a Financial Hub of Islamic Finance?' (2016) 37 *Company Lawyer* 69. See also: R Wigglesworth and E Moore, 'Cameron aims to boost Islamic finance' *Financial Times* (London 29 October 2013).

¹⁶ See for example, Lord Phillips the President of Qatar International Court and Dispute Resolution Centre, Available at: <<https://www.supremecourt.uk/news/lord-phillips-to-take-on-two-international-judicial-roles.html>> accessed 20/7/2016.

an ongoing influence from the UK system on Saudi Arabia and the rest of the GCC countries, and some researchers think that the economic freedom of the GCC is more of a British influence.¹⁷ Finally, the obvious Westernisation of some aspects of Company Law in Saudi Arabia is also one of the motivations for the survey of the UK system of corporate governance in the thesis, to provide a good basis for evaluating the current Saudi system.

1.2 Research importance

The research importance comes from the relevance of the corporate governance topic itself. There is no doubt that companies nowadays have a huge impact on many aspects of life, including everyday existence, society and the economy, which makes corporate governance a very important issue. Accordingly, corporate governance is still “the bedrock of business sustainability and sound stewardship, serving the long-term interests of investors and societies”.¹⁸ Corporate governance helps to clean up the environment that is related to it and promotes the values of many principles such as transparency and accountability. Furthermore, corporate governance is important in improving the internal issues of a company- it goes beyond that to influence a wide range of issues in the external environment, including the institutional development of a country, which is very important as well.

¹⁷ F Facchini, 'Economic Freedom in Muslim Countries: An Explanation Using the Theory of Institutional Path Dependency' (2013) 36 *European Journal of Law and Economics* 139.

¹⁸ IFC, 'Corporate Governance Success Stories' (International Finance Corporation, Washington DC 2015).

Despite the growing attention being paid toward a Sharia business system and transactions, corporate governance from a Sharia perspective has not been covered well in the existing literature. Chapter Four of this thesis has attempted to cover the main issues in this context, although the attempt to bridge the gap in this issue, which has not been given adequate attention, will face difficulties as this field is very broad.

One of the significance issues of this research is examining the new law that will be enforced just after the submission of the thesis. The fact that the Company Law 2015 has been issued after more than five decades of the last company law gives more importance to this research. There is a need for analysis and explanation of company law 2015 in the context of corporate governance legal and regulatory framework context.

The government's intention to open up the business environment of Saudi Arabia, with regard to foreign investment and companies, gives this research further importance, as the United Kingdom corporate governance legal and regulatory framework has been taken as the example.

There is no doubt that jurisdictions which have investment frameworks that serve the interests of shareholders will take the lead in the race to gain the trust of investors; otherwise, it would be like betting on the wrong horse, and "the attractiveness of a particular locality will depend on its system of corporate governance".¹⁹

¹⁹ B R. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan Via Toronto' (1999) 10 Duke Journal of Comparative and International Law 5.

Good corporate governance gives more efficient operations to companies, facilitating capital access, providing more protection against mismanagement, reducing the risk, raising the level of transparency and accountability and calming the concerns of stakeholders, as it gives companies the tools to respond to their questions. For development, corporate governance is making access to capital easier, thereby improving the chances of new investment, the possibility of improving employment opportunities and boosting economic growth.²⁰ From this point, Saudi Arabia as a developing country and emerging market has more reasons to examine corporate governance as a tool, as it could be a solution to a range of issues. It can be seen very clearly that Saudi Arabia is now moving towards the privatisation of many government held companies. One example is the news of the intention to list the state owned oil giant Saudi Aramco on the Saudi stock exchange, which is worth trillions of pounds, and this illustrates one of the aspects of the importance of this thesis.²¹

Not only can the GCC countries' corporate governance issues be seen in Saudi Arabia, but many issues affecting Saudi Arabia could be taken to reflect the situation across the GCC as a GCC representative "Often GCC country risk was analyzed through the Kingdom of Saudi Arabia as representative for GCC".²² Accordingly, the

²⁰ IFC official website, 'Corporate Governance Overview' (<www.ifc.org/corporategovernance> accessed 1/7/2015).

²¹ The Economist, 'A Thatcherite Revolution: Saudi Arabia Is Considering an IPO of Aramco, Probably the World's Most Valuable Company' (The Economist Group 2016) <<http://www.economist.com/news/middle-east-and-africa/21685529-biggest-oil-all-saudi-arabia-considering-ipo-aramco-probably>> accessed 1/2/2016.

²² M A. Ramady, *The GCC Economies : Stepping up to Future Challenges* (New York, NY : Springer New York, 2012) Page :101.

importance of this thesis relies on the Saudi Arabian example to show the situation in the GCC and to provide recommendations to GCC countries as well.

1.3 Research methodology

Critical analysis will be carried out of the provisions and texts of the laws and regulations that should relate to the framework of corporate governance regulations in this study. The research methodology will be based on a traditional doctrinal legal analysis using existing materials such as books, journals articles, case reports, legislation, government statements and supranational institutions such as the World Bank and The Organisation for Economic Co-operation and Development (OECD). To some extent, there is a relative dearth of academic literature related to corporate governance in Saudi Arabia, in particular, in both Arabic and English. The primary and essential sources for this research will be corporate laws, stock market regulations, listing rules, case law and other associated laws and regulations. The importance of this approach relies on the fundamental principles that will be provided by analysing such rules and regulations that form the Saudi system of corporate governance.

From the previous discussion, it can be seen that a traditional doctrinal legal analysis approach will form the best methodology for this thesis. However, some aspects of the comparative approach on a descriptive and analytical basis will be used in this thesis in order to draw the main lessons and benefits from the different frameworks of law. This will help to present an overview of the main principles of every system

through the support of this approach, which is important to produce good laws.²³ So, although the methodology of this research will be based on a traditional doctrinal legal analysis, the research will benefit from taking some aspects of a comparative law approach in the context of this thesis. This approach will help to provide an overview of the legal and regulatory frameworks and the mechanisms of corporate governance, and will shed light on the main developments as well as the main principles of corporate governance in each system. Legal improvements, as well as the legislative reforms, benefit from the comparative law approach.²⁴ There are many objectives for using such an approach, including providing both criticisms and efficiency for the existing rules, as well as helping to draft new rules. Therefore, a comparative investigation into laws will help with the legislative development.²⁵

Taking foreign law such as the UK legal system is important in order to "provide a models of how different sets of legal rules work in addressing a particular problem or in pursuing a particular policy" which therefore important for attracting investors and firms.²⁶ Moreover, legal transplants will be taken into account due to its important function as one of the main legal development sources. The issue of legal transplants in Watson's view is not a modern issue only, but it has been alive and active since 'Hammurabi's' time until now. Watson believes that the borrowing is the causes of the

²³ J Hill, 'Comparative Law, Law Reform and Legal Theory' (1989) 9 Oxford Journal of Legal Studies 101.

²⁴ Ibid.

²⁵ K Zweigert, *An Introduction to Comparative Law* (3rd ed. Oxford : Oxford University Press, 1998) P: 34.

²⁶ M Siems, *Comparative Law* (Cambridge University Press, 2014) Page: 4.

most changes in most systems and it is “the most fertile source of development”.²⁷ Under such theory, not every aspects of law that works in different jurisdictions can be adopted completely in other country, since each country has its own legal background, history, culture, tradition and society, which are important factors that contribute towards shaping the law; this may be explained by path dependency theory.²⁸ There are many advantages to legal transplants, including for the transplant country, for example, the country can chose the best after comparing the laws of others, which will benefit its legal system and economy. There are also benefits for the origin country as well, such as firms from the origin country doing business easily in the transplant country.²⁹ However, there are some researchers who are not in favour of comparative and legal transplants, such as Legrand.³⁰ There are critiques of legal transplants that need to be taken into account, as well as the cultural and societal differences, as Cornelius and Kogut state: “what works in Kansas might not work in Beijing.”³¹

²⁷ A Watson, *Legal Transplants : An Approach to Comparative Law* (Second edition edn University of Georgia Press, 1993) Page: 95.

²⁸ O A. Hathaway, 'Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System' (2001) 86 Iowa Law Review 601.

²⁹ M Siems, *Comparative Law* (Cambridge University Press, 2014) Page:191.

³⁰ P Legrand, 'The Impossibility of Legal Transplants' (1997) 4 Maastricht Journal of European and Comparative Law 111.

³¹ P Cornelius and B Kogut, *Corporate Governance and Capital Flows in a Global Economy* (Global Outlook Series, Oxford University Press, 2003) Page: 19.

Regarding the English corporate governance framework, light has been shed on the main aspects that are related to this research as an example in order to draw some lessons and to improve the current Saudi corporate governance system. In regard to Sharia, the main sources of the Quran and Sunnah, the classical writings and the work of modern commentators have been used, in addition to the work of Western writers in order to understand the Western view of 'Islamic law'.

Some important libraries in Saudi Arabia and the United Kingdom have been visited in order to find relevant and up to date material that relates to the research besides Lancaster University Library, Such as Precinct and the Main Library in Manchester University, Salford University and Imam Muhammed Bin Saud University in Riyadh. However, there are two important libraries that have special collections related to this research, which are the Institute of Advanced Legal Studies in London and the Institute of Public Administration Library in Riyadh. The researcher has also attended some conferences related to corporate governance to benefit from up to date papers and key speakers, for example: the Corporate Governance: 20 years after Cadbury conference in Sheffield in 2012.

1.4 Organisation of the Research

The thesis is divided into seven chapters. The first chapter forms an introduction. The second chapter focuses on four important issues, which are corporate governance's importance, definitions, theories and international standards. It is clear that international organisations and supranational authorities such as the World Bank and the Organisation for Economic Co-operation and Development play an effective role in providing benchmarks and recommendations. From this point, it provides

important support to many countries, including Saudi Arabia and around the world in the context of corporate governance.

Chapter Three examines the UK's system of corporate governance. Both the strengths and weaknesses of the corporate governance system in the UK are important, as it provides an example to determine the most suitable measures in the Saudi corporate governance framework context. Thus, an analysis of the development of corporate governance in the UK, as well as the corporate governance code, is important when examining Saudi Arabian corporate governance. Provisions and texts of the laws and regulations that relate to the framework of corporate governance regulations will be included, such as Common Law, the Small Business, Enterprise and Employment Act 2015, along with the institutional framework, such as the Financial Conduct Authority and the Financial Reporting Council.

Chapter Four will look more closely at Sharia as a Saudi supreme law on the one hand, and the relationship between Sharia and corporate governance on the other hand. It will cover corporate governance, management and responsibility from a Sharia perspective, as well as the concepts of reward and delegation from a Sharia perspective. This chapter will cover the scope of Sharia, its sources, Islamic jurisprudence and objectives, in order to explore the ability of Sharia to adapt and absorb new concepts such as corporate governance. This chapter will also reveal that, generally speaking, 'sharikah' in Sharia has two main types, which are sharikat amlak and sharikat alaqoud, and both of them are divided into several types of sharikah. Therefore, understanding the Sharia point of view concerning sharikah is crucial in order to analyse and study the relationship between all parties involved in the company.

Chapters Five and Six provide a general overview of the legal and regulatory framework of Saudi Arabian corporate governance, and consider executive and legislative authorities and the judicial authority. These issues, alongside the recent legal system reforms have a direct impact on the business environment of Saudi Arabia and the GCC in general; the background of the Saudi Arabian legal system has been influenced by societal and cultural issues. On the other hand, the authorities of the State in Saudi Arabia play a crucial role in the framework of corporate governance, and this needs to be examined. Also, the most recent law issued in Saudi Arabia is the Saudi Companies Law 2015, which will be analysed, as well as the 1965 version, as they are both very important in the context of Saudi Arabian corporate governance. Chapter Six will focus more on the Saudi Stock Exchange's Regulatory Authorities, including the Capital Market Authority. Moreover, the Capital Market laws and regulations such as Capital Market Law 2003, the 2004 listing rules and corporate governance regulations will be examined in more detail.

Finally, Chapter Seven lays out the general conclusions and will provide a summary of the whole thesis, as well as providing general recommendations related to the improvement of the system of corporate governance in Saudi Arabia.

2. Chapter two: Corporate governance importance, definitions, theories and international standards

2.1 Introduction

Corporate governance received what could be described as appropriate attention after the collapse of some of the role-model companies around the world, after long being ignored as a concept.³² The crucial role of corporate governance has been recognised by international organisations such as the World Bank and the Organisation for Economic Co-operation and Development. Accordingly, international organisations and supranational authorities play an effective role providing benchmarks and recommendations.³³ International organisations and supranational authorities on the one hand, and the international standards on the other hand, have provided important support to many countries around the world in the context of corporate governance. OECD, for example, has produced what may be described as an international benchmark that has worldwide acceptance.³⁴

³² S Ahmad and R Omar, 'Basic Corporate Governance Models: A Systematic Review' (2016) 58 *International Journal of Law and Management* 73.

³³ I Khan, 'The Role of International Organisations in Promoting Corporate Governance in Developing Countries - a Case Study of Pakistan' (2012) 23 *International Company and Commercial Law Review* 223.

³⁴ C Slahudin, 'Oecd Principles and the Islamic Perspective on Corporate Governance' (2008) 12 *International association for Islamic economics Review of Islamic Economic* 29.

Generally speaking, some of the Arab world has not completely survived the aftershocks of the worldwide economic crises of recent times as in many parts of the world. Some researchers such as Masri think that certain Arab countries including Egypt, Lebanon and Jordan have suffered many crises due to the lack of corporate governance. For example, until 2005 in Jordan, more than 37000 companies were liquidated annually some of which were terminated due to poor management and insolvency, which has a direct impact on the shareholders and debtors, as well as the community.³⁵ On the other hand, some researchers have shown that despite the fact that Egyptian corporate governance started officially in 2005 with the Egyptian Capital Market Authority, the Egyptian economy has already profited from the corporate governance regulations. The importance of this has become clearly apparent throughout the Egyptian economy in particular fields, including reducing the impact of the global financial crisis on the banks of Egypt.³⁶ Therefore, this chapter is essentially concerned with the importance of corporate governance in both a general context, and in the context of Saudi Arabia in the first section.

The OECD suggests that adopting effective supranational organisational standards; raising the awareness of implementing sound corporate governance practices between companies, as well as consultation with the public, will ensure that the framework of corporate governance is more likely to avoid over-regulation, uphold the exercise of

³⁵ A Masri, *The Legal Regulation of Corporate Governance: Comparative Study* (Alqanun wa Aleqtisad, 2012) Page: 11.

³⁶ A Khader, *Corporate Governance* (1 edn Dar Alfikr Aljamiey, 2012) Page: 4-5. It should be mentioned here that, Egypt has suffered from political crises recently, which might have impacted the economy.

entrepreneurship, and in both private sector and public institutions, reduce the risks of conflicts of interest.³⁷ Therefore, this chapter will attempt to cover the main international organisations, supranational authorities and international standards involved. Furthermore, there is a need in this context to shed light on the main corporate governance theoretical frameworks, due to the fact that there are several theoretical frameworks of corporate governance.

³⁷ *OECD Principles of Corporate Governance 2015*

2.2 The Importance of Corporate Governance

Corporate governance is very important issue as a result of the huge impact of corporations on many aspects of life as mentioned earlier.³⁸ Bakan believed that, corporations are governing our lives nowadays.³⁹ Moreover, the rapid growth nowadays in the world economy, accompanied by the growth of local and multinationals companies as a result of globalisation, has cast a shadow and raised many significant concerns, not only related to the economy; it goes beyond that to social, political and security impacts. This is due to the huge power that companies have, which is like a double edged sword. The impact could be a positive impact for the economy, community, politics and security. However, the negative impact could be very severe as the collapse of companies could lead to serious consequences for the economy and society as a whole.⁴⁰

At the beginning of the twenty-first century, due to the capitalist system in many countries around the world, there are a number of wealthy families who control big corporations. In the USA's capitalist system for instance, there is competition between corporations for customers, and CEOs are able to abuse their power and dictate their strategies to a passive board of directors. On the other hand, the real

³⁸ A Keay, *Enlightened Shareholder Value Principle and Corporate Governance* (Routledge, 2012) Page: 3.

³⁹ B Joel, *The Corporation: The Pathological Pursuit of Profit and Power* (Constable & Robinson, 2012) Page: 9.

⁴⁰ A Khader, *Corporate Governance* (1 edn Dar Alfikr Aljamiey, 2012) Page: 1.

owners of the corporations are millions of generally powerless and disorganised middle-class shareholders.⁴¹

It can clearly be seen that the world is now witnessing increasing attention being paid towards corporate governance. Although this has been caused by many reasons, the worldwide scandals that have occurred may be the most significant reason.⁴² However, it should be mentioned here that the internal governance problems are not the only reasons that cause the failure of companies, it could happen even if they are well-managed due to factors from the outside business environment such as the so-called 'domino effect'.⁴³ The present financial crises all over the world, starting from the mortgage situation in the USA followed by the collapse of Lehman Brothers, have stressed the importance of corporate governance. Moreover, some writers have attributed it to being the main cause of the collapses of Enron and Worldcom.⁴⁴ There are other examples of the consequences of the failure of corporate governance in the United Kingdom, such as the Northern Rock bank, which was founded in 1965. The number of employees reached more than 4000 and in 2006 the income of the bank

⁴¹ R Morck and S Lloyd, 'The Global History of Corporate Governance' in R Morck (ed) *A History of Corporate Governance around the World : Family Business Groups to Professional Managers* (Chicago ; London : University of Chicago Press, 2005)P: 1. It is worth mentioning that in the UK the key shareholders are institutional investors with real power if they choose to use it. See chapter three 3.2.7 for more details.

⁴² F Allen, 'Corporate Governance in Emerging Economies' (2005) 21 *Oxford Review of Economic Policy* 164.

⁴³ D Milman, *Governance of Distressed Firms* (Edward Elgar Publishing, 2013) Page: 37.

⁴⁴ C Law and Patricia Wong, 'Corporate Governance: A Comparative Analysis between the UK and China' (2005) 16 *International Company and Commercial Law Review* 350.

was around five billion pounds. However, the wave of the crises moved Northern Rock from the FTSE 100 index to the FTSE 250 index in 2007. Moreover, the Government's efforts to rescue the Bank failed, which resulted in the bank being nationalised in 2008. Therefore, as stated by Arora, the reputation of both the banking sector and individual banks has been damaged due to the failings of corporate governance.⁴⁵ On the other side of the world, the East witnessed 'the Asian financial crises' during the late 1990s. Some researchers believe that weak corporate governance could be the one of the factors that led to the crises. Although weak corporate governance might not have started the East Asian crises, corporate governance practices might have made these countries more vulnerable to the crises and may have aggravated it once it started.⁴⁶

Therefore, the importance of corporate governance is reflected in many important issues. Implementing the principles of corporate governance is essential, such as transparency, accountability and responsibility to guarantee the supervision of companies by improving accountability and disclosure and separating ownership from the management. These mechanisms will create a balance between the companies and the stakeholders. Likewise, ensuring an effective framework will lead to improving both the business environment and companies' efficiency.⁴⁷

⁴⁵ A Arora, 'The Corporate Governance Failings in Financial Institutions and Directors' Legal Liability' (2011) 32 *Company Lawyer* 3.

⁴⁶ T Mitton, 'A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis' (2002) 64 *Journal of Financial Economics* 215.

⁴⁷ A Khader, *Corporate Governance* (1 edn Dar Alfikr Aljamiey, 2012) Page 2-3.

Corporate governance is about safeguarding all parties' rights.⁴⁸ Shareholders for example, need to be protected especially with difficulty of exercising their power in some forms of companies. Moreover, as a collective body, shareholders "are not designed to be an effective organ for managerial decision-making".⁴⁹ So, if corporate governance does not provide protection for its real purposes, this could lead to many risks and crises. To large extent, weaknesses and failures in corporate governance arrangements are the reason behind the financial crisis in the view of Kirkpatrick.⁵⁰ Despite the fact that corporate governance in every country has a different legal, cultural and political context, with a variety of business forms, the need for extra transparency and creating more confidence is the reason for the introduction of corporate governance codes.⁵¹

Accordingly, there are many lessons that can be learned from the financial crises of the last two decades. The fact that the annual report of any corporation may appear good even if the reality is not means that collapses could occur, especially if there is no effective corporate governance.⁵² On the other hand, good corporate governance

⁴⁸ That is including: shareholders, management, customers, suppliers, financiers, government and the community.

⁴⁹ A Griffiths, *Contracting with Companies* (Contemporary Studies in Corporate Law, Hart Publishing, 2005) Page: 92.

⁵⁰ G Kirkpatrick, 'The Corporate Governance Lessons from the Financial Crisis' (2009) 3 OECD Journal: Financial Market Trends 61.

⁵¹ C A. Mallin, *Corporate Governance* (3rd edn Oxford University Press, 2010) Page: 26.

⁵² The Etihad-Etisalat 'Mobily' case, could be an example of a Saudi listed company is facing a crisis since the end of 2014. The annual reports have shown profits for several years until the company announced that there is a mistake in the financial statements with loses of nearly 1 billion Saudi Riyals.

may restore confidence and protect from collapse, which emphasises the importance of the issue of corporate governance.⁵³

Even though some developing countries are having huge financial increases in their economies that are making them real players in today's world, the profits are still out of the reach of the poor people. It is a fact that there are many reasons and causes for these problems. However, the lack of equitable distribution of wealth and chances could be one of the most important reasons. From this viewpoint, the importance of corporate governance is reflected in the essential link between corporate governance on the one hand and development on the other. Moreover, corporate governance is a possibly an effective solution to fixing many problems facing the world nowadays.⁵⁴

India, for example, has carried out what may be described as major corporate governance reforms by adopting Clause 49 of Listing Agreement.⁵⁵ Clause 49 has provided provisions about many issues that the company must comply with, including

The consequences has resulted the trading suspension of Mobily shares in Tadawul for some days. The share price of Mobily has dropped dramatically to lose about 70% of its original price. Moreover, the Capital Market Authority announced at the end of 2015 that "regarding the referral of a suspicion of violation to the Bureau of Investigation and Public Prosecution And filing a lawsuit before the Committee of the Resolution of Securities Disputes (CRSD)".

⁵³ C A. Mallin, *Corporate Governance* (3rd edn Oxford University Press, 2010) Page: 26.

⁵⁴ A Shkolnikov and A Wilson, 'From Sustainable Companies to Sustainable Economies' in E Hontz and A Shkolnikov (eds), *Corporate Governance: The Intersection of Public and Private Reform* (Center for International Private Enterprise, 2009) Page: 7.

⁵⁵ In India, if the company is eligible and would like to be listed in the stock exchange, there is an obligation from the stock exchange to execute a listing agreement that contains the imposed restrictions and obligations as a result of the listing. See: S Kevin, *Security analysis and portfolio management* (2 edn, PHI Learning Private Limited 2015) Page: 38.

board of directors issues such as composition of board, non executive directors' compensation and disclosures, provisions as to board and committees and code of conduct for all board members and senior management of the company. Clause 49 has also dealt with issues of audit committee, subsidiary companies, disclosures, CEO/CFO certification report on corporate governance and the issue of compliance. Generally speaking, the reform is being reflected in the changes of share prices that have occurred in the Indian case, even though large firms have benefited more than small firms. Therefore, "properly designed mandatory corporate governance reforms can increase share prices in an emerging market such as India."⁵⁶

From a conventional point of view, in developing countries, corporate governance is considered to be a subject for the big companies. However, the practice of corporate governance over the past few decades has proven to be more than that. The importance of corporate governance goes beyond being a matter that concerns investors and CEO's only. Therefore, corporate governance helps to clean up the environment that is related to it and promotes the values of transparency and accountability. The importance of corporate governance in this context can be seen by exposing the relationships with people of influence. Furthermore, through the ability to attract investments and create jobs, corporate governance could be a sustainable solution used to reduce poverty, and an effective instrument for building a successful

⁵⁶ B Black and V Khanna, 'Can Corporate Governance Reforms Increase Firm Market Values? Event Study Evidence from India' (2007) 4 Journal of Empirical Legal Studies 749.

sector for small and medium size enterprises.⁵⁷ This means that just as corporate governance is important in improving the internal issues of a company, it goes beyond that to influence a wide range of issues in the external environment, including the institutional development of a country, which is very important as well.

There are millions of households who have direct or indirect investments in capital markets around the world nowadays. Moreover, there are more than 200 million jobs that have been created by publicly listed companies. The right of participation needs to be addressed for stakeholders who have the ability of wealth creation of corporate companies. Therefore, there is a need for good corporate governance; however, it is not the final goal, as companies aiming towards equity capital for long term investment can achieve this with help to establish a business environment that is characterised by confidence and business integrity. In fact, this is the true meaning of good corporate governance as suggested by the OECD.⁵⁸

The increasing attention that has been paid to corporate governance over the past two decades could also be a result of the two tier crucial reform mechanism that has been played out by corporate governance. The first tier is related to the prevention of failure and collapse. However, the second type is important as well, and it can be described as a proactive mechanism which is associated with the state's search for

⁵⁷ A Shkolnikov and A Wilson, 'From Sustainable Companies to Sustainable Economies' in E Hontz and A Shkolnikov (eds), *Corporate Governance: The Intersection of Public and Private Reform* (Center for International Private Enterprise, 2009) P:15.

⁵⁸ *OECD principles of corporate governance* 2015.

investment, the need for improved competitiveness and gaining access to both regional and international markets.⁵⁹

Chkolenkov and Wilson, think that the conventional view of corporate governance, which is simply related to the separation between the ownership and the management to prevent any conflict of interest, is described as a narrow view. They think that this view will be beneficial only to large companies such as multinational companies where there are a huge number of shareholders on the one hand and strong managers on the other hand. Therefore, one of the most important aspects of corporate governance is that it is applicable to a wide range of companies, including multinationals companies that have shares in the biggest stock markets. However, many corporate governance mechanisms could be effective for small, medium enterprises and family businesses as well, by introducing transparency, accountability, and responsibility inside the decision making mechanism within the company.⁶⁰ Indeed, the benefits of good corporate governance are going beyond that to be important for the future social responsibility as well.⁶¹

According to the IFC, there are several benefits of good corporate governance, which shows the importance of corporate governance not only in the context of the GCC and

⁵⁹ A Shkolnikov and A Wilson, 'From Sustainable Companies to Sustainable Economies' in E Hontz and A Shkolnikov (eds), *Corporate Governance: The Intersection of Public and Private Reform* (Center for International Private Enterprise, 2009) Page: 12.

⁶⁰ Ibid Page: 18.

⁶¹ M Sun, 'Corporate Governance and Social Responsibility' (2015) 57 *International Journal of Law & Management* 38.

developing countries, as these benefits are crucial for the rest of the world as well. First of all, good corporate governance gives more efficient operations to companies. Secondly, another benefit is facilitating capital access. Thirdly, it will provide more protection against mismanagement. Fourthly, good corporate governance will reduce the risk. Fifthly, it raises the level of transparency and accountability. Sixthly, it will calm the concerns of the stakeholder as it gives companies the tools to respond to their questions. Moving to corporate governance's benefits for development, there are **three benefits** from good corporate governance practice as stated by the IFC. First of all, by making the access to capital easier, good corporate governance will improve the chances of new investment. Secondly, employment opportunities could also be improved. Lastly, good corporate governance will boost economic growth.⁶²

To sum up, the importance of corporate governance can be seen very clearly in its impact. First of all, corporate governance is key to bringing stability to the markets. Secondly, it promotes the institutions of the country. Thirdly, the mechanisms of corporate governance play a central role in preventing the risks from occurring. Fourthly, it improves investment and reduces the cost of capital. Fifthly, effective corporate governance could be a tool for weakening corruption. Sixthly, it promotes lending and reforms the state's own projects. The seventh point is promoting successful privatisation.⁶³ Eighth is enhancing the competitiveness for companies and

⁶² IFC official website, 'Corporate Governance Overview' (<www.ifc.org/corporategovernance> accessed 1/7/2015).

⁶³ Privatisation is an important issue in Saudi Arabia nowadays as there is a governmental intention towards privatising many institutions in the country including the oil giant Aramco. See: The Economist, 'A Thatcherite Revolution: Saudi Arabia Is Considering an IPO of Aramco, Probably the World's Most Valuable Company' (The Economist Group 2016) Available at:

economies. Ninth, good corporate governance builds transparent relationships between the business community and the state. And finally, it helps to combat poverty.⁶⁴ Putting some of the corporate officials' failings under the microscope shows the importance of corporate governance. These actions include reckless board practices, unjustified remuneration for executives and insufficient risk management. It is widely accepted that, the lack of good corporate governance is blamed as an important contributor to the global financial crisis.⁶⁵

2.2.1 The importance of corporate governance in the context of Saudi Arabia

Not only can the GCC countries' corporate governance issues be seen in Saudi Arabia, but many issues affecting Saudi Arabia could be taken to reflect the situation across the GCC as a GCC representative. For example, Ramady states, "Often GCC country risk was analyzed through the Kingdom of Saudi Arabia as representative for GCC".⁶⁶ Thus, the following paragraphs will shed light on the Saudi Arabian example to show the GCC situation in the context of the importance of corporate governance.

<<http://www.economist.com/news/middle-east-and-africa/21685529-biggest-oil-all-saudi-arabia-considering-ipo-aramco-probably>> accessed 1/2/2016.

⁶⁴ A Shkolnikov and A Wilson, 'From Sustainable Companies to Sustainable Economies' in E Hontz and A Shkolnikov (eds), *Corporate Governance: The Intersection of Public and Private Reform* (Center for International Private Enterprise, 2009) Page: 15.

⁶⁵ A Arora, 'The Corporate Governance Failings in Financial Institutions and Directors' Legal Liability' (2011) 32 *Company Lawyer* 3.

⁶⁶ M A. Ramady, *The GCC Economies : Stepping up to Future Challenges* (New York, NY : Springer New York, 2012) Page: 101.

Certainly, corporate governance is very important for any country in the world, and Saudi Arabia is no exception to that. However, there could be other issues regarding corporate governance in the context of Saudi Arabia which makes corporate governance more important. Moreover, there are differences in corporate governance between the emerging markets and developed markets that should be taken into account; these differences are a result of the emerging developed markets' financial structures.⁶⁷ From this point, Saudi Arabia as a developing country and emerging market has more reasons to examine corporate governance as a tool, as it could be a solution to some issues. Even though investing in emerging markets could generate more reward than the typical domestic market, investing in emerging markets could be more risky.⁶⁸

2.2.2 The importance for family businesses:

Needless to say, the importance of corporate governance in the context of family businesses in Saudi Arabia is very clear. Moreover, family business has a profile percentage of 80% of the business sector as some research shows. Moreover, some researchers believe that the contribution of family businesses to the GDP- excluding the oil industry- in Saudi Arabia is more than 90%;⁶⁹ whereas the UK for example

⁶⁷ A Gill, 'Corporate Governance Issues and Returns in Emerging Markets' in RE Litan, M Pomerleano and V Sundararajan (eds), *The Future of Domestic Capital Markets in Developing Countries* (Brookings Institution ; Bristol : University Presses Marketing, 2003) Page: 313.

⁶⁸ T J. Paradine, 'Venturing Abroad: The Challenges of Emerging Economies' (1996) 43 Risk Management 73.

⁶⁹ A Alalshaikh, 'Hawkamat Alsharikat Alaeliah Corporate Governance for Family Business' (CMA official website <<http://www.tadawul.com.sa/static/pages/ar/Publication/PDF/hawkama.pdf>> accessed 15/6/2015).

has a percentage of 66% of small and medium sized enterprises.⁷⁰ Therefore, family business in Saudi Arabia can be described as having a strong presence in the Saudi economy. Needless to say, there is an important role for corporate governance in the context of family business in GCC countries, including Saudi Arabia.

⁷⁰ Institute for Family Business, 'The UK Family Business Sector: Working to Grow the UK Economy' (IFB, London 2011).

2.3 Corporate Governance Definitions

Regardless of the fact that corporate governance was not a very well used term prior to the last two decades, it is widely accepted that ‘corporate governance’ as a concept is playing a crucial role nowadays in the business world. Moreover, the term corporate governance, which originated in the United States, is not only nowadays current issue- it goes back to the emergence of the ‘limited liability company’. However, it can be seen very clearly that the issues of corporate governance are scattered between company law and practice, especially financing, incorporation, management and promotion, in the view of Keay.⁷¹

Corporate governance has many definitions depending on the perspective; therefore, it may be hard to find a certain definition for the term corporate governance. Moreover, some researchers referring the lack of agreed definition to the multi-facet orientation “due to its multi-facet orientation, a single unanimously agreed upon definition does not exist as yet”.⁷² In the view of Parkinson, there is a range of meanings for the term 'corporate governance', and it can be divided into two meanings for the present purposes: Firstly, with regard to the 'public interest' where the company itself is being governed. This is attributed to the societal attempts to control the behaviour of the company, which can be seen via the state's regulations including employment law, consumer law and environmental law requirements. Secondly, the company-level

⁷¹ A Keay, *Enlightened Shareholder Value Principle and Corporate Governance*, The (Routledge, 2012) Page: 1.

⁷² S Ahmad and R Omar, 'Basic Corporate Governance Models: A Systematic Review' (2016) 58 *International Journal of Law and Management* 73.

governance that is described by Parkinson as the one that is familiar to company lawyers.⁷³ Claessens has divided the definitions on offer into two types as well. The first one “concerns itself with a set of behavioural patterns” while the second one “concerns itself with the normative framework”.⁷⁴ Alternatively, corporate governance definitions can be divided into a narrow view and broad view in the opinion of Allen. The narrow view is typically used in the UK and the USA, which takes the interests of shareholders as the priority by ensuring the operation of the firm for their interests, with standard mechanisms such as the unitary board of directors and executive compensation. The broad view, which is often stressed by Germany, Japan and France, goes beyond the narrow view as it concerns corporate governance ensuring society’s resources are used efficiently.⁷⁵ The following paragraphs will provide examples of the meaning, definitions, and understanding of corporate governance.⁷⁶ Lowry and Reisberg, for example, think that corporate governance is about alignment; ensuring the alignment between the interests of the managers and

⁷³ J. E. Parkinson, 'Corporate governance and the regulation of business behaviour' in S MacLeod (ed), *Global Governance and the Quest for Justice*, vol 2 (Global Governance and the Quest for Justice, Hart 2006) Page: 1.

⁷⁴ S Claessens, 'Corporate Governance and Development' (2006) 21 *The World Bank Research Observer* 91.

⁷⁵ F Allen, 'Corporate Governance in Emerging Economies' (2005) 21 *Oxford Review of Economic Policy* 164.

⁷⁶ For Sharia definition and perspective on corporate governance see chapter four 4.2.1.

the shareholders. The alignment concerns the mechanisms or the legal system of corporate governance.⁷⁷

The Committee on the Financial Aspects of Corporate Governance, which is known as the Cadbury Committee, defines corporate governance in its simplest form as: “corporate governance is the system by which companies are directed and controlled”⁷⁸. The roles are split between the parties, for example, appointing auditors and directors is the responsibility of the shareholders, whereas the board of directors' role is to govern their companies.⁷⁹ Monks and Minow define corporate governance in more detail, as a “relationship among various participants in determining the direction and performance of corporations”⁸⁰. Parkinson has defined corporate governance as “the process of supervision and control (of ‘governing’) intended to ensure that the company’s management acts in accordance with the interests of the shareholders”.⁸¹

The OECD states that corporate governance “involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders”⁸². A broadened OECD definition contains more detail, as it is defined broadly as follows:

⁷⁷ J Lowry and A Reisberg, *Pettet's Company Law: Company Law & Corporate Finance* (4 edn Pearson, 2012) P:141.

⁷⁸ Cadbury Committee, *The Financial Aspects of Corporate Governance* (Gee, 1992).

⁷⁹ Ibid.

⁸⁰ R Monks and N Minow, *Corporate Governance* (3rd edn Malden, 2004) Page: 1.

⁸¹ J. E. Parkinson, *Corporate Power and Responsibility : Issues in the Theory of Company Law* (Clarendon Press, 1993) Page: 159.

⁸² OECD, *Oecd Principles of Corporate Governance* (2004 edn OECD, 2004).

“refers to the private and public institutions, including laws, regulations and accepted business practices, which together govern the relationship, in a market economy, between corporate managers and entrepreneurs (“corporate insiders”) on one hand, and those who invest resources in corporations, on the other”.⁸³

The World Bank states that corporate governance “refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders”⁸⁴; whereas IFC has defined the corporate governance as “the structures and processes by which companies are directed and controlled”.⁸⁵ As mentioned above, it may be difficult to find a definition that can describe all aspects of corporate governance, as the different perspectives cause variations among the definitions.⁸⁶ However, generally speaking, all definitions agree on main themes: control and supervision of the company and/or of management as stated by Law and Wong.⁸⁷ Omar think that the reason for not finding an agreement upon one corporate governance definition is because of its

⁸³ C P. Oman, *Corporate Governance and National Development* ([OECD Development Centre], 2001).

⁸⁴ The World Bank, 'Corporate Governance Country Assessment : Kingdom of Saudi Arabia' (Report on the Observance of Standards and Codes (ROSC), 2009).

⁸⁵ IFC official website, 'Corporate Governance Overview' (<www.ifc.org/corporategovernance> accessed 1/7/2015).

⁸⁶ R Monks and N Minow, *Corporate Governance* (3rd edn Malden, 2004) Page: 1.

⁸⁷ C Law and P Wong, 'Corporate Governance: A Comparative Analysis between the UK and China' (2005) 16 *International Company and Commercial Law Review* 350.

multi-facet orientation.⁸⁸ However, the OECD definition may be the most accepted corporate governance definition.⁸⁹

⁸⁸ S Ahmad and R Omar, 'Basic Corporate Governance Models: A Systematic Review' (2016) 58 *International Journal of Law and Management* 73.

⁸⁹ P O. Mulbert, 'Corporate Governance of Banks' (2009) 10 *European Business Organization Law Review* 411.

2.4 Corporate governance international standards

Generally speaking, in the context of corporate governance and the GCC, there is a need to shed light on the international organisations and supranational authorities that are trying to provide a contribution and improvements to developed countries; and a fortiori, to developing and less developed countries. These improvements include many aspects, such as by providing benchmarks and recommendations for all issues that need to be improved in these countries.⁹⁰ Organisations such as the World Bank and the Organisation for Economic Co-operation and Development are expected to play an effective role in order to provide improvements and stability, support economic growth, and fight poverty. The motivation of such an organisations is social worldwide well-being and promoting the economic.⁹¹ In other word, this organisation's mission, as stated on the official website, is to improve living standards and economic success by promoting policies.⁹² The impact of these organisations is going beyond that to the contribution of streamlining acceptable worldwide protocol

⁹⁰ The World Bank for example is providing a Corporate Governance Country Assessment for several countries including Saudi Arabia. See for example: www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf.

⁹¹ A Anderson and P Gupta, 'Corporate Governance: Does One Size Fit All?' (2013) 24 *Journal of Corporate Accounting & Finance* 51.

⁹² OECD official website. 'About the Organisation for Economic Co-operation and Development (OECD)' <http://www.oecd.org/pages/0,3417,en_36734052_36734103_1_1_1_1_1,00.html> accessed 5/6/2012.

for companies, which has led to what could be described as a corporate convergence governance of policies.⁹³

The race towards attracting the international investment has made the convergence of corporate governance and the international standards more important. Moreover, attracting international investment "has impacted on the way in which countries and firms adopt regulation and governance practices, opting in many instances to implement international standards of best practices".⁹⁴ So, there is a need for evaluating of the current rules and regulations framework in the light of international standards to make the business environment more attractive for both local and international investors.

2.4.1 OECD

There is widespread acceptance of the OECD principles which have been crowned by the adoption of some international organisations such as FSB, the World Bank Group and Basel Committee on Banking Supervision as the OECD principles are treated as an international reference point and implementation effective tool. The Basel Committee on Banking Supervision has used the OECD principles as 'Guidelines on corporate governance of banks' basis. The Financial Stability Board (FSB) has also adopted OECD principles as one of the Key Standards for Sound Financial Systems

⁹³ C Robertson, A Diyab and A Al-Kahtani, 'A Cross-National Analysis of Perceptions of Corporate Governance Principles' (2013) 22 International Business Review 315.

⁹⁴ S Morley, 'The Subject Matter, Form and Process of Convergence and the Ever-Increasing Role of the Foreign Investor' (2016) 37 Company Lawyer 71.

serving the FSB. In addition, the World Bank Group has used OECD principles in more than 60 country reviews around the world.⁹⁵

Historically, the year 1961 witnessed the establishment of the OECD, which stands for the Organisation for Economic Co-operation and Development. However, the root of this organisation goes back to the Organisation for European Economic Cooperation (OEEC), which is made up of European countries only. The OECD was officially established in 1961 after the member countries signed the new OECD Convention. Nowadays, there are 34 countries participating as members of the OECD from all over the world. The OECD is expected to play an important role, encouraged by the success in Europe of the Organisation for European Economic Cooperation (OEEC).⁹⁶

The ministers of the OECD decided in 1996 to establish a Business Sector Advisory Group on Corporate Governance in order to review worldwide corporate governance matters.⁹⁷ Then, the year 1999 witnessed the introduction of OECD key standards. After that, a call for assessment was made by the OECD ministers, which resulted in a review of the previous standards in light of the crises, and the involvement of some companies around the world in certain scandals. The revised version of the OECD

⁹⁵ *OECD principles of corporate governance* 2015.

⁹⁶ The Historical Archives of the European Communities, 'Organisation for European Economic Co-Operation' (OECD <<http://www.oecd.org/general/organisationforeuropeaneconomicco-operation.htm>> accessed 10 August 2013.

⁹⁷ A Dignam, 'Exporting Corporate Governance: U.K. Regulatory Systems in a Global Economy' (2000) 21 *Company Lawyer* 70.

principles of corporate governance was published in 2004.⁹⁸ Corporate governance principles provided by the OECD may be described as the first principle standards that have wide international acceptance. The OECD principles have been used as standards and utilised to issue codes by both developed and developing countries as recognition of the importance of corporate governance and the principles of the OECD.⁹⁹

2.4.1.1 OECD Objectives

The OECD has many objectives. Definitely, one of the main objectives of the organisation is to give member governments the chance for comparative political experiences in order to produce answers to shared problems; identify good practices, and coordinate domestic and international policies. Moreover, the non-binding laws could provide motivation for these countries and may result sometimes in binding laws. However, the main objective may be to support governments to strive for financial stability and support economic growth in order to fight poverty and to foster wealth in their countries; while keeping an eye on the economic, social and environmental implications. The international organisations principles of corporate governance such as the OECD and the national laws related to corporate governance

⁹⁸ See: OECD official website, 'About the Oecd' (OECD <<http://www.oecd.org/about/>> accessed 9 August 2016).

⁹⁹ F Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 41.

are contributing toward “shaping the institutional environment in which a firm operates”.¹⁰⁰

The mechanism of the OECD in achieving these objectives starts with the Secretary collecting and analysing data, and then discussing policy with committees, before decisions are made by the Council. The process ends with the implementation of the recommendations by governments. The OECD, in committee-level discussions, could result in negotiations about international co-operation rules which sometimes culminate in formal agreements, arrangements, treatment, standards and models, or it could result in guidelines such as corporate governance principles .

The OECD official website has an abundance of sources on many subjects across several sections, such as the OECD iLibrary, OECD Online Bookshop and OECD publications. Moreover, OECD publishing can be described as one of the largest publishers of public affairs and economics, with more than 250 books, many statistical databases, working papers and journal articles. Moving on to the academic interest, there are some articles that have tried to shed light on the conventional standards of corporate governance, such as the OECD on the one hand, and the Islamic perspective of corporate governance on the other.¹⁰¹

¹⁰⁰ C Robertson, A Diyab and A AKahtani, 'A Cross-National Analysis of Perceptions of Corporate Governance Principles' (2013) 22 *International Business Review* 315.

¹⁰¹ See for example: AM Abu-Tapanjeh, 'Corporate governance from the Islamic perspective: A comparative analysis with OECD principles' (2009) 20 *Critical Perspectives on Accounting and C* Slahudin, 'OECD Principles and the Islamic Perspective on Corporate Governance' (2008) 12 *International Association for Islamic Economics Review of Islamic Economic* 29.

2.4.1.2 OECD and GCC

For the sake of supporting corporate governance reform, about 18 countries with up to 30 meetings have been held by the OECD in cooperation with the World Bank. The geographical coverage of these meetings has stretched across five continents. However, interestingly, there have been no Gulf countries participating in the roundtables, including Saudi Arabia.¹⁰² Nowadays, GCC countries, including Saudi Arabia, do not have membership of this organisation. However, there is cooperation between some of the GCC countries and the OECD. Saudi Arabia, the United Arab Emirates and Kuwait have been engaged in development co-operation for decades, as they provide development assistance and are donors, for example as part of the OECD Development Assistance Committee (DAC).¹⁰³

It is a fact that the GCC countries, especially Saudi Arabia, as emerging economies, vary considerably from the developed markets due to cultural factors and the national context.¹⁰⁴ Moreover, Almadi believes that the “unique characteristics in emerging markets have an influence on past, and still current, and predicted to be affect future corporate governance practices”.¹⁰⁵ However, it is important to benefit from international standards, such as the OECD principles. Moreover, the OECD principles

¹⁰² *OECD Principles of Corporate Governance* (2004 revision edn OECD, 2004).

¹⁰³ K Smith, T Yamashiro and F Zimmermann, 'Beyond the Dac the Welcome Role of Other Providers of Development Co-Operation' (DCD issues brief, OECD, 2010).

¹⁰⁴ C Robertson, S Al-AlSheikh and A Al-Kahtani, 'An Analysis of Perceptions of Western Corporate Governance Principles in Saudi Arabia' (2012) 35 *International Journal of Public Administration* 402.

¹⁰⁵ M Almadi, 'Organizational Governance, Board of Directors, and the Influence of Context in Emerging Markets' (2015) 10 *International Journal of Business and Management* 116.

of corporate governance using roundtable dialogue with OECD and non OECD members could possibly bridge the gap further. Moreover, as argued by Jesover and Kirkpatrick the OECD Principles are highly relevant to non-OECD economies.¹⁰⁶

Both OECD Member countries and G20 countries have been invited to participate in a new review of the OECD principles, carried out under the auspices of the OECD Corporate Governance Committee, as well as experts from international institutions such as the World Bank and Basel Committee. This is in addition to online public consultation; expert consultation and, notably, the participation of the Regional Corporate Governance Roundtables in different parts of the world such as the Middle East, Asia and North Africa.

2.4.1.3 Why OECD principles of corporate governance?

The OECD key standards were released in May 1999, and nowadays there are around 17 language texts- including Arabic- found on the official website of the OECD. However, the official languages are English and French. The OECD principles were published in 1999, then after the worldwide companies' crises and scandals, the ministers of the OECD called for an assessment of the principles in 2002, followed by revised version released in 2004. The last version of the OECD principles was released in September 2015.¹⁰⁷

It is a fact that due to the adoption of the OECD principles by many countries all over the world, the OECD principles can be described as sound and the most

¹⁰⁶ F Jesover and G Kirkpatrick, 'The Revised Oecd Principles of Corporate Governance and Their Relevance to Non-Oecd Countries' (2005) 13 Corporate Governance: An International Review 127.

¹⁰⁷ *G20/OECD Principles of Corporate Governance* 2015.

widespread.¹⁰⁸ On the other hand, international organisations currently use the OECD principles as a benchmark for the sake of corporate governance improvement in the countries that cooperate with these organisations, such as the World Bank and the Financial Stability Forum. Moreover, the Financial Stability Forum considers the OECD corporate governance principles to be “one of the 12 key standards for sound financial systems”.¹⁰⁹

Since 1999, not only have policy makers been taking the OECD as an international benchmark, corporations, investors, and other stakeholders have begun taking it as a benchmark as well. This worldwide acceptance is the result of some of the requirements that the OECD principles have set out.¹¹⁰ First of all, whether the country is a member of the OECD or not, the assistance of the OECD principles is there for the improvement and evaluation of governmental corporate governance efforts for regulatory frameworks, legislation and institutions. Secondly, and this could be the most important reason, the OECD principles offer specific guidance for regulatory initiatives and legislative purposes.¹¹¹

¹⁰⁸ A Abu-Tapanjeh, 'Corporate Governance from the Islamic Perspective: A Comparative Analysis with Oecd Principles' (2009) 20 *Critical Perspectives on Accounting* 556.

¹⁰⁹ *OECD principles of corporate governance* (2004 revision edn OECD, Paris 2004).

¹¹⁰ C Slahudin, 'OECD Principles and the Islamic Perspective on Corporate Governance' (2008) 12 *International Association for Islamic Economics Review of Islamic Economics* 29.

¹¹¹ I Khan, 'The Role of International Organisations in Promoting Corporate Governance in Developing Countries - a Case Study of Pakistan' (2012) 23 *International Company and Commercial Law Review* 223.

The fact that there is a global competition towards attracting international investment has made the convergence of corporate governance more important.¹¹² Moreover, the international need for accessible, concise and comprehensible corporate governance principles has caused the OECD principles to become an important benchmark for the worldwide community. However, the OECD principles are not intended by the OECD as a substitute for developing best practice codes through the initiatives of both governments and the private sector.

The contribution flowing from good corporate governance, such as the benefits to the business environment, investment, financial market stability and economic growth, have made the OECD principles very important. In particular, it could play a crucial role in world business nowadays. There are many reasons behind that, for example the 2004 review of OECD principles has taken into account the latest developments and recent experiences, not only of the OECD member states, but from countries around the world.

It is clear that international standards and supranational authorities will face some obstacles in attempting to provide a corporate governance benchmark, as laws and legal traditions vary across the world. However, the OECD principles have benefited from the roundtables that have taken place to bridge the gap between the implementation and the various formal provisions.¹¹³

¹¹² S Morley, 'The Subject Matter, Form and Process of Convergence and the Ever-Increasing Role of the Foreign Investor' (2016) 37 *Company Lawyer* 71.

¹¹³ F Jesover and G Kirkpatrick, 'The Revised OECD Principles of Corporate Governance and their Relevance to Non-OECD Countries' (2005) 13 *Corporate Governance: An International Review* 127.

Undoubtedly, the OECD corporate governance principles are not a magical recipe for governments or firms to solve all the problems faced in the business environment, as there are many issues surrounding this matter, especially in emerging economies and developing countries. Thus, requiring companies to adopt the OECD corporate governance principles “will not necessarily lead to better corporate governance.”¹¹⁴

2.4.1.4 OECD principles ¹¹⁵

The OECD principles are **six in number**, as stated in the 2004 OECD principles of corporate governance: Firstly, ensuring the basis for an effective corporate governance framework; the second principle is about the right of shareholders and key ownership functions; thirdly, the equitable treatment of shareholders; fourthly, the role of stakeholders in corporate governance; fifthly, disclosure and transparency, and lastly, the responsibilities of the board.¹¹⁶ However, generally speaking, four basic principles have shaped the theme of the OECD principles according to Abu-Tapanjeh. The first principle concerns the business ethics mechanism; whereas the second one is about the decision making process. The third deals with disclosure and transparency. Finally, there is the final principle relating to accounts and book keeping

¹¹⁴ V Chen, J Li and D Shapiro, 'Are Oecd-Prescribed “Good Corporate Governance Practices” Really Good in an Emerging Economy?' (2011) 28 Asia Pacific Journal of Management 115.

¹¹⁵ The OECD principles will be discussed in more details in later sections.

¹¹⁶ *OECD principles of corporate governance* (2004 revision edn OECD, Paris 2004).

mechanism.¹¹⁷ Slahudin adds more as he thinks that the OECD principles seem to be clearly aligned with Hakim.¹¹⁸

Despite the fact that the OECD principles concentrate on publicly traded companies, non-traded companies, such as state owned and the privately held companies, could benefit from the OECD principles in order to improve corporate enterprise “to the extent that they are deemed applicable.”¹¹⁹ Moving to the foundation of the OECD principles, the root goes back to the Cadbury, Greenbury and Hampel committees' reports in the United Kingdom.¹²⁰

With regard to the GCC countries, it is necessary in this context to shed light on the importance of laws and regulations on the one hand, and enforceability and the agencies that enforce the laws and regulations on the other hand. This is stated in the first principle of the OECD principles. Therefore, failing to achieve this could lead to

¹¹⁷ A Abu-Tapanjeh, 'Corporate governance from the Islamic perspective: A comparative analysis with OECD principles' (2009) 20 *Critical Perspectives on Accounting* 556. See also C Slahudin, 'OECD Principles and the Islamic Perspective on Corporate Governance' (2008) 12 *International Association for Islamic Economics Review of Islamic Economic* 29.

¹¹⁸ S Hakim, 'Islamic Banking: Challenges and Corporate Governance' {LARIBA; 2002}.

¹¹⁹ C Slahudin, 'OECD Principles and the Islamic Perspective on Corporate Governance' (2008) 12 *International Association for Islamic Economics Review of Islamic Economic* 29.

¹²⁰ I Khan, 'The role of international organisations in promoting corporate governance in developing countries - a case study of Pakistan' (2012) 23 *International Company and Commercial Law Review* 223. See also A Dignam, 'Exporting corporate governance: U.K. regulatory systems in a global economy' (2000) 21(3) *Company Lawyer* 70.

losing credibility in the business environment, which would have a direct impact on growth prospects and minority shareholders' abuse of majority shareholders.¹²¹

2.4.1.5 G20/OECD Principles of Corporate Governance 2015

Both OECD Member countries and G20 countries have been invited to participate in a new review of the OECD principles, carried out under the auspices of the OECD Corporate Governance Committee, as well as experts from international institutions such as the World Bank and Basel Committee. This is in addition to online public consultation; expert consultation and, notably, the participation of the Regional Corporate Governance Roundtables in different parts of the world such as the Middle East, Asia and North Africa.

There are some changes to the 2004 version, including introducing new issues, clarifying some issues and greater emphasis on other issues and recommendations around raising the awareness of good corporate governance to include smaller and unlisted companies by policymakers. However, it can be seen that the new version could be described as an extension of the previous one. In other words, this means there are more details on many issues added to the previous OECD Principles versions 1999 and 2004. Moreover, many of the recommendations from the previous OECD Principles versions have been maintained in the 2015 version, except for some changes to certain principles, as the following paragraphs will illustrate.

Regarding the differences between the titles of the 2004 and 2015 versions of the OECD principles, the titles of chapters have remained the same except for principle

¹²¹ F Jesover and G Kirkpatrick, 'The Revised OECD Principles of Corporate Governance and their Relevance to Non-OECD Countries' (2005) 13 *Corporate Governance: An International Review* 127.

number two and number three. It can be seen that the 2004 version has the title of 'The rights of shareholders and key ownership functions' whereas the 2015 version states 'The rights and equitable treatment of shareholders and key ownership functions.' Number three in the 2004 version had the general title of 'The Equitable Treatment of Shareholders' whereas the new version for 2015 is: 'Institutional investors, stock markets, and other intermediaries', which could be a reflection of the growing attention being paid towards this issue nowadays.¹²²

The first principle of the 2015 version is about ensuring the basis for an effective corporate governance framework, which is important in the context of this thesis. OECD principles emphasise the developing of the legal and regulatory framework for corporate governance to be aligned with the economic reality. Therefore, there is a need, when establishing private contractual relations, to have a suitable business environment that is protected by an effective corporate governance system. However, there are specific elements that help to ensure the effectiveness of corporate governance including the legal, regulatory and institutional framework that provides protection to the market participants. Every country has its circumstances, history and tradition of business practices that forms its corporate governance framework, besides the legislation, regulations, self-regulatory arrangements, voluntary commitments, and soft law elements, which complement that based on the “comply or explain” principle in order to fit the individual companies and provide more flexibility. Due to the fact that it is difficult to apply one set of regulations to fit every company, as a result of different circumstances, there is a need to review and adjust the corporate governance

¹²² *OECD principles of corporate governance 2015.*

framework to keep updated with the new surrounding circumstances. The result of that will be reflected in the integrity of the market and the economic performance.

Secondly, the 2015 OECD principles have maintained the second principle to be the same as the 2004 version: 'the rights and equitable treatment of shareholders and key ownership functions'. It can be seen that the basic shareholder rights have been identified in principle number two in both the 2015 and 2004 versions. For example, concerning the key company decisions, the right of shareholders to have information and participate in meetings has been maintained. Moreover, principle number two deals with the issue of disclosure of controlled structures. However, there are several issues that have been added to this chapter on OECD principles, such as use of information technology, decisions on executive remuneration, and approval of related party transactions.

Regarding the cross border listings -which is the listing of shares in a company on the stock exchange of other country- and the importance of fair and effective price discovery in stock markets, this new chapter of OECD 2015 principles also provides new principles for dealing with these issues.¹²³ It can be seen that the topic of institutional investors acting in a fiduciary capacity has been given more attention in the 2015 version due to the fact that there has been significant growth in the role of played by institutional investors such as mutual funds, pension funds, insurance companies and hedge funds. Therefore, the OECD recommends the disclosure of

¹²³ Cross-border listing is "the practice of listing shares in a company on the stock exchanges of different countries in order to create a larger market for the shares". See: J Law, *A Dictionary of Business and Management* (6th edn Oxford University Press, 2016) Available at: <http://www.oxfordreference.com/> accessed 20/3/2016.

institutional investors' policies with respect to corporate governance, with regard to their corporate governance and voting policies. Noticeably, OECD has mentioned the importance and the growing attention paid toward "stewardship codes" like in the UK, and the OECD suggests that institutional investors should sign up to this on a voluntary basis.

Principle number four of the 2015 version remains the same as 2004 concerning dealing with the role of stakeholders in corporate governance. Stakeholders' access to information on a timely and regular basis is supported as well by stakeholders' right to obtain redress for violations of their rights. The relationship between corporations and stakeholders with active co-operation has been emphasised, along with the recognition of stakeholders' rights that are established by law or through mutual agreement. Just like the 2004 version, the disclosure and transparency issue forms the fifth principle of the 2015 version. This chapter on OECD principles deals with disclosure and transparency, including the issue of remuneration; the objectives of the company; the financial and operating results; the ownership of majority shares, and board members. However, there are some new matters that the 2015 version contains, such being on a voluntary basis, and recognising the recent trends with respect to items of non-financial information that companies may include.

Finally, the sixth chapter deals with the board's responsibilities by providing guidance for the board of directors' key functions, such as corporate strategy review and selecting and compensating management. It can be seen that the role of the board of directors in risk management has been introduced as a new issue into the 2015 version, as well as internal auditing and tax planning. Moreover, training and evaluation of the board has been recommended as well as specialised board

committees' establishment as a recommendation. These committees are recommended to be established in a variety of areas, including risk management, remuneration and audit.¹²⁴

2.4.1.5 Conclusion

This section has discussed an important aspect of the background to the corporate governance principles of the OECD. Although the section has shed light on how important international standards and supranational authorities are to developing and less developed countries, it is important to understand that the OECD principles of corporate governance, and likewise the benchmarks, are not a magical cure for all corporate governance issues in such countries. Consequently, it is essential to understand that there is a need to bridge the gaps in the basic requirements of the institutional and legal and regulatory framework in order to improve corporate governance efficiency, which is described by Jesover and Kirkpatrick as an integral part of the Principles.¹²⁵

The gap between the previous version of the OECD principles was ten years before the 2015 edition; therefore, the fact that the world nowadays is experiencing rapid change, means that any regulations, including the OECD principles, should be reviewed regularly as a result of the changes circumstances. Since 1999, these

¹²⁴ *OECD principles of corporate governance* 2015.

¹²⁵ F Jesover and G Kirkpatrick, 'The Revised OECD Principles of Corporate Governance and their Relevance to Non-OECD Countries' (2005) 13 *Corporate Governance: An International Review* 127.

principles have become an international benchmark; however, the recent crises may have increased the need for the OECD to review these principles.¹²⁶

2.4.2 Center for International Private Enterprise

Since 1983, with market oriented reform and private enterprise, the Center for International Private Enterprise (CIPE) has many objectives and activities. In regard to corporate governance, the CIPE has an objective to improve corporate governance in both the public and private sector through transparency and accountability.¹²⁷ Surprisingly, although the CIPE has many partners around the world including in the Middle East Egypt, Lebanon, Jordan and Algeria, but there are no GCC member partners. However, the successful CIPE corporate governance projects have made the CIPE an internationally known centre for promoting the adoption of corporate governance standards.¹²⁸ For example, the Saudi Arabian Capital Market Authority has had some cooperation with the CIPE such as the request from the CMA to have access to CIPE information and resources to support the CMA project in the establishment and development of the Institute of Directors.¹²⁹

¹²⁶ R Tomasic and F Akinbami, 'Towards a New Corporate Governance after the Global Financial Crisis' (2011) 22 *International Company and Commercial Law Review* 237.

¹²⁷ CIPE, 'Center for International Private Enterprise official Arabic Website' (Center for International Private Enterprise <<http://www.cipe.org/language-intro/arabic>> accessed 20/3/2016).

¹²⁸ F Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 41.

¹²⁹ CIPE, 'Together towards the Reform' (The Center for International Private Enterprise <http://www.cipe.org/sites/default/files/publication-docs/flyerMena_Arabic_forWeb.pdf> accessed 20/3/2016).

2.4.3 MEPI

The US State Department established in 2002 the Middle East Partnership Initiative. The MEPI is aiming to create partnerships with civil society organisations in the Middle East including the Arabian Peninsula region.¹³⁰ MEPI is working in several countries in the Middle East including with some GCC members such as Saudi Arabia and Bahrain. There are many goals of the MEPI including supporting economic growth through some projects, and improving the legal and regulatory transparency in order to strengthen the global competitiveness of countries in the region.¹³¹ One of the examples of how MEPI impacts on corporate governance in Saudi Arabia can be seen through raising the awareness of corporate governance. For example, the website on Corporate Governance in the MENA region provides conference materials, articles and information about corporate governance, and was sponsored by the MEBI. This website has had visitors from all over the Arab world, although most of them are from Egypt, Saudi Arabia, and Lebanon.¹³²

¹³⁰ For example, both the Centre for International Private Enterprise (CIPE) and the Middle East Partnership Initiative (MEPI) supported the drafting of *Egypt Code of Corporate Governance Guidelines and Standards* 2005. Available at: <http://ir.egytrans.com/pdf/Egyptian%20Code%20of%20Corporate%20Governance.pdf>. Accessed at 12/3/2016.

¹³¹ MEPI The U.S. Middle East Partnership Initiative, 'Supporting The economic Growth' (The U.S. Department of State <<http://www.arabic.arabianpeninsula.mepi.state.gov/whatwedoconomy.html>> accessed 20/3/2016.

¹³² Center for International Private Enterprise, *Enhancing Corporate Governance in the Arab World* (CIPE MEPI Quarterly Programmatic Report, April-June 2005) Page: 3.

2.4.4 International Finance Corporation

The International Finance Corporation 'IFC' is one of the members of the World Bank group which aims to create opportunities for people to escape poverty and improve their living conditions through several projects. The IFC, which was established in 1956, could be described as the largest global development institution that focuses exclusively on the private sector in developing countries. The importance of the IFC in the context of this thesis is very clear, as the IFC has an important role in promoting corporate governance in many parts of the world including the Middle East and North Africa. Moreover, the last decade has witnessed successful projects creating a solid foundation for corporate governance in the region through many efforts, such as developing some institutes, launching codes and regulations, and raising the awareness of corporate governance.¹³³

2.4.5 Cadbury report

Whilst the Cadbury Committee will be covered in detail in chapter three, a brief mention should be made here as the Cadbury report has become a model for other internationally recognized governance code.¹³⁴ A series of business scandals such as Polly Peck and Maxwell, during the 1980's in the UK pointed to corporate

¹³³ IFC official website, 'Corporate Governance: Middle East and North Africa' (<http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Corporate+Governance/Advisory_Services_Regional_Programs/MENA/>) accessed 1/3/2016.

¹³⁴ M Blowfield and A Murray, *Corporate Responsibility : A Critical Introduction* (Oxford University Press, 2008) Page: 166. See chapter three 3.2.1.1 for more details.

governance failures.¹³⁵ For this reason, a panel of experts chaired by Sir Adrian Cadbury examined the main issues of corporate governance, including boards of directors and boards, executives, auditors and shareholders' relationships. The Cadbury Committee was set up in the interests of the private sector, including the London Stock Exchange, the Financial Reporting Council and the accountancy profession in May 1991.¹³⁶ The first draft of the report was produced in the middle of 1992. Therefore, a public debate in the UK was created as a result of the Cadbury Committee's report on ensuring ethical conduct and monitoring company executives and directors' activities.¹³⁷

Through balancing between power and authority, the Cadbury Committee introduced best practice principles in order to encourage companies, whether listed or not listed on the stock exchange in London. Therefore, the Cadbury Committee included findings and recommendations, including accountability, integrity and openness, and regarding boards of directors and their liability. In addition, the Committee included the company and shareholders' role in the audit committees' establishment. Moreover, the Cadbury Committee introduced what may be described as a 'code of conduct for companies' in the words of Blowfield and Murray.¹³⁸ The importance of

¹³⁵ A Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' [2015] *Journal of Business Law* 551.

¹³⁶ J C. Shaw, *The Cadbury Report, Two Years Later* (Comparative Corporate Governance : Essays and Materials, Walter de Gruyter, 1997) Page: 23.

¹³⁷ C Boyd, 'Ethics and Corporate Governance: The Issues Raised by the Cadbury Report in the United Kingdom' (1996) 15 *Journal of Business Ethics* 167.

¹³⁸ M Blowfield and A Murray, *Corporate Responsibility : A Critical Introduction* (Oxford University Press, 2008) Page: 216.

the Cadbury report goes beyond being a local report to being recognised as an international corporate governance code.

2.4.6 Hawkamah institute

There are many objectives for Hawkamah and it has a crucial role to play. However, the attempts at resolving the Islamic corporate governance issues might be one of the most important efforts in this context as a local institute of corporate governance based in one of the GCC countries- the UAE. Hawkamah institute's approach is towards resolving internal and external corporate governance issues, for example, encouraging disclosure and raising awareness of the protection of minority shareholders by introducing new corporate governance plans. On the other hand, regarding external issues, there is an example that can be seen from the involvement of Hawkamah in new regulatory frameworks development based on the Islamic Finance Board guidelines and acceptable to IIFS. Moreover, market discipline self-regulatory initiatives involvement is also a good example of the efforts of Hawkamah.¹³⁹

¹³⁹ A Ahmed, 'An Examination of the Principles of Corporate Governance from an Islamic Perspective: Evidence from Pakistan' (2011) 25 Arab Law Quarterly 27.

2.5 Corporate governance theoretical framework

Due to the variety of academic research that deals with corporate governance on the one hand, and the different corporate forms that need economic solutions to their problems and to search for new economic opportunities on the other hand, there are several corporate governance theoretical frameworks.¹⁴⁰ Thus, the evolution of several diverse theoretical frameworks is a result of corporate governance explanation and analysing. The variety of views, disciplines, perspectives and the terminologies of corporate governance, as well as the legal influences, have resulted in different frameworks approaches.¹⁴¹ However, the theoretical frameworks overlap and share significant commonalities, as they are tackling similar problems from different perspectives, as observed by Solomon.¹⁴²

Adam Smith could be described as the father of the modern economics.¹⁴³ The argument of Adam Smith regarding the separation between the company's ownership and the management is very important in this context. Actually, the argument is not new as it was introduced early on in 1776 by Smith; he argued that "The directors of such joint-stock companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it

¹⁴⁰ T Clarke, *Theories of Corporate Governance : The Philosophical Foundations of Corporate Governance* (Routledge, 2004) Page: 2.

¹⁴¹ J. Solomon, *Corporate Governance and Accountability* (2nd ed. John Wiley, 2007) Page: 16.

¹⁴² Ibid Page: 16.

¹⁴³ P Yeoh, 'Corporate Governance in the UK: A Time for Reflection' (2015) 36 Business Law Review 130.

with the same anxious vigilance with which the partners in a private co-partnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company".¹⁴⁴

In the view of Parkinson, the contractual analysis of the corporation dominated the theoretical work on company law in the 1990s, and most writers accepted that maximising the wealth of shareholders is the company's function, which means the structure of corporate governance should be designed with this exclusive purpose in view. The late 1980s witnessed the emergence of 'non-shareholder constituency' in the USA, which facilitated the way for taking interest groups other than shareholders into account, such as employees.¹⁴⁵

Therefore, there is a need to have an effective alignment between the interests of the organisation's managers and the owners. The separation has resulted in plenty of arguments and discussions around this issue.¹⁴⁶ The following paragraphs are an

¹⁴⁴ M C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305.

¹⁴⁵ J. E. Parkinson, 'The contractual theory of the company and the protection of non-shareholder interests' in D. Feldman and F. Meisel (eds), *Corporate and commercial law: Modern developments* (Corporate and commercial law: Modern developments, Lloyd's of London Press LTD 1996) Page: 121.

¹⁴⁶ P Santosh, *The Theoretical Framework for Corporate Governance* (October 26, 2011). SSRN.

attempt to shed light briefly on the main theoretical frameworks of corporate governance.

2.5.1 Agency theory

First of all, the root of agency theory goes back to the economic theory expounded in 1972 by Alchian and Demsetz. Moreover, the works of Jensen and Meckling in 1976 and Feman and Jensen in 1983 are very important in this context as well in the view of Millan.¹⁴⁷ The importance of agency theory is as a theoretical base for most of corporate governance research according to Dalton, who claims that to large extent, the theoretical foundation of corporate governance research is provided by the agency theory.¹⁴⁸

Agency theory clarifies the agency relationship- in the corporate context- as the delegation of work from one party 'the owner' as 'the principal'- to the other party 'the Director' as 'the agent'.¹⁴⁹ Moreover, all parties' actions are based on the goal of maximising their profits. However, the objectives are not always compatible with each other, and might to some extent have some conflict of interests. However, regardless of the conflict of interests and the variety of goals, both parties need to maintain the relationship between them. The agent needs to have some

¹⁴⁷ C A. Mallin, *Corporate Governance* (3rd ed. edn Oxford University Press, 2010) P:17 See also: A A. Alchian and H Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 *The American Economic Review* 777.

¹⁴⁸ D R. Dalton and others, 'Meta-Analyses of Financial Performance and Equity: Fusion or Confusion?' (2003) 46 *The Academy of Management Journal* 13.

¹⁴⁹ C A. Mallin, *Corporate Governance* (3rd ed. edn Oxford University Press, 2010) Page: 17.

decentralisation and power to act and make decisions, whereas the owner 'the principal' needs to have a contract that binds the agent to act in accordance with the interests of the agency parties and prevent the agent from acting in a way that could harm the 'the principal's' interests.

So, do the fact that there are a diversity of goals between the agent and the principal, the agency theory predict that possible conflicts of interest could arise, not between the agent and the principal, but beyond that to all the related parties? While they have a network of relations and they know the information and news earlier than the others, which enables them to use it in accordance to their own benefits, some managers plan strategies and make decisions in order to protect their own rights and to achieve their personal goals. On the other hand, to prevent the agent's behaviour causing an infringement to the company's articles, the shareholders as 'the principal' are going to use an approach that protects their rights and interests, and monitor the managers' actions by issuing a corporate governance system. This system will facilitate monitoring the internal organs of the company such as the management, as well as by external bodies, such as monitoring of the capital market.

Therefore, agency theory pays more attention to the behaviour of the company's management and how to provide mechanisms and regulations that encourage effective management and prevent the possible side effects that could emerge due to the wide powers and making the management act as the owner of the company. It is clear that there are problems that could emerge from the separation between the ownership and the management. Therefore, it could be argued that the object of corporate governance regulations is to in reduce or minimise the problems that could arise as a

result of the separation of ownership and management. The theoretical model of corporate governance in the Anglo American view is based on agency theory.¹⁵⁰

2.5.2 Stewardship theory

Stewardship theory is rooted in psychology and sociology.¹⁵¹ As an alternative view to agency theory, according to stewardship theory, the managers will work responsibly as stewards if they left on their own. The motivation for the steward's performance has been explained by Davis, Schoorman and Donaldson as follows: "A steward protects and maximises shareholders' wealth through firm performance, because by so doing, the steward's utility functions are maximised".¹⁵²

Stewardship theory has certain mechanisms such as executive compensation, levels of benefits and rewarding managers with incentive plans. These incentive schemes to improve the performance of the executives include giving them shares to ensure that their financial interests are in alignment with the company's interests. Moreover,

¹⁵⁰ L Miles and S Goulding, 'Corporate Governance in Western (Anglo-American) and Islamic Communities: Prospects for Convergence?' [2010] *Journal of Business Law* 126.

¹⁵¹ A Haslinda and B Valentine, 'Fundamental and Ethics Theories of Corporate Governance' (2009) 7 *Middle Eastern Finance and Economics* 88.

¹⁵² J H. Davis, F. D Schoorman and L Donaldson, 'Toward a Stewardship Theory of Management' (1997) 22 *The Academy of Management Review* 20.

financial rewards ensure loss reduction.¹⁵³ Stewardship theory is at the heart of corporate governance from a legal perspective in the view of Tricker.¹⁵⁴

2.5.3 Stakeholder theory

In agency theory, the systems and mechanisms of corporate governance are related to the protection of the shareholders' rights as the main goal of the company to maximise the profits and generate more wealth to the shareholders. So, while agency theory focuses on the separation between the management and the ownership perspective, there are additional perspectives that consider other responsibilities such as social responsibility. Thus, this perspective describes the relationship between the parties that have a direct relationship with the company, which means the company needs to form a positive relationship with all stakeholders in order to generate sustainable economic wealth.

CEOs play a central role in the management of the relationships between all the stakeholders; the goal is to maximise wealth through these relationships. However, this will be accomplished via a company's social commitment, and social and environmental responsibility, which shows the difference to agency theory, where the central role is that of the shareholders.

¹⁵³ L Donaldson and J H. Davis, 'Stewardship Theory or Agency Theory: Ceo Governance and Shareholder Returns' (1991) 16 Australian Journal of Management (University of New South Wales) 49.

¹⁵⁴ B Tricker, 'Re-Inventing the Limited Liability Company' (2011) 19 Corporate Governance: An International Review 384.

Carroll has explained the social responsibilities of the company and believes that the company must work in accordance with legal, ethical, philanthropic and economic responsibilities, as the following paragraphs will show in more detail. **First of all**, economic responsibilities may be described as the first and the most important responsibility, as the company must work to provide goods and services to society and to maximise profits- be profitable. **Secondly**, concerning legal responsibilities, society expects that the company is not working to generate money and profits only- the company must show compliance with the law, regulations and the legal framework of the country. **Thirdly**, ethical responsibilities: although this could be included under legal and economic responsibilities, society expects the company to comply with the cultural standards of the society. **Fourthly**, there are philanthropic responsibilities, and although this point could be an optional responsibility, society expects the business to act as a good corporate citizen, to contribute towards the welfare of society.¹⁵⁵ Corporate governance in this context is the mechanism that ensures the responsibility of the organisation to steer its actions towards a fair system for all parties involved.

Being more descriptive has attracted some researchers' attention towards certain criticisms, as stakeholder theory describes what the company's actions are on the basis of ethical philosophy. The company in this context has the goal of maximising the sustainable economic wealth to all stakeholders including shareholders, employees, customers and all the parties who have rights in this company. Some companies could have success as a business, but could fail in the context of social

¹⁵⁵ A B. Carroll, 'The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders' (1991) 34 Business Horizons 39.

responsibility at the same time. However, it is not possible, generally speaking, vice versa.¹⁵⁶ To some extent, it could be said that agency theory is more relevant to the Saudi context. On the other hand, the stakeholder model most closely resembles Corporate Governance from an Islamic perspective as stated by Kasri.¹⁵⁷

2.6 Conclusion

Due to the fact that there are several systems that are related to corporate governance, such as the political and economic systems, the rules, regulations and the legal context of corporate governance will remain the safest factor to ensure effective corporate governance. From this viewpoint, the importance of corporate governance regulations is revealed through **three factors** as stated by Khader: First of all, ensuring commitment from all related parties; secondly, by ensuring the efficiency of the market, and thirdly, it will result in the fulfillment of all parties' rights.¹⁵⁸

In order to reduce the risk, encourage domestic savings in the capital market, and to facilitate funding for the expansion of projects and the establishment of new investments, there is a need to promote the corporate governance system in many Arab countries. However, in the view of Abdulsabour, this cannot be done without recognising the importance of corporate governance through a clear understanding of board of directors' duties, the separation between the job of the CEO and the job of the Chairman of the Board of Directors, and developing strategy plans for decision

¹⁵⁶ T Hammad, *Houkmat Alshrkah Walazmah Almaliah Alaalmiah* (Aldar Aljamieah, 2009) Page: 511.

¹⁵⁷ RA Kasri, 'Corporate Governance: Conventional vs. Islamic Perspective' (2009) SSRN 11.

¹⁵⁸ A Khader, *Corporate Governance* (1 edn Dar Alfikr Aljamiey, 2012) Page: 9.

making and evaluation.¹⁵⁹ Khader stated that, the importance of corporate governance can be seen through the successful results that have been achieved in the commercial sector, taking into account that corporate governance is a new concept in nowadays.¹⁶⁰ To sum up, “Corporate governance remains the bedrock of business sustainability and sound stewardship, serving the long-term interests of investors and societies” as stated by the IFC.¹⁶¹

Both developed and developing countries have benefited from the contribution and improvements provided by international organisations and supranational authorities such as the World Bank and the Organisation for Economic Co-operation and Development. These contributions and improvements include providing benchmarks, recommendations, stability, support of economic growth, and fighting poverty. One OECD mission, for example, is to improve living standards and economic success by promoting policies.¹⁶² On the other hand, corporate governance theories can be described as being in a state of "never-ending evolution" as can be seen throughout the history of corporate governance.¹⁶³ As a result, in order to have effective corporate

¹⁵⁹ A Masri, *The Legal Regulation of Corporate Governance: Comparative Study* (Alqanun wa Aleqtisad, 2012)Page: 12.

¹⁶⁰ A Khader, *Corporate Governance* (1 edn Dar Alfikr Aljamiy, 2012) Page: 8.

¹⁶¹ IFC, 'Corporate Governance Success Stories' (International Finance Corporation, Washington DC 2015).

¹⁶² See: OECD official website. 'About the Organisation for Economic Co-operation and Development (OECD)' <<http://www.oecd.org/>> accessed 20/3/2016.

¹⁶³ A Haslinda and B Valentine, 'Fundamental and Ethics Theories of Corporate Governance' (2009) 7 Middle Eastern Finance and Economics 88.

governance, a combination of various theories is suggested, rather than a single corporate governance theory approach.¹⁶⁴

The previous chapter has shown the importance of international standards and supranational organisations such as the OECD and IFC in the context of the GCC and Saudi Arabian corporate governance for several reasons. This chapter illustrates the benefits, contribution and recommendations of international organisations and supranational authorities for developed countries, which developing countries can learn from as they are more likely and more vulnerable to suffering from the lack of effective corporate governance frameworks and its consequences. Therefore, the fact that Saudi Arabia is a developing country and an emerging economy indicates more the importance of benefitting from international standards. The roundtable dialogue with OECD and non OECD members could possibly bridge the gap between the variety of cultural factors and the national contexts, and the participation of Saudi Arabia in the last version of the OECD principles is a significant step towards the right path. From this point, the next chapter will deal with the main issues related to UK corporate governance as an example that shows the main differences between the Saudi legal system and other world legal systems. The various levels of regulations that shape the framework of corporate governance in the UK, including common law and statutory rules, alongside the internal measures and structures, will be examined in order to take lessons and examine the ability of the Saudi legal system to be improved and its capability of adapting to emerging concepts.

¹⁶⁴ Ibid.

3. Chapter three: The United Kingdom corporate governance system: the legal and regulatory framework

3.1 Introduction

Nowadays, Western concepts dominate the business world and, clearly, corporate governance is a good example of this.¹⁶⁵ On the other hand, the Saudi Arabian legal system has a different approach which has been described as being 'complex' by some researchers, a fact which should be taken into account in this context.¹⁶⁶ Moreover, history, culture, tradition and society are important factors that contribute towards shaping the law as well, when considering corporate governance frameworks, which may be explained by path dependency theory.¹⁶⁷ However, some researchers predict that 'convergence theory' will impact on corporate governance, as all the systems of corporate governance will converge to meet the Anglo-American shareholder model, despite divergences in tradition, culture or systems, as the Anglo-American shareholder model is seen as the "optimal means of ensuring high

¹⁶⁵ N H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 European Business Organization Law Review 3.

¹⁶⁶ See: F E. Vogel, *Islamic Law and Legal System : Studies of Saudi Arabia* (Leiden ; Boston : Brill, 2000) Page: 364.

¹⁶⁷ O A. Hathaway, 'Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System' (2001) 86 Iowa Law Review 601.

standards".¹⁶⁸ Generally speaking, developing countries such as Saudi Arabia have different arrangements and systems as Almadi stated, "emerging markets economies, governments, businesses and societies have unique characteristics that differ significantly from their advanced counterparts".¹⁶⁹ Thus, the differences between the Saudi legal system, and other world legal systems, provide the motivation to shed light on the key aspects of a developed and different system in order to take lessons and examine the ability of the Saudi legal system to absorb and adapt to emerging concepts. Thus, the effectiveness of the legal and regulatory frameworks should be examined to assess its strengths and weaknesses. Therefore, the question of adaptation and legal transplantation reveals the importance of this chapter in the context of Saudi Arabia.¹⁷⁰

In this context, there is an important question to be asked: is there convergence in Western corporate governance? Generally speaking, there are two main corporate governance systems that can be found in the contemporary literature on corporate governance. The first one is the 'unique outsider' Anglo American system which can be found in the United Kingdom and the United States. On the other hand, the second system of corporate governance in Germany and the rest of the European countries is

¹⁶⁸ L Miles and S Goulding, 'Corporate Governance in Western (Anglo-American) and Islamic Communities: Prospects for Convergence?' [2010] *Journal of Business Law* 126.

¹⁶⁹ M Almadi, 'Organizational Governance, Board of Directors, and the Influence of Context in Emerging Markets' (2015) 10 *International Journal of Business and Management* 116.

¹⁷⁰ For more details of Sharia capability of adaptation see chapter four 4.3.

the 'insider system'.¹⁷¹ The differences between the three systems in the UK, US and Germany can be attributed to the wars and the economic crises as the major catalysts "The UK and US victories has led to more governmental influence on corporate behavior and minimize the role of state in defeated Germany."¹⁷²

There is no doubt that jurisdictions which have investment frameworks that serve the interests of shareholders will take the lead in the race to gain the trust of investors; otherwise, it would be like betting on the wrong horse. In fact, the global competition to attract capital and gain the trust of foreign investors is causing adjustments to local norms to make the local markets more attractive, and this seen as a matter of priority. Hence, corporate governance plays a crucial role in this context. So Cheffins notes, the attractiveness of a certain region will depend on its corporate governance system.¹⁷³ Therefore, the race towards attracting the international investment has made the convergence of corporate governance more important. Moreover, the Anglo-American model could be described as dominating the attention of both countries and firms when considering adopting and implementing international standards of best practices "The effect of competition has thus meant that governance

¹⁷¹ F. Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Sabic Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) P: 12.

¹⁷² A Dignam and M Galanis, *The Globalization of Corporate Governance* (Ashgate Publishing, 2009) P: 349.

¹⁷³ B R. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan Via Toronto' (1999) 10 *Duke Journal of Comparative and International Law* 5.

practices worldwide are becoming incredibly similar, particularly in relation to disclosure and transparency rules".¹⁷⁴

Therefore, the outstanding UK approach towards corporate governance has attracted the attention of researchers from many parts of the world. Moreover, the framework of corporate governance in the UK has been described as highly developed and stringent, not only in comparison with the UK's European neighbours' markets, but also many parts of the world. Again, Cheffins states: "The work which has been done in the United Kingdom has spurred reviews of corporate governance in markets around the world and has provided a yardstick against which investment frameworks in other countries are measured."¹⁷⁵ Moreover, the Cadbury report has a proven record for providing the true foundations of corporate governance, and the Cadbury report has played a crucial role in the UK and on a worldwide level as well.¹⁷⁶ For example, in comparison with the US approach, Barnard has described British companies' attitudes towards governance problems as having a distinctive and appealing character: "the process of corporate-governance reform in Britain seems

¹⁷⁴ S Morley, 'The Subject Matter, Form and Process of Convergence and the Ever-Increasing Role of the Foreign Investor' (2016) 37 *Company Lawyer* 71.

¹⁷⁵ B R. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan Via Toronto' (1999) 10 *Duke Journal of Comparative and International Law* 5.

¹⁷⁶ S Ahmad and R Omar, 'Basic Corporate Governance Models: A Systematic Review' (2016) 58 *International Journal of Law and Management* 73.

very different from, and more sensible than, the lawyer-driven approach to corporate governance we have become accustomed to in the US."¹⁷⁷

There are various levels of regulations that shape the framework of corporate governance in the UK, including common law and statutory rules, alongside the internal measures and structures. However, as stated by Keay, for listed companies, the UK Corporate Governance Code is the main pillar of the regulations that form the UK framework of corporate governance, because "as far as listed companies are concerned it is based on the UK Corporate Governance Code".¹⁷⁸ In relation to the key aspects of corporate governance, such as board leadership, the relationships with shareholders, issues of remuneration, and accountability, it is obvious that the function of the UK Corporate Governance Code is to set out standards of good practice. It is very important to take the UK as an example in the Saudi Arabian context, which is due to several reasons. The UK's long history of business environment framework regulations, as well as the 'well-developed market' with a variety of shareholders forms is one of the main reasons as stated by Mallin.¹⁷⁹ Furthermore, the UK's history of corporate governance, as well as several international key players, has impacted on the development of corporate governance, and its codes add more importance; for example, the OECD, the World Bank, International Corporate Governance Network 'ICGN', Global Corporate Governance

¹⁷⁷ J W. Barnard, 'The Hampel Committee Report: A Transatlantic Critique' (1998) 19 *Company Lawyer* 110.

¹⁷⁸ A Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' [2015] *Journal of Business Law* 551.

¹⁷⁹ C A. Mallin, *Corporate Governance* (3rd ed. Oxford University Press, 2010) Page: 27.

Forum ‘GCGF’ and the Commonwealth Association for Corporate Governance ‘CACG’.¹⁸⁰ The importance of the UK corporate governance approach in the context of this thesis can be seen in the widespread acceptance of the UK corporate governance code, which goes beyond the EU’s endorsement to be emulated by other jurisdictions.¹⁸¹ Moreover, Arcot and others believed that the Combined Code of Corporate Governance is seen as an international benchmark for good corporate governance practice to large extent.¹⁸²

To sum up, it can be seen from the previous discussion that this chapter will take the UK system of corporate governance into consideration to evaluate the current Saudi system. As mentioned earlier, the long history of corporate governance in the UK in comparison to Saudi Arabia, with its series of committees, ongoing workshops and provision of benchmarks, makes the UK system of corporate governance a good basis for evaluating the current Saudi system. Moreover, the influence of the UK system in various parts of the World, including some Gulf states, and the Westernisation of some aspects of Company Law in Saudi Arabia, as well as the UK initiative to advance the Islamic finance sector, all provide a solid rationale for choosing the UK in the context of this research. Therefore, the next sections will shed light on the various levels of regulations and institutions in the UK with regard to the evaluation

¹⁸⁰ Ibid. Page: 27.

¹⁸¹ A Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' [2015] *Journal of Business Law* 551.

¹⁸² S Arcot, V Bruno and A Faure-Grimaud, 'Corporate Governance in the UK: Is the Comply or Explain Approach Working?' (2010) 30 *International Review of Law and Economics* 193.

of the current rules and regulations' framework of corporate governance in Saudi Arabia in order to discover ways to improve it.

3.2 The Legal and Regulatory Framework of UK Corporate Governance

3.2.1 The development of corporate governance in the UK

The UK corporate governance system is a result of what may be described as a rich history that has developed over many years. In fact, corporate governance is not something strange to the United Kingdom. Moreover, the 'Joint Stock Companies Act 1844' could be described as the root of Companies Law in essence. However, the 1990s witnessed the beginning of dealing with corporate governance as a specific issue with a series of committees, starting with the watershed Cadbury Committee.¹⁸³ However, the motivation that started the reform of UK listed companies were the successive shocks of the late 1980's scandals and the recession in the opinion of Dignam and Lowry.¹⁸⁴ These reports mainly linked with the financial scandals at the Bank of Credit and Commerce International (BCCI) and closures of companies linked to Robert Maxwell as stated by Yeoh.¹⁸⁵ Therefore, it is not a secret that the impetus

¹⁸³ V Youngusband, 'Corporate Governance in the UK' (1998) 9 *International Company and Commercial Law Review* 275.

¹⁸⁴ A J. Dignam and John P. Lowry, *Company Law* (8th edition edn Oxford University Press, 2014) Page: 426.

¹⁸⁵ P Yeoh, 'Corporate Governance in the UK: A Time for Reflection' (2015) 36 *Business Law Review* 130.

behind developing effective corporate governance was the collapse of corporations and financial scandals.¹⁸⁶

Therefore, the development of corporate governance in the UK initially began just prior to the 1990s in the shadow of several corporate scandals, such as Maxwell and BCCI. Noticeably, the weaknesses in the UK's corporate governance system were one of the main motivations for setting up corporate governance committees, including the Cadbury and Greenbury Committees.¹⁸⁷ The need for increasing and restoring confidence in not only existing investors, but potential investors as well, alongside transparency and accountability, was the motivation behind introducing corporate governance codes in the opinion of Mallin.¹⁸⁸ In fact, the work of committees is not the only factor that has contributed to the development of corporate governance in the UK. It must be mentioned in this respect the work of the UK scholars and researchers who have enriched the academic field concerning this important issue. Scholars and researchers' efforts at raising the profile of corporate governance issues in the UK have accompanied the work of the committees, which has resulted in the current UK corporate governance regulations.¹⁸⁹

¹⁸⁶ C A. Mallin, *Corporate Governance* (3rd ed. edn Oxford University Press, 2010) Page: 26.

¹⁸⁷ V Youngusband, 'Corporate Governance in the UK' (1998) 9 *International Company and Commercial Law Review* 275.

¹⁸⁸ C A. Mallin, *Corporate Governance* (4th edn Oxford University Press, 2013) Page: 26.

¹⁸⁹ See for instance the work of John Parkinson who was a key figure in raising the profile of corporate governance issues in English law in academic discourse.

Generally speaking, the development of corporate governance in the UK has been influenced by four broad areas since 1998. **First** of all, the reports that have tackled issues of corporate governance, such as: internal controls by the Turnbull Report; institutional investment by Myners; and the role of non-executive directors in the Higgs Review. The **second** broad area that influenced the first UK Stewardship Code 2010 is the Institutional Shareholders' Committee (ISC), through the institutional shareholders responsibilities statement. **Thirdly**, the Company Law Review, the Walker review for HM Treasury and the FSA review have influenced the corporate governance regulatory framework. **Finally**, external influences have come from the EU and the USA, for example, Sarbanes-Oxley Act, the EU Corporate Governance Framework and EU review of company law.¹⁹⁰

Thus, there is a need for a brief introduction to the committees' work in order to further understand the United Kingdom's approach to corporate governance.¹⁹¹ Therefore, the following paragraphs are an attempt to show the important historical chain of the key aspects of developments in the UK, which have contributed towards shaping current UK corporate governance.

3.2.1.1 The Cadbury Committee¹⁹²

Whilst the Cadbury Committee has been covered briefly in chapter one, mention should be made here as well, as the Cadbury Committee may be described as the cornerstone to current UK corporate governance. The corporate failures in May 1990,

¹⁹⁰ C A. Mallin, *Corporate Governance* (4th edn Oxford University Press, 2013). Page: 28.

¹⁹¹ J Birds and others (eds), *Boyle & Birds' Company Law* (9th edn Jordans, Bristol 2014) P:357.

¹⁹² For more about Cadbury committee, see chapter two 2.4.5.

such as the Maxwell Empire, BCCI and Polly Peck in the United Kingdom, indicated the need for greater examination of corporate governance and improving the standards of corporate governance. May 1990 witnessed the establishment of the Committee on the Financial Aspects of Corporate Governance, which later became known as the Cadbury Committee, and this was set up by the Financial Reporting Council, the London Stock Exchange and the accountancy profession. For 18 months, the Committee on the Financial Aspects of Corporate Governance, led by Sir Adrian Cadbury, examined aspects of corporate governance.¹⁹³ One of the findings of Cadbury Committee was the “massive incidences of lack of essential corporate disclosures in both as well as others in the corporate UK sector”.¹⁹⁴

Listed companies incorporated in the UK are ordered to 'comply or explain' according to the Cadbury Code, so new Listing Rules were introduced by the London Stock Exchange.¹⁹⁵ The outline of the Cadbury Committee was published in 1992, including important recommendations for the separation between the CEO and chairman; the board's balanced composition; non-executive directors selection processes; financial reports transparency, and internal controls.¹⁹⁶ To sum up, the Code of Best Practice of the Cadbury Committee has introduced **four important principles** in order to

¹⁹³ V Youngusband, 'Corporate Governance in the UK' (1998) 9 International Company and Commercial Law Review 275 .

¹⁹⁴ P Yeoh, 'Corporate Governance in the UK: A Time for Reflection' (2015) 36 Business Law Review 130.

¹⁹⁵ V Youngusband, 'Corporate Governance in the UK' (1998) 9 International Company and Commercial Law Review 275 .

¹⁹⁶ Cadbury Committee, *The Financial Aspects of Corporate Governance* (Gee, 1992) .

improve corporate behaviour in the view of Shaw. First of all, to ensure the balance between authority and power, at the head of the company, there must be a clear division of responsibilities. Secondly, a sufficient number and calibre of non-executive directors should be included in the board in order to make important decisions. Thirdly, a positive interest in the composition of boards of directors should be taken by institutional investors. Lastly, clear recognition should be ensured by the board structure with help of an Audit Committee to secure the significance of the function of the finance.¹⁹⁷ Briefly, the Cadbury Committee is all about the freedom of boards to work and compete in favour of their companies, while ensuring that the work is carried out within the accountability framework.¹⁹⁸ It is fact that the influence of Cadbury Report has spread to cover many parts of the world.¹⁹⁹

3.2.1.2 The Greenbury Committee

Despite the fact that the Cadbury Committee had dealt with the issue of executive directors' remuneration, the establishment of the Greenbury Committee in January 1995 was because of this specific reason, according to the initiative of the Council for British Industry (CBI). Obviously, the excessive remuneration packages were still a concern, despite the fact that the Cadbury Committee had tackled this issue. The Greenbury Committee prepared a Code of Best Practice on directors' remuneration, which was published in July 1995. Moreover, the Listing Rules' requirement of

¹⁹⁷ J C. Shaw, *The Cadbury Report, Two Years Later* (Comparative Corporate Governance : Essays and Materials, Walter de Gruyter, 1997) Page: 24.

¹⁹⁸ J Birds and others (eds), *Boyle & Birds' Company Law* (9th edn Jordans, Bristol 2014) Page: 357.

¹⁹⁹ C A. Mallin, *Corporate Governance* (4th edn Oxford University Press, 2013) Page: 27.

confirming whether there has been compliance by the companies with section A of the Best Practice Provisions was introduced after the Greenbury Committee's report. Indeed, corporate governance disclosures requirement was one of the main impacts of both the Cadbury and Greenbury committees.²⁰⁰

In short, the main recommendations of the Greenbury Committee include: **Firstly**, a independent remuneration committee consisting non-executive directors to determine the directors' remuneration; **secondly**, information about the named directors' salaries with full disclosure; **thirdly**, the requirement of disclosure and explanation if the period of the directors' service contracts are more than one year; **fourthly**, directors are encouraged to hold onto shares, and shares should not be vested; **fifthly**, instead of capital gains on disposal, it recommends the taxation of executive share option gains as income.²⁰¹ In fact, Greenbury Committee went further in comparison with Cadbury by advocating that "the three mentioned committees should be made up of independent directors".²⁰²

3.2.1.3-The Hampel Committee

Following the Cadbury and Greenbury committees, and recommended by them, there was a need for a new Committee to review and revise the findings, and check the implementation of their recommendations, which was the reason for establishing the

²⁰⁰ V Youngusband, 'Corporate Governance in the UK' (1998) 9 International Company and Commercial Law Review 275.

²⁰¹ John Birds and others (eds), *Boyle & Birds' Company Law* (9th edn Jordans, Bristol 2014) Page: 358.

²⁰² P Yeoh, 'Corporate Governance in the UK: A Time for Reflection' (2015) 36 Business Law Review 130.

Committee on Corporate Governance. The committee, known as the Hampel Committee, was established in November 1995, and was followed by the Hampel report two years later. The committee was chaired by Sir Ronald Hampel who was appointed by the Department of Trade and Industry.²⁰³ Unlike Cadbury and Greenbury, the establishment of the Hampel Committee contained several players in terms of initiative, which were the chairman of the Financial Reporting Council and six sponsors: the LSE, the CBI, the Institute of Directors, the Consultative Committee of Accountancy Bodies, the Association of British Insurers, and the National Association of Pension Funds. There was an obvious difference between Hampel and the previous Committees, as the Hampel Committee shifted from the restricted remit of ‘Cadbury and Greenbury’ to cover the whole field of corporate governance.²⁰⁴

The Hampel Committee published its report with a large endorsement of the Cadbury and Greenbury committees’ conclusions. Moreover, the Hampel Committee’s endorsement of the previous committees’ conclusions about the remuneration of the directors to be put to a shareholder vote at the annual general meeting, could be described as controversial at the time.²⁰⁵ Moulton and Higgs contend that there are two very significant conclusions from the Hampel Committee. **First of all**, instead of explicit rules, good corporate governance is a matter of behaviour and an issue of

²⁰³ R Moulton and N Higgs, 'Corporate Governance in Financial Institutions' (2013) 109 Compliance Officer Bulletin 1.

²⁰⁴ V Youngusband, 'Corporate Governance in the UK' (1998) 9 International Company and Commercial Law Review 275.

²⁰⁵ R Moulton and N Higgs, 'Corporate Governance in Financial Institutions' (2013) 109 Compliance Officer Bulletin 1.

principles that aim to ease the regulatory burden on companies with flexibility that should meet the company's specific needs. **Secondly**, there was a concern that, in the work of the previous committees, the emphasis on accountability had neglected, to some extent, the major responsibility of the board regarding the issue of acting in the best interests of the shareholders. Moreover, the Hampel Report promotes the involvement of the shareholder in issues of governance. Remarkably, the principle of stakeholders who have an interest in the company's success, such as governments, local communities, customers, suppliers and employees, was later put into a statutory footing in the Companies Act 2006.²⁰⁶

Unlike Cadbury and Greenbury, Hampel goes beyond being entirely focused on the UK to be distinguished by having experts' advice in corporate governance practice from the United States and Germany as well. However, it may be important in the context of the adaptation of a new system, in comparison with the 'adopted Saudi Arabian corporate governance', to note that the Hampel Committee does "not recommend the adoption of a whole system developed elsewhere".²⁰⁷ The importance of the previous three Committees, Cadbury, Greenbury and Hampel, is due to the fact that the Combined Code is based on their reports and the Cadbury Committee's Code of Best Practice.²⁰⁸

²⁰⁶ Ibid.

²⁰⁷ V Youngusband, 'Corporate Governance in the UK' (1998) 9 *International Company and Commercial Law Review* 275.

²⁰⁸ A Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' [2015] *Journal of Business Law* 551.

3.2.1.4 The Turnbull Report

One of the requirements of the Combined Codes of 1998 and 2003 from companies is to provide a statement on their application process for the Code Principles and Code Provisions in regard to internal control in their annual reports; therefore, there is the need for companies to know the approach that should be taken. Thus, the Institute of Chartered Accountants in England and Wales established the Turnbull Committee in 1998, chaired by Nigel Turnbull. In September 1999, the Guidance for Directors on the Combined Code was published, and then the FRC updated this to a new version in 2005 and then again in 2014.²⁰⁹

3.2.1.5 The Higgs Report

Chaired by Derek Higgs, the review of the role and effectiveness of non-executive directors was published in 2003. The conclusions of the Higgs Report have been incorporated into the 2003 Code's revised version. These recommendations cover several issues, such as the composition of the board, remuneration policy matters, the evaluation of performance, accountability, and the issue of responsibilities of directors. One of the recommendations of the Higgs Report has been to tackle the issue of establishing a nomination committee, as Higgs recommended the establishment of a nomination committee in all listed companies that are chaired by an independent non-executive director, with an independent non-executive directors' majority.²¹⁰

²⁰⁹ R Moulton and N Higgs, 'Corporate Governance in Financial Institutions' (2013) 109 Compliance Officer Bulletin 1.

²¹⁰ Ibid.

3.2.2 The Combined Code and its revisions

On the 25 June 1998, the publication of the Combined Code of Corporate Governance followed the Hampel Report. So, from 31 December 1998, all listed companies have been subject to the 1998 Principles of Good Governance and Code of Best Practice. The importance of the Combined Code is that it followed the work of three important committees- Cadbury, Greenbury and Hampel- covering the main elements of corporate governance. Generally speaking, the Combined Code covers many issues, with a mix of principles and provisions regarding the board's structure and operations, for example the remuneration of directors; accountability, and the issue of institutional shareholders in regard to its relations and its responsibilities. To date, the Combined Code has witnessed a series of revisions, in 2003, 2006, 2008, 2010, 2012 and 2014, and the FRC is anticipating an update of the Combined Code every two years.²¹¹ In 2010, the UK Corporate Governance Code was published as the new name for the Combined Code while retaining its principles to a large extent. Since the start of the Combined Code in 1992, 'comply or explain' has gained the support of both shareholders and companies. It is fact that the scope of corporate governance code covers listed companies; however, private and unlisted companies are still encouraged to adopt the code's principles.²¹² Unlike hard law, there are several advantages to the Corporate Governance Code being a soft law, including flexibility, the ability of fast modification, the ability to adapt according to the company's

²¹¹ Ibid.

²¹² J Birds and others (eds), *Boyle & Birds' Company Law* (9th edn Jordans, Bristol 2014) Page: 362.

circumstances, and lastly, it is less costly.²¹³ In relation to the corporate management performance, it can be seen nowadays that the courts when handing down judgment they are progressively referring to corporate governance practices.²¹⁴ Therefore, the following paragraphs are an attempt to shed light on the development of the Combined Code since 1998, with more focus on the latest UK corporate governance code.

To start with, the Combined Code 1998 operates on the basis of the well-known concept of ‘comply or explain’, as mentioned earlier. There are two main sections that aim at covering two issues- companies and institutional investors. The Combined Code 1998 could be described as the Cadbury, Greenbury and Hampel reports combined. In 2003, the new revision of the Combined Code was published with the incorporation of the Higgs 2003 and Smith 2003 reviews. The chairman and the senior independent director’s role are clarified in the 2003 code, and independent non-executive directors must make up at least half of the larger listed companies boards. Three years later, the Combined Code’s new revision was published in June 2006, with three central changes, including, the allowance of the chairman of the company to serve only on the remuneration committee- not to chair- where is he or she is considered as independent, providing the option of ‘vote withheld’, and publishing the recommendation of proxies lodged at general meetings on the company’s websites. Two years later, the new revised Combined Code was published in June 2008 following the FRC’s review of the impact of Combined Code. The 2007 FRC review

²¹³ A Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' [2015] *Journal of Business Law* 551.

²¹⁴ D Milman, *Governance of Distressed Firms* (Edward Elgar Publishing, 2013) Page: 28.

found that there was general support from the 2006 Combined Code and the FRC would focus on practical application. The FRC published the UK Corporate Governance Code 2010, retaining the well-known ‘comply or explain’ approach and incorporating some of the Walker recommendations, as well as following the effectiveness of the combined code progress report of 2009. Notably, in the 2010 revision, ‘the Combined Code’ became ‘the Code’ thereafter.²¹⁵ Two years later, a revised version of the UK Corporate Governance Code was issued in 2012, which included changes to section B.2.4 and B6.²¹⁶

Moving to the current version of the UK corporate governance code which was issued in September 2014; like the 2012 version, the last version has the same five main sections, including: leadership, effectiveness, accountability, remuneration and relations with shareholders.²¹⁷ First of all, the FRC has adopted changes to some of the Code’s provisions, such as the requirement of making two separate statements, including the going concern statement ‘Provision C.1.3’ and a viability statement ‘Provision C.2.2’.²¹⁸ Thus, companies should make a statement about whether they take into account the appropriateness of adopting the going concern basis of accounting. Concerning risk management, the Code assures the risk assessment of the company's principal risks and explains how they deal with it or mitigate it, as well as

²¹⁵ C A. Mallin, *Corporate Governance* (4th edn Oxford University Press, 2013) Page: 34.

²¹⁶ *Ibid* Page: 36.

²¹⁷ *Corporate governance code* 2014.

²¹⁸ J Lewis, S Gado and B Dickinson, 'The UK Corporate Governance Code' (2014) 38 *Company Secretary's Review* 105.

stating whether the company believes it has the ability to continue working and achieve their liabilities under the main risks and current position; moreover, a minimum of one review of the company's effectiveness annually and reporting it in the annual report. In terms of remuneration, the key change was about adding more emphasis to ensuring the company's long-term success by designing remuneration policies, which is the remuneration committee's responsibility. Furthermore, arrangements should be made to enable the recovery or withholding of variable pay when needed. Moving on to shareholder engagement, in the case of a significant percentage of shareholders having voted against any resolution, during the publishing of the general meeting results, the company should explain the way in which it is intending to engage with shareholders.²¹⁹

3.2.3 Common Law

Unlike Scotland, English Law is based on common-law principles and applies in England, Wales and Northern Ireland. Common Law is derived from custom and judicial precedent. On the other hand, based on civil law principles, Scottish Law can be described as a pluralistic system combining civil law principles and elements of common law. Noticeably, some laws in England and Wales have recently become more like civil law, as a result in part of EU membership. The UK corporate governance regulations could be a reflection of the common law system, generally

²¹⁹ Financial Reporting Council, 'FRC Updates UK Corporate Governance Code' (FRC 2014) <<https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/September/FRC-updates-UK-Corporate-Governance-Code.aspx>> accessed 11/12/2015.

speaking, and how the UK has dealt with it.²²⁰ Noticeably, taking the corporate managers duties- including fiduciary duties- into consideration will lead to there being a crucial influence from the Common law rules on corporate governance development. The good faith and honesty fiduciary duty, alongside the care and skill duties, are obligations of companies' directors under the rules of common law's basis.²²¹

In fact, common law has played a crucial role in the context of corporate governance standards' development, as this section has shown. The fiduciary duties, duty of care in negligence, as well as giving judicial recognition to corporate governance codes are examples of what common law has done to develop corporate governance in the UK.²²² Some of the steps have been codified later on, such as what can be found in section 172 of the Companies Act 2006, which will be discussed in a later section.

3.2.4 Statutes

Corporate governance in the UK also consists of rules derived from statutes: the CA 1985, the CA 1989 and CA 2006 regarding directors' administrative duties such as

²²⁰ F Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 135.

²²¹ J Birds and others (eds), *Boyle & Birds' Company Law* (8th edn Jordans, Bristol 2011) Page: 595.

²²² There are many key cases relating to corporate governance and some of them have mentioned Cadbury report. See for example: *Re Astec (BSR) plc* [1998] 2 BCLC 556.

issues in regard to vote counting meetings being held.²²³ Perhaps the UK government's approach towards the corporate governance of listed companies can be described as a minimal standard approach. Accordingly, the Companies Acts and related legislative instruments may be described as being in alignment with the authorities' future view of the UK.²²⁴

In the context of statutes, there are other laws that need to be mentioned here, such as the Insolvency Act 1986, the Company Directors Disqualification Act of 1986 (“CDDA”) and the Financial Services and Market Act 2000. Firstly, the Insolvency Act 1986, contains an important issue with regard to the liabilities of directors of insolvent companies. Thus, criminal and civil liabilities will be imposed if the director of the company knew, or ought to have known, about insolvent liquidation that could not be avoided and still operates the company's business at the same time. The second Act is the Company Directors Disqualification Act 1986, which is intended to protect future generations of both shareholders and companies from the misconduct of managers. Gross incompetence, commercial morality standards violation, or even negligence, are examples of reasons for disqualifying managers. Therefore, the CDDA 1986 Act imposes penalties on disqualified managers who continue to act

²²³ F Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 148.

²²⁴ J P. Charkham and H Ploix, *Keeping Better Company : Corporate Governance Ten Years On* (2nd edn Oxford University Press, 2005) Page 297.

after the disqualification. Finally, FSMA 2000 serves the financial services industry by establishing a self-regulation structure.²²⁵

3.2.4.1 Companies Act 2006

A brief introduction to the Companies Act 2006 in this context is important to show the principal issues related to the legal and regulatory framework. Therefore, the following paragraphs will shed light on the main issues. The Company Law Reform Bill was published by the Government in November 2005 following the need for a revision of Corporate Law. Therefore, late 2006 witnessed the issuance of the Companies Act 2006, which to some extent has updated the previous legalisation and added some important new provisions.²²⁶ The Companies Act 2006 has many important features, such as the codification of directors' duties, the increasing usage of electronic communication with shareholders, and the limitation on directors' duties being agreed by shareholders. Moreover, proxy right enhancement will ease the process for shareholders in appointing others to attend general meetings and vote. In the context of institutional investors, the Companies Act 2006 provides the power to require them to disclose how they have used their vote, which has responded to the call over a number of years for institutional investors' voting disclosure. Thus, from

²²⁵ F Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 154.

²²⁶ *Companies Act 2006*.

the previous points, it can be seen very clearly that shareholders' rights have been improved in several ways by the Companies Act 2006.²²⁷

3.2.4.2 Section 172

Prior to the introduction of section 172, the directors of companies were subjected to the requirements of common law and fiduciary duties. One of the main fiduciary duty requirements concerns the directors exercising their powers in the best interests of the company; however, the evaluation of how the best interests of a company can best be served "is left to the business judgment of its directors and the courts are not prepared to review decisions which have been reached in the appropriate way".²²⁸

It may be said that section 172 of the Companies Act 2006 could be described as the 'successor' to some common law and fiduciary duties. Keay stated that, section 172 "has been the most controversial and challenging duty that has been introduced in the Act, and the one that has given lawyers, companies and their directors the most concern".²²⁹ Clearly, section 172 has shifted directors' duties into a codified statutory statement: "A director of a company must act in the way he considers, in good faith,

²²⁷ C A. Mallin, *Corporate Governance* (4th edn Oxford University Press, 2013) Page: 37-38.

²²⁸ A Griffiths, 'Regulating directors' self-dealing in a unitary board system of corporate governance: the role of the declaration required by the Companies Act 1985, s.317' (1997) *Company Financial and Insolvency Law Review* 95.

²²⁹ A Keay, 'The Duty to Promote the Success of the Company: Is It Fit for Purpose in a Post-Financial Crisis World?' in *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar Publishing, Inc.' 2012) Page: 54.

would be most likely to promote the success of the company for the benefit of its members as a whole”.²³⁰

Moreover, it states six matters that directors have to consider. Firstly, the long term likely consequences of a decision, as it is possible to say that section 172 requires directors to make their ‘decision-making’ more inclusive by imposing this duty on them;²³¹ secondly, the consideration of the interests of the employees; thirdly, enhancing the business relationships of the company with others, such as suppliers and customers; fourthly, taking into account the community and the environment; fifthly, maintaining the reputation of the company through high standards of business conduct, and lastly, recognising the necessity of acting fairly between members of the company.²³² However, it has been argued that section 172 could have more of an educational Impact rather than making a change. Again Keay states that section 172 “is not likely to make a lot of difference as far as the corporate governance issues that were problematic in the period leading up to the credit crunch and financial meltdown were concerned”.²³³ From the above discussion, it appears that section 172 has

²³⁰ *Companies Act 2006.*

²³¹ A Keay, 'The Duty to Promote the Success of the Company: Is It Fit for Purpose in a Post-Financial Crisis World?' *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar Publishing, Inc.' 2012) Page: 54.

²³² *Companies Act 2006.* See for examples: *John David Hedger (The Liquidator of Pro4Sport Limited) v David Adams* [2015] EWHC 2540 (Ch) and *Peter Hook v Bernard Sumner and Ors* [2015] EWHC 3820 (CH) as the Judge refer to section 172 of the Companies Act.

²³³ A Keay, 'The Duty to Promote the Success of the Company: Is It Fit for Purpose in a Post-Financial Crisis World?' *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar Publishing, Inc.' 2012) Page: 94.

importance and could be described as relevant to a large extent, taking into account some related cases such as *Re HLC Environmental Projects Ltd*, which have tackled the concern of the issue of enforcement.²³⁴ However, the fact that it still may be difficult to prove the breach under section 172 makes it merely encourage box ticking at board meetings for now. In fact, section 172 is not a magical solution for making the directors consider the other stakeholders immediately, which means section 172 would promote good governance in the long term by bringing about a healthier debate about English law in the context of promoting enlightened shareholder value.²³⁵

3.2.5 Small Business, Enterprise and Employment Act 2015

The Small Business, Enterprise and Employment Act 2015 provisions cover the responsibilities of many departments, including the Department for Business, Innovation and Skills, the Cabinet Office, HM Treasury, HM Revenue & Customs and the Insolvency Service. There are many motivations behind the introduction of the Small Business, Enterprise and Employment Act 2015. However, it is crucial for the UK to maintain worldwide recognition as an innovative and competitive oasis for small businesses, with opportunities and trust, and a fair environment in which to do business. Thus, the new Act ought to strengthen the current system, by introducing new rules to increase trust by obtaining and holding information about the company's

²³⁴ See for example: *HLC Environmental Projects Ltd, Re* [2013] EWHC 2876 (Ch). and *Odyssey Entertainment Ltd v Kamp* [2012] EWHC 2316 (Ch).

²³⁵ D Fisher, 'The enlightened shareholder - leaving stakeholders in the dark: will section 172(1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?' (2008) 20 *International Company and Commercial Law Review* 10.

owners and controllers; moreover, by providing new powers to the Treasury in order to cure possible directors' misconduct and unfair employment practices. Finally, for small businesses, there is a greater reduction in the burden, and for the issuing of administrative insolvencies, the new Act ensures a strong regulatory regime.²³⁶

The Small Business, Enterprise and Employment Act 2015 has made important changes and amendments to different core elements of the Companies Act 2006.²³⁷ It can be seen very clearly from section 87 that all company directors are required to be natural persons. Whereas, section 155 of the Companies Act 2006 used to require "companies required to have at least one director who is a natural person".²³⁸ The importance of this amendment in the context of corporate governance arises from the requirement of all company directors to be a natural person- not a legal person- which will make all the directors accountable, and they could be prosecuted personally. And so, this could prevent some of the company members from acting against the shareholders' interests.

3.2.6 Institutional investors

During the last half century, the balance of the market's dominant forces has changed due to the crucial changes to the securities' market circumstances. Institutional investors, such as pension fund and insurance companies, held about 34% of UK

²³⁶ *Small Business, Enterprise and Employment Act (2015) Explanatory notes.*

²³⁷ D Milman, 'Revisiting the Core Principles of Modern Corporate Law' (2015) 371 *Company Law Newsletter* 1.

²³⁸ *Companies Act 2006.*

equities in 1969.²³⁹ On the other hand, the last five decades has witnessed the decreasing of physical persons' direct ownership of public equity from 54% to 11% only.²⁴⁰ Institutional investors have taken the place of individual shareholders.²⁴¹ In terms of the recognition of the role and influence of institutional investors in the UK, this was identified in the early 1990s by the Cadbury Committee.²⁴² The Cadbury Committee requested institutional investors, as they hold a significant collective stake in ensuring "the companies in which they have invested comply with the Code".²⁴³

The impact of the institutional investors are clear and can be seen through the power of challenging the management of the companies, which sometimes reaches the level of forcing the CEO to leave his or her post. This could be as a result of the institutional investors' attention being paid towards the company's performance in its portfolio. Institutional investors could show their fury in the case of unpopular decisions being taken by management, or unsatisfactory performance by the company. Having a large bundle of stock makes institutional investors willing to work more as corporate monitors, as the liquidity of investment is more difficult. In other

²³⁹ J. E. Parkinson, *Corporate Power and Responsibility : Issues in the Theory of Company Law* (Clarendon Press, 1993)Page: 166.

²⁴⁰ S Çelik and M Isaksson, 'Institutional Investors and Ownership Engagement' (2014) 2013/2 OECD Journal Financial Market Trends 93.

²⁴¹ Y Zhao, 'Competing Mechanisms in Corporate Governance: Independent Directors, Institutional Investors and Market Forces' (2010) 21 International Company and Commercial Law Review 338.

²⁴² C A. Mallin, A Mullineux and C Wihlborg, 'The Financial Sector and Corporate Governance: The UK Case' (2005) 13 Corporate Governance 532.

²⁴³ Cadbury Committee, *The Financial Aspects of Corporate Governance* (Gee, 1992).

words, "illiquid investors are “trapped” in the company" which creates concerns about the company's performance as an act of self-interest.²⁴⁴ Parkinson believed that: “institutions in many cases are locked into their portfolio companies and therefore have an incentive to play an active supervisory role, rather than merely selling, if they become dissatisfied with company performance.”²⁴⁵

Obviously, the directors of companies should understand the fact that institutional investors nowadays are monitoring their performance. It should be mentioned in this context, in the capital market, that the share prices of a company could be the 'barometer' that shows the efficiency of the management in achieving the stakeholders' goals. Therefore, if the company's price is lower than it should be, if the management was more talented, that would make the company more likely to be attractive for takeover. From this point of view, the 'market for corporate control' term refers to the transferring process of ownership and control from one group of investors and managers to another, as stated in the OECD glossary of statistical terms.²⁴⁶ So, to have the right to vote on a new board of directors, there is the need to buy enough shares in order to replace the current ineffectual management so that the share prices of the company could rise due to corporate performance. The benefit of this is reflected in many things, such as market discipline for the managers, as well as

²⁴⁴ Y Zhao, 'Competing Mechanisms in Corporate Governance: Independent Directors, Institutional Investors and Market Forces' (2010) 21 *International Company and Commercial Law Review* 338.

²⁴⁵ J. E. Parkinson, *Corporate Power and Responsibility : Issues in the Theory of Company Law* (Clarendon press, 1993) Page: 167.

²⁴⁶ OECD glossary of statistical terms. Available at <https://stats.oecd.org/glossary/detail.asp?ID=3255> . Accessed 10/3/2016.

the capital markets, robust competition, market discipline and labour markets.²⁴⁷ In the context of institutional investors, who are described as ‘a new class of professional shareholders’, they have the opportunity in the ‘market for corporate control’ to carry out the functions of corporate governance: “the best people to carry out or at least to supervise the functions of corporate governance”.²⁴⁸ However, the market for corporate control may not always be the best solution, especially for emerging economies and developing countries, for example in the case of India which “is a poor avenue through which institutional investors may attempt to hold the company's controllers accountable.”²⁴⁹

On the other hand, “in large companies small shareholders are too disorganised and powerless to impose their will”.²⁵⁰ Thus, the individual shareholders’ traditional problem with inter-shareholder communication deficiencies and free riding is being overcome by the institutional investors who monitor their ability to collectively organise in order to impose pressure on the company’s management. The way of institutional investors achieving this power is by forming a majority voice, which is as

²⁴⁷ J Macey, 'Market for Corporate Control' (library of economics and liberty 2008) Available at: <<http://www.econlib.org/library/Enc/MarketforCorporateControl.html>> accessed 10/3/2016.

²⁴⁸ T Hadden, *Corporate Governance by Institutional Investors? Some Problems from an International Perspective* (Institutional Investors and Corporate Governance, de Gruyter, 1994) Page: 89.

²⁴⁹ A Paranjpe and K Shorewala, 'Institutional Investors, Corporate Governance and Global Standards: An Indian Perspective' (2011) 22 *International Company and Commercial Law Review* 135.

²⁵⁰ A Keay, 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders' [2007] *Journal of Business Law* 656.

a result of co-ordinating their responses.²⁵¹ By bringing about the concentration of ownership, institutional shareholder ownership could be the indirect solution to the 'free rider' problem when shareholders are not active and are 'taking a backseat' and gaining benefits from other active shareholders' work.²⁵²

Regarding the UK Stewardship Codes which were issued in 2010 as the first iteration, followed by a second issue in 2012, the aim is to promote the long term success of companies, as stated in the 2010 version, and to help the shareholders' long-term returns improvement and governance exercises' efficiency by enhancing the quality of engagement between institutional investors and companies, as mentioned in the 2012 UK Stewardship Code. Obviously, the UK Stewardship Code is seen as being complementary to the UK Corporate Governance Code, and shares the 'comply or explain' basis as well. Moreover, the FRC has included many areas of good practice in the 2012 UK Stewardship Code for institutional investors. However, in the view of Cheffins, "the Code is unlikely to foster substantially greater shareholder involvement in UK corporate governance."²⁵³

²⁵¹ Y Zhao, 'Competing Mechanisms in Corporate Governance: Independent Directors, Institutional Investors and Market Forces' (2010) 21 *International Company and Commercial Law Review* 338.

²⁵² C Nyombi, 'A Critique of Shareholder Primacy under UK Takeover Law and the Continued Imposition of the Board Neutrality Rule' (2015) 57 *International Journal of Law & Management* 235.

²⁵³ B R. Cheffins, 'The Stewardship Code's Achilles' Heel' (2010) 73 *The Modern Law Review* 1004.

3.3 The United Kingdom corporate governance institutional framework

3.3.1 Financial Conduct Authority

Another important player in the corporate governance institutional framework in the UK is the Financial Conduct Authority. However, there is a relationship between the FCA and the FSA that should be mentioned briefly in the context of the Financial Conduct Authority. The FSA was an independent non-governmental body funded by the firms that are regulated by it, and accountable to Treasury Ministers and Parliament. Under the Financial Services and Markets Act 2000 (FSMA), the Financial Services Authority (FSA) had statutory powers. However, these powers have been replaced by the introduction of the FCA, as the FSA –which has been in operation since the 1997- became two separate regulatory authorities in 2013. Sections 3-6 of FSMA 2000, which was amended by the FSA 2010, has illustrated its regulatory objectives, including market confidence, financial stability, consumer protection and reduction of financial crime, as well as "Contributing to the protection and enhancement of the stability of the UK financial system".²⁵⁴ Generally speaking, in terms of supervising and managing the financial services industry and banking, 'a new regulatory framework' has been created through the introduction of the Financial

²⁵⁴ I MacNeil, *An Introduction to the Law on Financial Investment* (2nd edn Hart, 2012) Page: 71.

Services Act 2012.²⁵⁵ So, one of the FSA tasks was overseeing the compliance with 2006 Code.²⁵⁶

In terms of admitting securities to listings as well as making the Listing Rules and supervising compliance, the competent authority in the UK was the LSE until May 2000. However, the Financial Services Act 1986 has been replaced by the issuance of the Financial Services and Markets Act 2000. Thus, the Listing Authority has been passed to the Financial Services and Markets Act 2000 as stated in section 72, and remained so for around 13 years, ending with the introduction of the Financial Services Act 2012. In fact, the introduction of the Financial Services Act 2012 could be a reflection of the regulatory reforms that followed the start of the financial crisis in 2007. Therefore, the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) are the new two regulatory bodies which were previously the FSA.²⁵⁷ The Financial Conduct Authority has inherited the responsibility of the UK Listing Authority.²⁵⁸

²⁵⁵ J Roberts and E Tran, *Financial Services Act 2012: A New UK Financial Regulatory Framework* (Harvard Law School, Harvard 2013).

²⁵⁶ P Yeoh, 'Corporate Governance in the UK: A Time for Reflection' (2015) 36 *Business Law Review* 130.

²⁵⁷ It is worth mentioning in this context of the Prudential Regulation Authority that in 8 April 2016, the PRA imposed a fine of 1.385 million pounds on Qatar Islamic Bank QIB UK for failings in reporting its financial resources to the regulator in 2011 and 2012. See: <http://www.bankofengland.co.uk/publications/Pages/news/2016/044.aspx> for more details.

²⁵⁸ A Dignam and J Lowry, *Company Law* (8th edition edn Oxford University Press, 2014) Page: 70.

Moving on to the FCA, the impact of an institution like the FCA will be reflected in the financial markets and the business environment, as the goal of the FCA is to make sure that a fair deal will be available to consumers. The FCA's approach to achieving this is by ensuring the good working of the financial markets. First of all, this involves ensuring the integrity of firms in the financial industry; secondly, supplying consumers with suitable services and products, and finally, increasing the trust that firms are working in the best interest of consumers.²⁵⁹ More than 70,000 businesses are currently regulated by the FCA, including many of them being under consideration of whether they meet prudential standards, in order to decrease the chance of potential harm being caused if they fail, for both consumers and the industry.

In order of giving authorisation, the first step taken by the FCA is to assess the firm or individual, and whether they will meet the expectations of the FCA, and the risk that will be posed to the objectives of the FCA. Therefore, if the firm or individual does not meet the standards of the FCA, they will be prevented from entering the market. Practically, the FCA's early intervention, when poor behaviour has occurred in the firm or by an individual under the FCA's supervision, would prevent the harm from reaching consumers and markets. One of the FCA's objectives is to make sure "consumers are at the heart of a firm's business".²⁶⁰ The FCA enforcement powers are used to prevent firms and individuals who do not follow the FCA rules from reaching the stage where damage could occur to confidence in the financial markets, consumer

²⁵⁹ Financial Conduct Authority official website, 'Financial Conduct Authority' (FCA 2015) <<http://www.fca.org.uk/about>> accessed 1/9/2015.

²⁶⁰ Ibid.

interests, or the integrity of financial markets.²⁶¹ In the context of the linkage between corporate governance and the business environment, the FCA plays a crucial role in enhancing the market's integrity in order to have transparent and open markets in which consumers can place their trust. The FCA does that by supporting the financial system, which can be described as successful and healthy.²⁶² It is not one of the FCA roles to assess the companies' responses to corporate governance code. However, while it could be difficult to assess the occurrence of contravention, FCA could "penalise a failure to comply or explain on the basis that it would be a contravention of the Listing Rules".²⁶³

The influence of the FCA goes beyond being local to the UK only, to involving not only European countries, but also on the international level. The fact that the financial markets of the UK, in terms of integrity, rely on the European and international financial systems' security and activity, makes its involvement in this influence of international policy important. Given that, European policy developments play a crucial role in some of the UK markets and wholesale regulations.²⁶⁴ There are several examples of the FCA's contribution towards multilateral forums and policy

²⁶¹ Both the rules and practices of good corporate governance ensures the principles of accountability, transparency and fairness which help to ensure integrity of financial markets. See: B Witherell, 'Corporate Governance and Responsibility: Foundations of Market Integrity' (2003) OECD Observer 7.

²⁶² Financial Conduct Authority official website, ' Our approach to regulation ' (FCA 2015) < <http://www.fca.org.uk/about/what/regulating> > accessed 1/9/2015.

²⁶³ A Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' [2015] Journal of Business Law 551.

²⁶⁴ Financial Conduct Authority official website, ' Enhancing market integrity ' (FCA 2015) <<http://www.fca.org.uk/about/what/enhancing-market-integrity>> accessed 15/8/2015.

making processes, for example the Financial Stability Board (FSB), the International Organisation of Securities Commissions (IOSCO), and the Basel Committee on Banking Supervision (Basel).²⁶⁵ In fact, there is an important issue with regard to the FCA being an independent body (in comparison to the Saudi institutional framework).²⁶⁶ Being a completely independent body means the FCA is not funded by the Government; the FCA instead receives funding from the fees of the firms that are regulated by the FCA by performing the firms' financial activities. However, the FCA is accountable to the Treasury.²⁶⁷

3.3.3 Financial Reporting Council

One of the factors that contribute towards the economy's health and growth is the capital markets. Accordingly, establishing an institution that helps to give more confidence to investors, such as the Financial Reporting Council, is a matter of urgency. So for that reason the Financial Reporting Council has established and "officially took over the role of reviewing and updating the UK Corporate Governance Code".²⁶⁸ However, reaching this reasonable confidence should have a solid basis of four elements, according to the FRC, including: 1- effective boards with

²⁶⁵ Financial Conduct Authority official website, ' International ' (FCA 2015) < <http://www.fca.org.uk/about/what/international> > accessed 15/8/2015.

²⁶⁶ The Capital Market Authority in Saudi Arabia for example is a government institution and linked directly to the prime minister 'the King' which will be discussed later more details.

²⁶⁷ Financial Conduct Authority official website, ' International ' (FCA 2015) < <http://www.fca.org.uk/about/what/international> > accessed 15/8/2015.

²⁶⁸ P Yeoh, 'Corporate Governance in the UK: A Time for Reflection' (2015) 36 Business Law Review 130.

good communication 2- reporting, accounting, actuarial standards and auditing accompanied with effectiveness and robustness 3- assurance reports, annual reports and accounts with reliability 4- accountancy and actuarial professions that are regulated perfectly.²⁶⁹

Needless to say, the issue of fostering investment and the business environment is crucial in corporate governance and one of its important goals. Therefore, it is very important in this context to shed light on the UK's independent regulator 'The Financial Reporting Council' who has the responsibility of fostering investment by promoting high quality corporate governance and reporting. And of course, the UK Corporate Governance Code is the instrument that is used by the FRC to foster high standards of corporate governance. It is not only responsible for setting standards for auditing and corporate reporting, but one of the key functions of the FRC is to supervise the regulatory activities of the actuarial profession alongside professional accountancy bodies. Also, for public interest cases involving accountants and actuaries, the FRC operates independent disciplinary arrangements, according to the FRC's official website.²⁷⁰ However, assessing the responses of companies to the provisions of the corporate governance code is not the Financial Reporting Council or any other UK regulatory body role.²⁷¹

²⁶⁹ Financial Reporting Council, 'The Frc and Its Regulatory Approach' (The Financial Reporting Council Limited, London 2014).

²⁷⁰ Financial Reporting Council, 'Who Are We and What We Do' (The Financial Reporting Council Limited, London 2015).

²⁷¹ A Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' [2015] *Journal of Business Law* 551.

The FRC approach to fostering investment is by promoting high quality corporate governance and reporting, which requires eight steps to accomplish: **First of all**, in order to improve the way of running companies, which has a direct impact on fostering trust, there is the Corporate Governance and Stewardship codes' maintenance. **Secondly**, as promoting understandable, balanced, fair, clear and concise reports is a very important issue, one of the FRC's roles concerns corporate governance standards- their implementation and monitoring. **Thirdly**, is the goal of enhancing confidence in the audit's value and quality by developing standards and behaviour. **Fourthly**, the FRC supervises standards that support high quality actuarial practice, along with competency, transparency and the integrity of the actuarial profession. **Fifthly**, operating an investigative organisation that is independent, proportionate and effective, as well as disciplinary procedures and monitoring in order to protect accountants, and the integrity of auditors and actuaries. **Sixthly**, both in the UK and internationally, the FRC influences key developments in issues that have an impact on stakeholders. The **seventh** point is that the FRC ensures responsiveness to stakeholders' needs through continuous engagement at each stage of the process. **Finally**, the FRC has its own Financial Reporting Lab that operates to promote improvements to reporting through the collaboration between companies and investors together.²⁷²

²⁷² Financial Reporting Council, 'Who Are We and What We Do' (The Financial Reporting Council Limited, London 2015).

3.4 Conclusion

It is generally accepted that, just like legal systems vary from one country to another, the variety of corporate governance approaches are a result of various factors, such as the history, culture, politics and traditions of a country. Generally speaking, path dependency theory could aid an explanation in this context.²⁷³ There is no doubt that, in the GCC countries and especially Saudi Arabia, religion may be the principal influence. However, there are other important factors that could explain the Westernisation of some aspects of Company Law. Facchini has described this as a “double institutional dependence path”, and he believes that the economic freedom of the GCC is more of a British influence.²⁷⁴ Even so, it is widely accepted that there is the need for an effective and consistent corporate governance system across borders. The demand for this is motivated by two important factors: Firstly, the fact that investment and business are of a growing international nature nowadays; secondly, the corporate scandals’ regulatory responses. Therefore, comparability and harmonisation of standards could be an important solution to reducing the possibility of confusion and complications. However, it is a fact that a unified corporate governance system will not be suitable for all countries across the world, taking into account legal and cultural differences. Yet this fact is not an obstacle to the

²⁷³ O Hathaway, 'Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System' (2001) 86 Iowa Law Review 601.

²⁷⁴ F Facchini, 'Economic Freedom in Muslim Countries: An Explanation Using the Theory of Institutional Path Dependency' (2013) 36 European Journal of Law and Economics 139.

“opportunities for commonly accepted practices to encourage more efficient global capital markets”.²⁷⁵

Therefore, the United Kingdom’s evolving jurisprudence, with over 10 centuries of legal evolution, has resulted in what could be described as a unique legal system. It can be seen very clearly through the last annual report of Developments in Corporate Governance and Stewardship 2014, which was issued in January 2015, that: "The UK is a market which attracts capital as a result of confidence in a sound governance framework and associated practices, combined with flexibility and the ability to innovate".²⁷⁶ This chapter has shown that UK corporate governance has attracted the attention of researchers in many parts of the world as a result of the outstanding UK approach. It has been described as highly developed and stringent, not only in comparison with the UK’s European neighbours’ markets, but also to many parts of the world. In the opinion of Cheffins, “the work which has been done in the United Kingdom has spurred reviews of corporate governance in markets around the world and has provided a yardstick against which investment frameworks in other countries are measured.”²⁷⁷ Therefore, the importance of taking the UK as an example is very clear in this context. However, it is true that a good unified corporate governance system is not a magical solution that can be applied to all countries across the world

²⁷⁵ K Wearing, *Effective Corporate Governance Framework: encouraging Enterprise and Market Confidence* (Beyond the Myth of Anglo-American Corporate Governance, Institute of Chartered Accountants in England & Wales, 2006).

²⁷⁶ FRC, 'Developments in Corporate Governance and Stewardship 2014' (The Financial Reporting Council Limited, London 2015).

²⁷⁷ B R. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan Via Toronto' (1999) 10 *Duke Journal of Comparative and International law* 5.

due to several reasons, such as the legal and cultural differences between one country and another. But, this fact is not an obstacle to the “opportunities for commonly accepted practices to encourage more efficient global capital markets”.²⁷⁸

This chapter has shown how the framework of UK corporate governance is shaped by different levels of regulations, such as common law and statutory rules, alongside internal measures and structures. The rich developmental process of the corporate governance code in the UK has added to its effectiveness and value, starting with the well-known Cadbury Committee to passing revisions to the code, and the importance of this is clear in the context of this thesis. The series of corporate governance committees, reports and reviews provide an example of the non-stop effort paid toward this important issue, which could reflect the impact on many aspects of life, including the business environment. However, some researchers think that adopting the UK approach to corporate governance is narrow and focuses more on the company’s internal structure with the main goal of the shareholders and their profit maximisation “One limitation of corporate governance in the UK is the arguably narrow perspective that has been adopted”.²⁷⁹

This chapter has also identified the main regulatory bodies such as Parliament, and the institutional framework such as the Financial Reporting Council and the Financial Conduct Authority. Also, the Small Business, Enterprise and Employment Act 2015,

²⁷⁸ K Wearing, *Effective Corporate Governance Framework: encouraging Enterprise and Market Confidence* (Beyond the Myth of Anglo-American Corporate Governance, Institute of Chartered Accountants in England & Wales, 2006).

²⁷⁹ J Birds and others (eds), *Boyle & Birds' Company Law* (9th edn Jordans, Bristol 2014) Page: 371.

and the role of institutional investors, and their power to challenge the management of the companies has been covered in order to evaluate and draw lessons to improve the current rules and regulations framework of corporate governance in Saudi Arabia. Having pointed out in this chapter that Western style law is very important for the evaluation of the current rules and regulations framework of corporate governance in Saudi Arabia, some aspects of the comparison may be quite broad.²⁸⁰

Sharia is the supreme law in Saudi Arabia, and the influence of Sharia goes beyond being a supreme law to impact on many aspects of life in Saudi Arabia in particular, and the rest of the GCC countries as well, with different levels of influence. Furthermore, there is growing attention being paid towards the Sharia economic system, which to a large extent has overlapping issues with the concept of corporate governance in general. From this point, the next chapter will attempt to illustrate the concept of corporate governance from an Islamic perspective and the Sharia business principles and ethical frameworks. Moreover, the next chapter will discuss the issue of Sharia- as a supreme law of Saudi Arabia- and the potential to adopt new concepts such as corporate governance; also, if there any areas of conflicts, how these will have an impact on the Saudi legal system if found.

²⁸⁰ N H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 European Business Organization Law Review 3.

4. Chapter four: Sharia and corporate governance

4.1 Introduction

It is accepted that there is increasing attention being paid towards the Sharia economic system. This growing interest goes beyond Islamic countries, and is found throughout many parts of the world. Recently, the United Kingdom was the first country, outside the Muslim world, to host the World Islamic Economic Forum which known as the Islamic Davos.²⁸¹ The UK Government is aiming to boost the Islamic finance sector by new moves, such as offering products and services which are compatible with the principles of Islamic finance, for example issuing Islamic bonds ('sukuk'). Moreover, the announcement of a new Islamic index by the London Stock Exchange Group, in addition to the previous reforms, is making London the Islamic finance foremost Western centre.²⁸² This reflects the important role played by Islamic economic ideas in the international banking and finance system nowadays, which could be explained by the huge geographical area stretching to cover about 75 countries, with around 600 Islamic financial institutions at the end of 2012.²⁸³

²⁸¹ B Moldakhmet and others, 'Islam in Kazakhstan: Modern Trends and Stages of Development' (2012) 6 International Journal of Social, Behavioral, Educational, Economic, Business and Industrial Engineering 957.

²⁸² F Manjoo, 'Is London Ready to Become a Financial Hub of Islamic Finance?' (2016) 37 Company Lawyer 69. See also: R Wigglesworth and E Moore, 'Cameron aims to boost Islamic finance' *Financial Times* (London 29 October 2013).

²⁸³ DA Trakic, 'Malaysian two-tier Shari'ah governance framework for Islamic financial institutions: what does the Malaysian model offer?' (2013) Journal of International Banking Law and Regulation 89.

It is fact that not all Islamic countries (including some Gulf Cooperation Council countries) are implementing Islamic law as the law of the state. However, many Islamic countries are implementing aspects of Sharia and are influenced by the Sharia in many walks of life.²⁸⁴ Sharia in some Islamic countries could be described as the legal root that shapes the legal framework of the law. Consequently, these points illustrate the importance of this chapter for the analysis and the discussion of Sharia and its relation with corporate governance in one hand, and the corporate governance in the context of Saudi Arabia and GCC in general.

Historically, nearly all Islamic countries were applying Sharia until the middle of the nineteenth century with regard to obligations and contract law.²⁸⁵ However, it is important to mention that, in the view of Saleh, Islamic law in this regard is a combination of revealed law, different sects' and schools' teachings, customary practice and "an inevitable measure of foreign influence and alterations impelled by performance and the passage of time."²⁸⁶ After that, Western law came to influence some aspects of law in some Muslim countries such as India and the Ottoman empire, which caused a composite legal system that is still in the process of adaptation until now. This composite legal system, according to Saleh, may be described as not always being systematic.²⁸⁷

²⁸⁴ L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' [2010] *Journal of Business Law* 126.

²⁸⁵ AS Muhammad 'International arbitration contract principles: analysis of Middle East perceptions' (2010) 9 *Journal of International Trade Law & Policy* 148.

²⁸⁶ NA Saleh, 'Financial transactions and the Islamic theory of obligations and contracts' in C Mallat (ed) *Islamic law and finance* (Graham & Trotman, London 1988) Page: 13.

²⁸⁷ *Ibid* Page: 14.

Some argue that Sharia has lost - in some legal aspects, such as business law- its sovereignty in some parts of the Islamic world, including the Gulf States nowadays. For example, Qatar, the UAE, Kuwait and Bahrain could be described as supporting 'dual commercial tracks'. Moreover, in Saudi Arabia- where Sharia is the law of the state- and Oman the situation is described as "curtailing the Shari'a's ascendancy significantly".²⁸⁸

However, despite some breaches and various critiques by some researchers²⁸⁹, it may be argued that countries like Saudi Arabia are evidence to deny this argument, as the fundamental legislative text has stated that any article of the law "must not prejudice against the requirements of Shariah" or must be "in accordance with Sharia" in many of the royal decrees and laws issued, such as the Company law. The question of adapting will be discussed in further sections²⁹⁰.

It is clear that not all business transactions and industrial economic sectors are included in 'traditional' Sharia. In the context of the GCC in particular, and the Arab world in general, there is a real need for new rules and regulations; therefore, they have adopted many rules and regulations from either French or English law.²⁹¹ It is, however, important to note that in the case of Saudi Arabia the legislators have also adopted new rules and regulations from other countries such as Egypt, or from other

²⁸⁸ AS Muhammad 'International arbitration contract principles: analysis of Middle East perceptions' (2010) 9 *Journal of International Trade Law & Policy* 148.

²⁸⁹ See NA Saleh, 'Financial transactions and the Islamic theory of obligations and contracts' in C Mallat (ed) *Islamic law and finance* (Graham & Trotman, London 1988) Page: 15 for example.

²⁹⁰ See Chapter 4 section 3.

²⁹¹ B Al-Haddab and GV Puig, 'The protection of minority shareholders in the Gulf Cooperation Council' (2013) 13 *Journal of Corporate Law Studies* 123.

Western countries. The distinguishing point here is that the Sharia remains as the supreme law in Saudi Arabia, and the legislators' work is always in accordance with Sharia principles ; this means the rules must not “contravene the spirit of Islamic law”²⁹². It is important, however, not to assume the applicability of Sharia in all cases in Saudi Arabia.

There is, however, a further point to be considered. Puig and Al-Haddab, claim that for religious reasons and to avoid its secular connotations, the term "law" in Saudi Arabia may be seen as problematic, so using Sharia is more appropriate for these reasons in such a country.²⁹³

Academic interest in corporate governance over the last three decades has also witnessed rapid growth.²⁹⁴ Corporate governance has attracted the attention of the GCC countries, and Saudi Arabia in particular - where Sharia is the law of the state - as in many other parts of the world. The relationship between corporate governance and Sharia in this rapidly changing world needs to be addressed as a matter urgency.

This chapter attempts to shed light on the concept of corporate governance in Sharia. This chapter is divided into eight sections. The first section is an introduction to show the importance of this chapter in this thesis. Then, it may be best to start discussing corporate governance from an Islamic perspective, to examine if there is an accepted

²⁹² Ibid.

²⁹³ B Al-Haddab and GV Puig, 'The protection of minority shareholders in the Gulf Cooperation Council' (2013) 13 Journal of Corporate Law Studies 123.

²⁹⁴ A Dignam and M Galanis, 'Corporate Governance and the Importance of Macroeconomic Context' (2008) 28 Oxford Journal of Legal Studies 201.

definition of this new concept in Sharia, by focusing on Sharia business principles and ethical frameworks.

Needless to say, efficiency in the adaption of law and legal systems for contracting needs is essential; therefore, another point to mention about Sharia law is the potential to adapt. Thus, the third section will deal with the possibility, if at all, of Sharia to adapt to new concepts, using 14th century sources- the holy Quran, Sunnah, and 'Fiqh' (Jurisprudence). The Islamic fiqh, which was established in the light of the Sharia sources through the effort of the Sharia scholars, can be divided into four main schools.²⁹⁵

Sharia has its own type of sharikah which means, in its simplest form, a sharing between two or more parties. Section four of this chapter is an attempt to explore the sharikah rules, regulations and types, such as alamlak and aloqoud on the one hand, and the prohibited financial transactions, such as riba, gharar and maisir on the other hand.

Understanding the influences of Sharia and religion on directors and management in general is very important as a "Moslem administrator is more likely to be influenced in his thinking, behaviour, and lifestyle by his religious beliefs".²⁹⁶ Management from a Sharia point of view includes the concept of shura 'consultation' and this chapter will examine the gap between the theory of this concept and current practice.

²⁹⁵ There are four main schools of thought, which are Hanafi, Maliki, Shafi'i and Hanbali who have some minor differences in general. However, in all four schools, Shari'a principles remain the same. Sunny schools will be discussed in more details 4.3.3.2.

²⁹⁶ S Abuznaid, 'Islam and management: What can be learned?' (2006) 48 Thunderbird International Business Review 125.

Responsibility from a Sharia point of view, and its legal root in Sharia and the jurisprudential rules, will be discussed in the fifth section; including issues such as alwakalah and aldhman, taking into account the Saudi Arabian case where the Sharia is the law of the state.

The issues of reward and delegation also are a significant topic, which indicates the need to understand them in the context of Sharia and corporate governance. Section six is an attempt to address the reward and delegation from a Sharia point of view. The acceptable limits of directors' rewards and remuneration in Sharia will be explained. On the other hand, nowadays, companies vary in terms of their shareholder profiles and in terms of the type of company. Indeed, this issue and the basic types of sharikah in sharia indicate the need to understand if there is room in Sharia to cope with the new types of company. So, from this point, the delegation in Sharia will be examined in this section, taking into account the Saudi Arabian case.

The importance of this chapter 'Sharia and corporate governance' is clear, since one of the research questions of this thesis is an attempt to analyse the legal and regulatory frameworks of the Saudi Arabia, which have a direct effect on the business environment of Saudi Arabia and the rest of the GCC countries. Interestingly, the GCC Countries in general, and Saudi Arabia in particular, have a business environment that may be described as one of the most attractive in the world. On the other hand, the legal and regulatory system can be seen as very important in the context of corporate governance framework, and as mentioned above, Sharia has influenced all of life's aspects and the legal framework of the law in many Islamic countries including GCC countries. Furthermore, Sharia is the law of the state of Saudi Arabia- the biggest among the GCC countries.

Finally, as the scope of Sharia is very wide, this chapter cannot provide a comprehensive review of all Sharia aspects. However, it is an attempt to shed light on the main issues that should be covered in the context of corporate governance from a Sharia perspective.

4.2 The Sharia perspective of corporate governance

First of all, it is important to understand that, in Sharia, there is latitude for governments to produce rules to regulate human activity, even though certain Sharia rules and principles exist already. However, these rules or principles must not violate the Islamic legislation that has been “established by Muslim scholars in light of the Holy Quran and the Sunna”²⁹⁷.

Protecting the rights of all parties is one of the most significant targets of corporate governance, and Islam supports every procedure that aims to achieve this, providing it does not violate Islamic law. Thus, concerning corporate governance, “the concept is not essentially strange to Islam.”²⁹⁸ The importance of the Islamic business perspective is clear, as there is increasing attention being paid towards Islamic banking. Moreover, there are many Islamic countries around the world which implement aspects of Sharia. Even for the rest of the Islamic countries where Sharia is not used as law for business or other aspects, the influence of Islam is very clear in all of life’s aspects.²⁹⁹

²⁹⁷ M Almadani, 'The role of Sharia law in protecting minority shareholders in private companies' (2010) 21 International Company and Commercial Law Review 395.

²⁹⁸ 'Islamic finance in the spotlight' (2009) Banker, Middle East . Available at <http://search.proquest.com.ezproxy.lancs.ac.uk/docview/232390090?accountid=11979>.

²⁹⁹ L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' [2010] Journal of Business Law 126.

4.2.1 Corporate governance - a definition from an Islamic perspective

Corporate governance has many definitions depending on the perspective, although in general it is about safeguarding all parties' rights. The definition of corporate governance at its simplest can be described as: "corporate governance is the system by which companies are directed and controlled"³⁰⁰. Furthermore, the conventional definition does not differ much from the Islamic perspective of corporate governance as a concept.³⁰¹

There are two aspects which shape Islamic corporate governance's nature in the view of Lewis. The **first** one is the sovereignty of sharia over all aspects of life- civil jurisdiction and criminal aspects - along with ethical and social aspects as well. The **second** one is financial and Islamic economic principles like the prohibition of riba (usury) and the imposition of zakat, which directly affects the policies and practices of companies in addition to the ensuring of business ethics.³⁰²

Consistent with Alkhodiry, administrative work based on elements of Islamic doctrine provides restrictions and limitations, and forms a path which controls the leader's conduct; the organisation, and the employees. This system is based on the Islamic faith controlling their relationships with each other, and their relationship with the community. Therefore, the comprehensive message of administration from an Islamic

³⁰⁰ Cadbury Committee, *The financial aspects of corporate governance* (Gee, 1992).

³⁰¹ Z Hasan, 'Corporate Governance : Western and Islamic Perspectives' (2009) 5 *International Review of Business Research Papers* 277.

³⁰² M Lewis, 'Islamic Corporate Governance' (2005) 9 *Review of Islamic Economics* 5.

view uses an integrated framework containing transactions, ethics and worship, which are impossible to be separated from each other.³⁰³

The previous definition could be used for corporate governance as it focuses on the relationships between all parties and the processes for controlling these to avoid any conflict of interest, taking into account the role of Islamic principles, which are: justice, responsibility, accountability and transparency, to ensure the effectiveness of this system.³⁰⁴

4.2.2 Sharia business principles

One of the five basic human interests which are protected by Sharia law is **property**, and from the main sources, there are many verses in the Quran and many sayings of the Prophet Muhammad (pbuh) that deal with the Islamic view towards money. Accordingly, muslim jurists developed a commercial law system which could be described as a sophisticated system of commercial law in the words of Foster.³⁰⁵

Islam as a religion goes beyond simply religious rituals, as it deals with all of life's aspects. Business, for example, must be conducted in accordance with Sharia, and some business transactions are prohibited; riba for instance.³⁰⁶ Verse number 29 of

³⁰³ M Alkhodairy, 'Management thought in Islam' in M Albourey and M Morsi (eds), *Management in Islam* (The Islamic Development Bank, Islamic research & training institute, Jeddah 2001) Page: 145.

³⁰⁴ C Bourakba, 'Corporate governance In Islamic Banks' King AbdulAziz University.

³⁰⁵ N H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 *European Business Organization Law Review* 3.

³⁰⁶ AM Abu-Tapanjeh, 'Corporate governance from the Islamic perspective: A comparative analysis with OECD principles' (2009) 20 *Critical Perspectives on Accounting* 556.

Surat An-Nisa is translated as: “Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent”, and verse number five from Surat An-Nisa is translated as: “And give not unto the foolish your property which Allâh has made a means of support for you”³⁰⁷ which indicates the importance of money management and that it should be assigned to someone qualified.

Sharia business principles involve “calling for the development of an economic system based on profit and loss sharing”³⁰⁸. Despite the fact that the Islamic economy and conventional economy perform mostly similar functions "there is always a distinct unique form of differences between both the principles they implement"³⁰⁹.

Islamic corporate governance pays more attention to moral and ethical issues, which can be seen very clearly in the text of the Quran and Sunnah. Miles and Goulding think that, there is concern about the lack of a moral dimension in today’s business conduct, which may be one of the reasons for the growing attention towards Islamic business principles.³¹⁰ During the peak of Islamic civilization, the Islamic financial

³⁰⁷ Sûrat An-Nisâ’ Verse Five and verse 29, Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

³⁰⁸ M Lewis, 'Islamic Corporate Governance' (2005) 9 *Review of Islamic Economics* 5.

³⁰⁹ AM Abu-Tapanjeh, 'Corporate governance from the Islamic perspective: A comparative analysis with OECD principles' (2009) 20 *Critical Perspectives on Accounting* 556.

³¹⁰ L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' [2010] *Journal of Business Law* 126.

system was at the height of prosperity, and the principles of corporate governance may not have been alien to the Islamic financial system.³¹¹

4.2.3 Corporate governance from a Sharia perspective

An Islamic ethical framework contributes towards the well-being of society, as well as an efficient business environment, by emphasising moral aspects such as justice, trustworthiness, truthfulness and brotherhood.³¹² To begin with, justice could be described as one of the fundamental pillars of contracts in Sharia, even in the case of dealing with enemies, and there are some verses and ahadith about this principle. For example “Stand out firmly for justice”³¹³ and “And whenever you give your word (i.e. judge between men or give evidence), say the truth even if a near relative is concerned”³¹⁴.

In addition to justice, responsibility is very important aspect as well. Indeed, determining the responsibilities of each party has to be done with honesty and sincerity. The scope of responsibility in Sharia is wider, as it goes beyond the contracted parties to include responsibility in front of God. As stated by Alkhodiry,

³¹¹ A M Abu-Tapanjeh, 'Corporate governance from the Islamic perspective: A comparative analysis with OECD principles' (2009) 20 Critical Perspectives on Accounting 556.

³¹² L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' [2010] Journal of Business Law 126.

³¹³ Sûrat An-Nisâ' Verse135, Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

³¹⁴ Sûrat Alan-am' Verse152, Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

responsibility in the Islamic view “is extended, comprehensive, integrated and personal at the same time”³¹⁵. Responsibility and trustworthiness are mentioned in some Quranic verses, for example, “O you who believe! Betray not Allâh and His Messenger, nor betray knowingly your Amânât (things entrusted to you, and all the duties which Allâh has ordained for you)”³¹⁶. Responsibility will be addressed with more detail in the next section.

Moving to accountability, all transaction contracts in Sharia have the fundamental aspect of accountability to ensure that every party is committed to the performance of its obligations towards the contract. Moreover, Sharia establishes penalties, not only judicial and administrative, but goes further to include accountability in front of God.³¹⁷ Hadith states that: “every one of you is a shepherd and everyone is answerable with regard to his flock. The Caliph is a shepherd over the people and shall be questioned about his subjects (as to how he conducted their affairs)”.³¹⁸ In fact, in Islam all human beings are accountable for their actions, and this

³¹⁵ M Alkhodairy, *Management Thought in Islam* (The Islamic Development Bank islamic Research & Training Institute, Jeddah 2001) Page: 145.

³¹⁶ Sûrat An-Nisâ’ Verse27, Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

³¹⁷ C Bourakba, 'Corporate governance In Islamic Banks' (2009) 20 , Available at: <http://iei.kau.edu.sa/Pages-Hiwar-1430-05.aspx>.

³¹⁸ Sahih Muslim, Translator: Abd-al-Hamid Siddiqui. Available at: http://d1.islamhouse.com/data/en/ih_books/single/en_Sahih_Muslim.pdf.

accountability is not only for worldly reasons, but because the hereafter depends on the actions taken while on this earth.³¹⁹

Finally, transparency is one of the foundations of an Islamic economy. The concept of transparency is made clear in the following verse: “O you who believe! When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you. Let not the scribe refuse to write as Allâh has taught him, so let him write. Let him (the debtor) who incurs the liability dictate, and he must fear Allâh, his Lord, and diminish not anything of what he owes.”³²⁰

4.2.4 Decision-making

Lewis argues that there are three corporate governance decision-making dimensions: ‘by whom’, ‘for whom’ and ‘with what , to whom’ Firstly, by whom- in the Quran there is a Surah called Alshura which can be translated as ‘Consultation’, which is the key word of this Surah.³²¹ Verse number 38 states that “and who (conduct) their

³¹⁹ L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' [2010] Journal of Business Law 126.

³²⁰ Sûrat Albaqarah Verse 282 , Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&ScOrder=4&SubSecOrder=1>.

³²¹ M Lewis, 'Islamic Corporate Governance' (2005) 9 Review of Islamic Economics 5.

affairs by mutual consultation, and who spend of what We have bestowed on them.”³²²

The second is, for whom? As with every business in Islam, business and economics should not contradict the goal of the business with regard to Islamic Sharia law, and the means must also be compatible with Sharia. For example, since the early days of Islam, there has been ‘Hisba’, which is an institution for ensuring compliance with Sharia. Hisba and Shura are considered to represent the Islamic corporate governance’s core elements to some extent.³²³

Lastly, with what and to whom?: the religious supervision is there to make sure that all contracts and operations in companies are in accordance with Islamic law. The religious auditors’ functions are threefold: firstly, to advise the board about new products and the contractual arrangements of the firm to ensure that they are acceptable to religious rules and standards. The second function is dealing with shareholders by providing an independent report about the management’s compliancy with Islamic principles. Thirdly, is to ensure the assessment of zakah is correct and distributed and administered appropriately by performing an audit. These religious auditors’ functions can be clearly seen in Islamic financial institutions.³²⁴

³²² Surat Alshura Verse 38 , Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

³²³ M Lewis, 'Islamic Corporate Governance' (2005) 9 Review of Islamic Economics 5.

³²⁴ Ibid.

4.2.5 The Islamic Corporate Governance Model

There are a number of theories of corporate governance, as there are differences in the management of companies, with varying degrees of control and ownership, cultural factors, and regulatory frameworks. The stakeholder model most closely resembles the Islamic Corporate Governance perspective, in the view of Kasri. However, the Islamic perspective is more comprehensive and related more to the Islamic ethical values.³²⁵

³²⁵ RA Kasri, 'Corporate Governance: Conventional vs. Islamic Perspective' (2009) SSRN 11.

4.3 Sharia and adaptation

It is a fact that, nowadays, the world is characterized by many new features. The rapid change in all of life's aspects is one of them. So the emergence of new transactions and issues could be a logical result of these rapid changes. As a result, there are many more issues and problems that need to be solved on the one hand, and new regulations and laws are required to control these new economic transactions on the other hand. From a Sharia point of view, these issues raise many questions that need to be answered, and definitely one of them is about the potential of Sharia law to adapt. Thus, to what extent, if at all, can Sharia adapt to new concepts such as corporate governance? Although Sharia adaptation is an important issue: in the words of Foster "the possibility of adapting the shari'a to the modern world was not considered until very recently"³²⁶. The following paragraphs will attempt to answer this question.

The ability of the law to adapt to changes is one of the most important determinants of financial development. Hence, in order to foster the economic system, the efficiency of the adaption of law and legal systems for contracting needs is essential. In the view of Ahmed "Adaptability underscores the formalism of laws and the ability of legal traditions to evolve".³²⁷

³²⁶ N H.D. Foster, 'Islamic Commercial Law: An Overview (I)' (2006) 4 InDret: revista per a analisi del dret 384.

³²⁷ H Ahmed, 'Islamic law, adaptability and financial development ' (2006) 13 Islamic Economic Studies 79.

4.3.1 Sharia scope

It is very important to answer the question of coverage of Sharia, in other words, what are the aspects that are covered by Sharia? The importance of this question in this context is to understand the roots of Islamic law on the one hand, and the capacity of Sharia for adaption to the modern world on the other. Consequently, the most significant question is to what extent does Sharia have the ability to absorb new concepts?

First of all, in Foster's opinion, Sharia's scope is wider than the Western view of law. Sharia includes all aspects of life, which start from worshipping, morals and ethics, to the government, transactions and the law. Sharia provides a comprehensive way of life for the person.³²⁸ There are many examples of verses from the Quran and Ahadith (Prophet's sayings) which organise various aspects of life, and interestingly, the longest verse in the Quran is verse number 282 from surat Albaqarah which deals with transactions. This verse regulates the contract of debt for a fixed period between the parties, addresses the registration and certain exceptions.³²⁹

The way for Sharia to cope and keep up with this rapidly changing modern world in all of life's aspects is through the Fiqh, by using the 14th century's sources including the Sharia rules and principles which are described by Ali as a "complex system of

³²⁸ N H.D. Foster, 'Islamic Commercial Law: An Overview (I)' (2006) 4 InDret: revista per a analisi del dret 384 .

³²⁹ Sûrat Albaqarah Verse 282, Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

jurisprudence”.³³⁰ Therefore, the next paragraph is an attempt to shed light on Fiqh - jurisprudence.

4.3.2 Sharia sources

There is no doubt that there are main sources for Sharia, which are the holy Quran and the Sunnah and there is a third one which is “Ejmae” (consensus). Furthermore, Sharia scholars can deduce from them, which is referred to as other sources such as “Qiyas” (analogy). In other words, “Islamic law consists of primary and secondary sources”.³³¹ As the Quran and Sunnah are holy sources, they are used as comprehensive sources and they are able to be used at all times and in all places. Hence, there are comprehensive rules and legitimacy, and there is a space for qualified scholars to derive rulings.

Taking corporate governance as an example could show the adaption of a new concept, as can be seen in the previous section. ‘Corporate governance’ could be described as a new term as it emerged at the 1980s.³³² Moreover, there is no corporate governance concept in Sharia’s main sources; however, there are many verses and hadiths which support justice, responsibility, accountability and transparency. These texts from the main sources can be taken as the root, as stated previously. Foster states, “there has to be a return to basic principles in the Koran and the Sunna and an

³³⁰A Ali, 'The role of Islamic jurisprudence in finance and development in the Muslim world' (2010) 31 Company Lawyer 121.

³³¹ AA Oba, 'Islamic law as customary law: the changing perspective in Nigeria' (2002) 51 International & Comparative Law Quarterly 817.

³³² L Berghe and L Ridder, *International standardisation of good corporate governance : best practices for the board of directors* (Kluwer Academic, Boston, Mass ; London 1999).

application of those principles to present needs, using modern adaptation techniques.”³³³

4.3.3 Islamic jurisprudence (Fiqh)

Islamic jurisprudence (fiqh) depends on the sources of Sharia, which are the holy Quran and Sunnah and Ejma. However, Islamic jurisprudence can be derived from other secondary sources, within which the scholars of fiqh have diverse views among themselves.³³⁴ Unlike the Quran and Sunnah, Islamic jurisprudence (fiqh) is a work or product of Muslim scholars which is deduced from the main sources.³³⁵

In the Quran there is a verse that explains how to deal with issues, it states: “if only they had referred it to the Messenger or to those charged with authority among them, the proper investigators would have understood it from them (directly).”³³⁶

There is another text from the Sunnah that deals with the procedure for the judge if an issue is not addressed in the main sources of Quran and Sunnah. This procedure is included in Hadith when the Prophet (pbuh) appointed one of his companions as a judge and sent him to Yemen. The judge must work first according to Quran then

³³³ N H.D. Foster, 'Islamic perspectives on the law of business organisations: Part 2: the Sharia and Western-style business organisations' (2010) 11 European Business Organization Law Review 273.

³³⁴A Ali, 'The role of Islamic jurisprudence in finance and development in the Muslim world' (2010) 31 Company Lawyer 121.

³³⁵ME Badar, 'Islamic law (Sharia) and the jurisdiction of the International Criminal Court' (2011) 24 Leiden Journal of International Law 411.

³³⁶ Sûrat Alnisa Verse 81, Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

Sunnah then Ijtihad.³³⁷In the case of issues where there is no answer provided by the Quran and Sunnah, the consensus of jurists (Ijma') after the death of the Prophet (pbuh) is one of the sources used for the consideration of some rules.

Qias (or analogy) is considered to be the fourth source of Sharia. If there is a case where there is no specific information found in the main sources, the Mujtahid can take the rule from a similar original case which is contained in previous sources and adapt it to the new case which "has the same effective cause as the original one".³³⁸

4.3.3.1 Sharia objectives (Almaqasid alshari'ah)

In the word of Ahmed "The question of adaptability of the law to changing circumstances is vital to the development of Islamic financial system."³³⁹ Thus, it is extremely important to understand the nature of Sharia and Islamic law, and from where the Sharia provisions and rules could be deduced or formulated.

In general, in an Islamic economy, rules can be divided into two sets or provisions. These rules or provisions are characterised first by fixed rules, for example the prohibition of riba (usury) as there is a text in the holy Quran: "whereas Allâh has permitted trading and forbidden Riba (usury)."³⁴⁰

³³⁷ ME Badar, 'Islamic law (Sharia) and the jurisdiction of the International Criminal Court' (2011) 24 Leiden Journal of International Law 411 .

³³⁸Ibid.

³³⁹ H Ahmed, 'Islamic law, adaptability and financial development ' (2006) 13 Islamic Economic Studies 79.

³⁴⁰ Sûrat Albaqarah Verse 275 , Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

On the other hand, the second set of rules and provisions are changeable provisions. This kind of rule is characterised by being proven by presumptive evidence. These provisions are subject to 'ijtihad' and could be changed due to some circumstances and for the sake of benefit and advantages. Scholars who practice ijtihad can choose the best provision for specific new concepts and matters according to the authenticity of 'Almaqasid alshariah.'³⁴¹

4.3.3.2 Islamic schools

In terms of jurisprudence, Sharia scholars follow **four** main schools of thought³⁴², which are Hanafi, Maliki, Shafi'i and Hanbali, and those schools have some minor differences. However, in all four schools, "Shari'a principles remain the same."³⁴³

Historically, Hanafi and Maliki appeared in the second Islamic century, whereas Shafi'i and Hanbali appeared in the third century, therefore, the four schools started with Abo Hanifah who died in 767 and ended with Ahmed bin Hanbal who died in 855. Geographically, Hanafi jurisprudence arose in Iraq, followed by Maliki jurisprudence which appeared in Madinah in the Arabic peninsula, then Shafi'i in Iraq and Egypt, and then lastly, Hanbali in Iraq.

Firstly, the Hanafi Islamic school is attributed to Abo Hanifah Alnoaman bin Thabit (died 767); secondly, Maliki has its roots with Imam Malik bin Anas (died 795); thirdly, Shafi'i from Mohammed bin Adrees Alshafei (died 820); lastly, Hanbali is

³⁴¹ M Alqahtani, *Economic System in Islam* (Saudi Arabia 2002).

³⁴² The jurisdictions in the GCC countries are varying according to the Islamic schools.

³⁴³ D Elshurafa, 'Islamic finance and construction - is there a place for one in the other?' (2012) 28 *Construction Law Journal* 144.

attributed to Imam Ahmed bin Hanbal Alshaibani (died 855). These scholars can be described as mujtahideen (those who practiced ijihad).³⁴⁴ The four madhabs depend on their understanding of the Quran and Sunnah and they derive rulings from them by using specific rules and *usul al-fiqh* - the roots of *fiqh*. Consequently, decisions depend on the interpretation of the rules used and the knowledge of the prophet's Hadeeth; therefore, the four schools sometimes differ and the scholars "validly disagree with one another on the interpretation of the same matter."³⁴⁵

Taking *Al-maqasid* into account, the main difference between these four schools (*madhahib*) is in some secondary sources, as in general, the scholars agree on *Ijma'* and *Qiyas* as secondary sources as stated by Oba. There are some examples of differences among these four schools, for example some schools use 'public interest' which is called '*Istihsan*' as a secondary source; whereas some of them use '*al-Masalih Mursalih*' or '*Istislah*' which takes the best of general interest as a base for the preferred juristic decision.³⁴⁶

³⁴⁴ FE Vogel and SL Hayes, *Islamic law and finance : religion, risk, and return* (Arab and Islamic laws series, Kluwer Law International, Boston, Mass. 1998) page: 32.

³⁴⁵ E Elshurafa, 'Islamic finance and construction - is there a place for one in the other?' (2012) 28 *Construction Law Journal* 144 .

³⁴⁶ AA Oba, 'Islamic law as customary law: the changing perspective in Nigeria' (2002) 51 *International & Comparative Law Quarterly* 817.

4.3.4 The role of Sharia groups in the adaptation of modern concepts

Nowadays, in order to make sure that transactions are compatible with Sharia, some organisations in Muslim countries have a dedicated section for Sharia compliance. Islamic Banks for instance have a department called Alhai'ahalshari'ah (Sharia group) or (Sharia board) which has many functions. These functions are considered very important and mean this section plays a crucial role, thus it could be described as a fundamental pillar for the organisation. Furthermore, developing products in the light of Islamic Sharia may be one of the most important functions. It can be seen that Sharia boards have a very important role to play and a great deal of influence because of their position in the institution, and it is worth noting that Sharia boards usually include a Sharia scholar. Consequently, analysing the influence of religious scholars in this context is very important. It is no surprise that religious scholars have a very important role, and their influence may be described as profound; Vogel and Hayes explain: "there is no equivalent in other religious cultures."³⁴⁷

As an example the Sharia group in Alrajhi Bank - which is one of the earliest banks to establish a department for Sharia- aims to shift Jurisprudence from being traditional to being modern through the revival of Jurisprudence in the light of Sharia. Adoption of financial tools derived from Islamic jurisprudence, and the development and revision of traditional tools and rationales commensurate with Sharia rules have been carried out.³⁴⁸ It is a fact that there is lack of unified principles, which is due in part to

³⁴⁷ Vogel FE and Hayes SL, *Islamic law and finance : religion, risk, and return* (Kluwer Law International 1998) Page: 9.

³⁴⁸ The Sharia Group of Al Rajhi Bank, *The decisions of the Sharia Board of Al Rajhi Bank* (Kunoz Ashbilia, Saudi Arabia 2010).

jurisprudence in terms of the multiplicity of schools of thought. This may cause a diversity of fatwa between organisations as “sharia scholars decide on the religious compliance of new products”³⁴⁹. This could cause a rise in the importance of establishing centers such as Saleh Kamel Centre of Islamic Economics (SKCIE) at Al-Azhar, where scholars can discuss and issue new decisions for the new concepts in modern law and business.

Generally speaking, the Sharia board in Islamic banks is characterised by being completely independent and its decisions are binding. In terms of services and products, they must be approved by the Sharia board before launching. Furthermore, in order to make sure about the implementation of its decisions, Sharia boards monitor the banks’ actions.³⁵⁰

In the context of a Western view of corporate governance, if the management of the Islamic organisation remains independent, in general, a Sharia board does not clash with the European understanding of Corporate Governance. Germany, for example, is soon to establish the first fully Sharia compliant banks, as the German Federal Financial Supervisory Authority is expected to make a decision about this soon.³⁵¹

There are many examples in this context about cases that show the Sharia board role and influence in Al Rajhi Bank. To begin with, first case is the decisions made by the

³⁴⁹AA Jobst and J Sole, 'The governance of derivatives in Islamic finance' (2009) 24 *Journal of International Banking Law and Regulation* 556.

³⁵⁰ The Sharia Group of Al Rajhi Bank, *The decisions of the Sharia Board of Al Rajhi Bank* (Kunoz Ashbilia, Saudi Arabia 2010).

³⁵¹ M Casper, *Sharia Boards and Sharia Compliance in the Context of European Corporate Governance* (Rochester 2012).

Sharia boards number 32, 46, 47, and 226 which approved the use of credit cards such as Visa and MasterCard with some terms, conditions and restrictions implemented. Moreover, many decisions about modern transactions have been made, for instance 302, 464, 467 and 673 which deal with credit cards transactions, and number 12, 95 and 714 which deal with lease purchases.³⁵² Finally, although Sharia adaption is an important issue, Foster does note that the possibility of adapting was not considered until very recently.³⁵³

³⁵² The Sharia Group of Al Rajhi Bank, *The decisions of the Sharia Board of Al Rajhi Bank* (Kunoz Ashbilia, Saudi Arabia 2010).

³⁵³ N H.D. Foster, 'Islamic Commercial Law: An Overview (I)' (2006) 4 *InDret: revista per a analisi del dret* 384 .

4.4 Sharikah in Sharia

It is a fact that trade is an important element in everyone's life in order to obtain essential needs and to exchange goods and to make profits. Consequently, to maintain markets and to guarantee the rights of all the parties involved in trade, there is the need for rules and regulations. Sharia as a system has many provisions, laws, rules and regulations that appear either in the Quran and Sunnah, or in the fiqh heritage Islamic books from the Islamic libraries which were started from the seventh century.

Historically, the early days of the life of Prophet Muhammad peace be upon him (pbuh) show the importance of trade in Sharia. Furthermore, trade trips were made by the Prophet (pbuh), starting with him accompanying his uncle, and then the trade trip when he was hired by the woman that became his wife, Khadijah. Thus, commerce has a positive image in Sharia; moreover, the Prophet himself was a "highly respected trader and arbitrator".³⁵⁴

4.4.1 Sharia: financial transactions

Generally speaking, the principle of financial transactions in Islam is according to permissibility; however, there are some prohibited financial transactions such as riba. Morality and ethics could be described as a fundamental part of Islamic finance as the finance principles are derived from the holy Quran and Sunnah. Therefore, there are many reasons from a Sharia perspective to prevent these transactions, and protecting

³⁵⁴ N H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 European Business Organization Law Review 3 .

all the parties may be one of them. Generally, there are four main prohibited transactions in Islamic finance: riba, gharar, misir and the selling or production of the forbidden. The following paragraphs show some of the prohibited transactions.³⁵⁵

Firstly, Riba which is one of the prohibited transactions in Sharia, as it has been mentioned in the holy Quran several times. Surat Albaqarah for example contains some of the verses which deal with riba: “That is because they say: ‘Trading is only like Ribâ (usury),’ whereas Allâh has permitted trading and forbidden Ribâ (usury)”³⁵⁶ and Surat Alimran: “O you who believe! Eat not Ribâ (usury) doubled and multiplied, but fear Allâh that you may be successful”³⁵⁷.

Riba (usury) is of various types such as riba alfadhl and riba alnase’ah. As explained by Ali, as the holy Quran has prohibited riba clearly but without details, which has allowed some debate on the forbidden riba definition.³⁵⁸ Finally, Rethela explains that

³⁵⁵ H Harasani, 'Analysing the Islamic Prohibition on Riba: A Prohibition on Substance or Form' (2013) 27 Arab Law Quarterly 289.

³⁵⁶ Sûrat Albaqarah Verse 275, Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

³⁵⁷ Sûrat Alimran Verse 130 Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

³⁵⁸ A Ali, 'The role of Islamic jurisprudence in finance and development in the Muslim world' (2010) 31 Company Lawyer 121 .

riba is “unjustified increase; narrowly interpreted as the paying or receiving of interest”.³⁵⁹

Secondly, gharar which is other prohibited transactions in Sharia. Gharar has been defined by Elshurafa as “the sale of probable items whose existence or characteristics are uncertain or speculative”³⁶⁰, whereas Rethela has defined it more simply as “making profit from uncertainty”.³⁶¹ Ayub has added detail as he refers to gharar as “the sale of a thing which is not present at hand or the sale of a thing whose “Aqibah” (consequence) is not known or a sale involving hazard in which one does not know whether it will come to be or not”.³⁶²

Usually, classical fiqh books provide examples of algharar transactions. For example, selling fruit before it is ripe or selling birds in the air. The aim of the prohibition of gharar is to protect the weaker party. Al-Rimawi thinks that the development of the gharar concept under Sharia is for the sake of the weaker party’s protection “in Islamic contractual obligations from ghubn (or injury) due to jahel (want of knowledge)”³⁶³. There are many Quranic verses and Ahadith of the Prophet (pbuh) about gharar. However, the interpretation of gharar is more difficult than the

³⁵⁹ L Rethel, 'Whose legitimacy? Islamic finance and the global financial order' (2010) 18 Review of International Political Economy 75.

³⁶⁰ E Elshurafa, 'Islamic finance and construction - is there a place for one in the other?' (2012) 28 Construction Law Journal 144 .

³⁶¹ L Rethel, 'Whose legitimacy? Islamic finance and the global financial order' (2010) 18 Review of International Political Economy 75.

³⁶² M Ayub, *Understanding Islamic finance* (Wiley ; Chichester : John Wiley [distributor], Hoboken, N.J. 2007) Page: 58.

³⁶³ L Al-Rimawi, 'Relevance of Sharia as a legislative source in a modern Arab legal context: a brief constitutional synopsis with emphasis on selected commercial aspects' (2011) 32 Company Lawyer 57.

interpretation of riba among the Muslim jurists.³⁶⁴ There are many cases where the Administrative Court of Diwan Almathalim regarding 'gharar' transaction. For example, Case number 5534/1/G/Year 1429. Due to the fact that the contract is containing a prohibited transaction, the court decision was that the contract is void, which means the consequences of the contract are void as well.³⁶⁵

The **third** prohibited transactions is maisir. Generally speaking, maisir meaning 'gambling' and maisir mentioned many times in the main sources of Sharia- the holy Quran and Sunah. Muhammed stated that the prohibition of maisir initially was as part of the cleansing commerce of unconscionable practices.³⁶⁶ Maisir means "easily available wealth or acquisition of wealth by chance, whether or not it deprives the other's right".³⁶⁷

There are many reported legal cases concerning prohibited transactions. One of them is the case from the Board of Grievances Administrative Court (Diwan Almathalim) Case no 167/3/G/Year 2006. In the case, the judge dealt with a contract containing riba (usury). The plaintiff claimed that the consequences of the contract were sale on credit, but the defendant stated that the contract was a fictitious, sham contract. From the evidence, it shows that there is an intention to circumvent riba (usury) and it contains gharar. The court decision was that the contract is void and its consequences

³⁶⁴ L Al-Rimawi, 'Middle East: Islamic models of equity markets' (2000) 21 *Company Lawyer* 161.

³⁶⁵ Case number 5534/1/G/Year 1429.

³⁶⁶ N Mohammed, 'Principles of Islamic Contract Law' (1988) 6 *Journal of Law and Religion* 115.

³⁶⁷ M Ayub, *Understanding Islamic finance* (Wiley ; Chichester : John Wiley [distributor], Hoboken, N.J. 2007) Page :61. See also: S AlDareer, *Al Gharar in Contracts and Its Effect on Contemporary Transactions* (Islamic research and training institute Saudi Arabia 1997).

are void. The regulations that the court used are the Commercial Court Law 1931, Cabinet decision no 241 dated 2002 and no 261 dated 1986.³⁶⁸

In a Saudi Arabian context, there is a Sharia board within some companies and banks.³⁶⁹ The role of this board depends on many factors. Moreover, a Sharia board's functions vary from one company to another. However, the main role of the Sharia board is to make sure that the company or the bank is moving toward legitimate products under Islamic law. Furthermore, the Sharia board determines the consistency of any products with the constants of Sharia and makes sure that the products are free of prohibited transactions such as *riba*, *gharar*, *misir* and the selling or production of the forbidden.

Although Sharia boards play a significant role, there are criticisms. First of all, a member of this board could participate in an unlimited number of institutions, which can be seen very clear in banks nowadays. This is due to the fact that there are no regulations for controlling the number of boards he or she can be a member of. On the other hand, article 12 of corporate governance regulations is very clear about members of the board of directors' participation in joint stock companies. It states in paragraph H: 'A member of the Board of Directors shall not act as a member of the Board of Directors of more than five joint stock companies at the same time'.³⁷⁰

It is a fact that the Sharia view of business is not the only one based on religious and ethical principles, and undoubtedly, there are additional perspectives on business

³⁶⁸ Case no 167/3/G/Year 1427.

³⁶⁹ See section 4.3.4.

³⁷⁰ *corporate governance regulations* 2006.

whether among Western law and corporate governance regulations, or beyond the Anglo American model. For example, we note the Quakers group, which describes itself as 'The Religious Society of Friends of the Truth'. Quaker families have played a pivotal role in some of the UK's most high profile firms, for example, Cadbury, Fry, Rowntree and Terry. Noticeably, these all these are Quaker firms in their origin and have monopolised the chocolate and confectionery business in the UK for long time. The Quaker view of business, for example, has five business principles including: truth and integrity, justice, equality and community, simplicity, peace and the light within.³⁷¹ These principles to some extent are similar to Sharia business principles.

4.4.2 Zakah

Due to the financial conditions of Islamic companies and banks, there may be a need to shed a light on other items such as zakah, according to an Islamic perspective of corporate governance. One of the obligations of companies within Sharia is zakah, therefore it is important to examine zakah in this context.³⁷² The importance of Zakah is very clear in Islamic law as it is the third pillar of Islam, so it can be described as an essential obligation within Sharia. There are many objectives of zakah from an Islamic perspective; however, one of the main aims is the protection of the socio-economic welfare of needy people in society.³⁷³ Unlike a taxation system, zakah not

³⁷¹ P Whitehouse, 'Quakers and Business Group Business Principles' (Quakers & Business Group 2009) <<http://qandb.org/documents/func-startdown/308/>> accessed 17 November . See also: F Cranmer, 'Regulation within the Religious Society of Friends' (2003) 7 Ecclesiastical Law Journal 176.

³⁷² A Saif and M Jorih, 'Introduction to corporate governance from Islamic perspective' (2012) 28 Humanomics 220.

³⁷³ W Norazlina Abd and R Abdul Rahim Abdul, 'A framework to analyse the efficiency and governance of zakat institutions' (2011) 2 Journal of Islamic Accounting and Business Research 43.

only plays an important role in law and finance , but it provides a contribution towards the welfare of society as zakah goes to the people in need as the first category of people eligible to receive it ³⁷⁴.

Zakah is an annual obligation for all Muslims who have ‘nisab’ which is the financial means. However, the assets which meet the conditions of nisab must be continuously owned over the year to be subject to zakah collection. The amount of zakah depends on the type of assets the individual possesses and the wealth of the individual. For capital assets, for example money, the amount of zakah is 2.5%. Other goods such as agricultural items and metals vary depending on the type of goods.

Generally, zakah is an obligation on all individuals with a certain amount of wealth. However, the question to be asked in this context is what about companies, and how does zakah apply to companies? Primarily, the obligation of zakah in the case of a joint stock company, for example, is the shareholders’ responsibility. However, the company management pays zakah on behalf of the shareholders in **four cases** stated by the International Islamic Fiqh Academy, which is part of the Organisation of the Islamic Conference. The decision states that this applies: **Firstly**, if it is stated in the company’s articles of association. **Secondly**, if there is a resolution by the general assembly. **Thirdly**, if the law of the country binds companies to pay zakah – Saudi Arabia for example-. **Finally**, through authorisation from the shareholders for the company to pay zakah on behalf of him or her. The management of a company should treat all shareholders' shares as one person’s money, and then pay the zakah taking

³⁷⁴ N H.D. Foster, 'Islamic perspectives on the law of business organisations: Part 2: the Sharia and Western-style business organisations' (2010) 11 European Business Organization Law Review 273.

into account the normal person's terms and conditions of zakah as mentioned in the previous paragraphs.³⁷⁵

Saudi Arabia has a system for zakah which may be described as unique system. The department of zakat and income tax is responsible for collecting zakah from companies and individuals who are engaged in business under the business records or licenses. However, individuals such as employees who have no commercial activities can pay their zakah directly to recipients who qualify to receive zakat funds. It may be important in this context to mention that there is a taxation system for the income tax of non-Saudi persons who are subject to taxation, such as the resident capital company, with respect to shares of non-Saudi partners.³⁷⁶

The legal background of collecting zakat in the Saudi legal system is the Royal Decree which was published and became effective on the 8th of August 1956. Article one of this Royal Decree states that: "Zakat duty shall be collected in full in accordance with the provisions of Islamic law (Shariah) from all Saudi persons, shareholders of Saudi companies whose shareholders are all Saudi, and Saudi shareholders of joint companies whose shareholders are Saudi and non-Saudi nationals."³⁷⁷

³⁷⁵ International Islamic Fiqh Academy, 'Fourth session decision' (International Islamic Fiqh Academy 1988) <<http://www.fiqhacademy.org.sa/>> accessed 17 October 2013.

³⁷⁶ J-C Bancal, 'Legal, tax and fiscal engineering for industrial co-operation in Saudi Arabia' (1993) *International Business Law Journal* 685.

³⁷⁷ Department of Zakat and Income Tax, 'Royal Decree' (Department of Zakat and Income Tax 1956) <<https://dzit.gov.sa/en/royal-decree>> accessed 17 November.

The Ministry of Corporate Affairs in India recently published the new Companies Act on the 29th of August 2013. Section 135 of this Act states that every company which is obligated under subsection (1) to constitute a Corporate Social Responsibility Committee “shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy”³⁷⁸. However, this is not entirely similar to the Saudi Arabian example, as in the Saudi example, this obligation is called zakah and it is due to religious obligation, and ‘Saudi’ companies do not pay tax. Finally, unlike CSR, zakah must be paid to eight types of people who are eligible only as stated in the Quran.³⁷⁹

4.4.3 Sharikah in Sharia

Sharikah is an Arabic word which basically means sharing. Legally, sharikah’s root in Islamic Jurisprudence (Fiqh) is in a return to the main sources as it is mentioned in the holy Quran and the sayings of the Prophet (pbuh). Moreover, there is consensus (Ijma) among Sharia scholars about the permissibility of the concept of sharikah (sharikah). However, there are some opinions and differences between scholars on certain types of sharikah. The current types of ‘Company’ with its legal personality and limited liability has been recognised to be compatible with Sharia types of sharikah by the decision 130 (4/14) by the International Islamic Fiqh Academy.³⁸⁰

³⁷⁸ *Indian Company Act 2013.*

³⁷⁹ Sûrat Altawbah Verse 60, Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

³⁸⁰ See International Islamic Fiqh Academy: <http://www.fiqhacademy.org.sa/qyarat/14-4.htm>.

The Islamic concept of the company has several definitions depending on the school of Fiqh. One of them is that the company must prove the right to something for two parties or more.³⁸¹

4.4.4 Sharikah types

The types of Sharikah vary according to different scholars' views. However, in general, sharikah types can be divided into two main categories- property partnership or (sharikat almulk) and contractual partnerships (sharikat alaoqoud). However, some jurists have added a third one, which is sharikat aibaha, and this can be described as individuals' common right to collect and own free commodities. This section attempts to shed light on the main types of companies in Islamic Jurisprudence (Fiqh).

4.4.4.1 sharikat almulk or alamlak

Sharikat almulk can be described as a property partnership which refers to joint ownership without joint exploitation.³⁸² The ownership of real estate because of inheritance for example. This type can be divided into two types- compulsive and optional (amlak).

4.4.4.2 sharikat alaoqoud

The second type of sharikah in Islamic jurisprudence (Fiqh) is sharikat alaoqoud, which may be called contractual partnerships. Sharikat alaoqoud has three types in general: sharikat alamwal where the money is the main investment (finance

³⁸¹ M Aljundy and K Alkholaify, *Companies: provisions, types and managment* (Konoz Ashbilia, Riyadh 2010) Page: 13.

³⁸² L Al-Rimawi, 'Middle East: Islamic models of equity markets' (2000) 21 *Company Lawyer* 161.

partnership); sharikat ala'mal, where the skill of the partners is the main investment (labour partnership), and sharikat alowjoh (credit partnership).³⁸³ Moreover, these three types may be extended to be five or six types according to the jurists' schools and opinions, as the following paragraphs show.

First of all, **sharikat alenan** is a partnership between two or more in capital and effort or labour, so it could be called a finance partnership. As an example, joint stock companies could be one of the modern applications of sharikat alenan in the Saudi Arabian Company laws.³⁸⁴

Capital shares, and the control and the profits in this kind of company do not have to be equal between parties, so this depends on the agreement decided between them.³⁸⁵

Sharikat alabdan or ala'amal is the **second type** of sharikah. In this version, the association between partners is in services rather than capital. This type of company could be described as a labour partnership. Thus, the partners are working then sharing what they have earned according to the contract they have agreed.

Thirdly, sharikat alwujoh, which is based on reputation. In sharikat alwujoh, there is no capital at the beginning. For example, in this type, the company partners can loan capital and then share the profit according to the contract agreed between them.

Sharikat almudharabah is the **fourth type** of sharikah in Fiqh. Despite the fact that some jurists consider mudharabah to be an independent sharikah type, the Hanbali

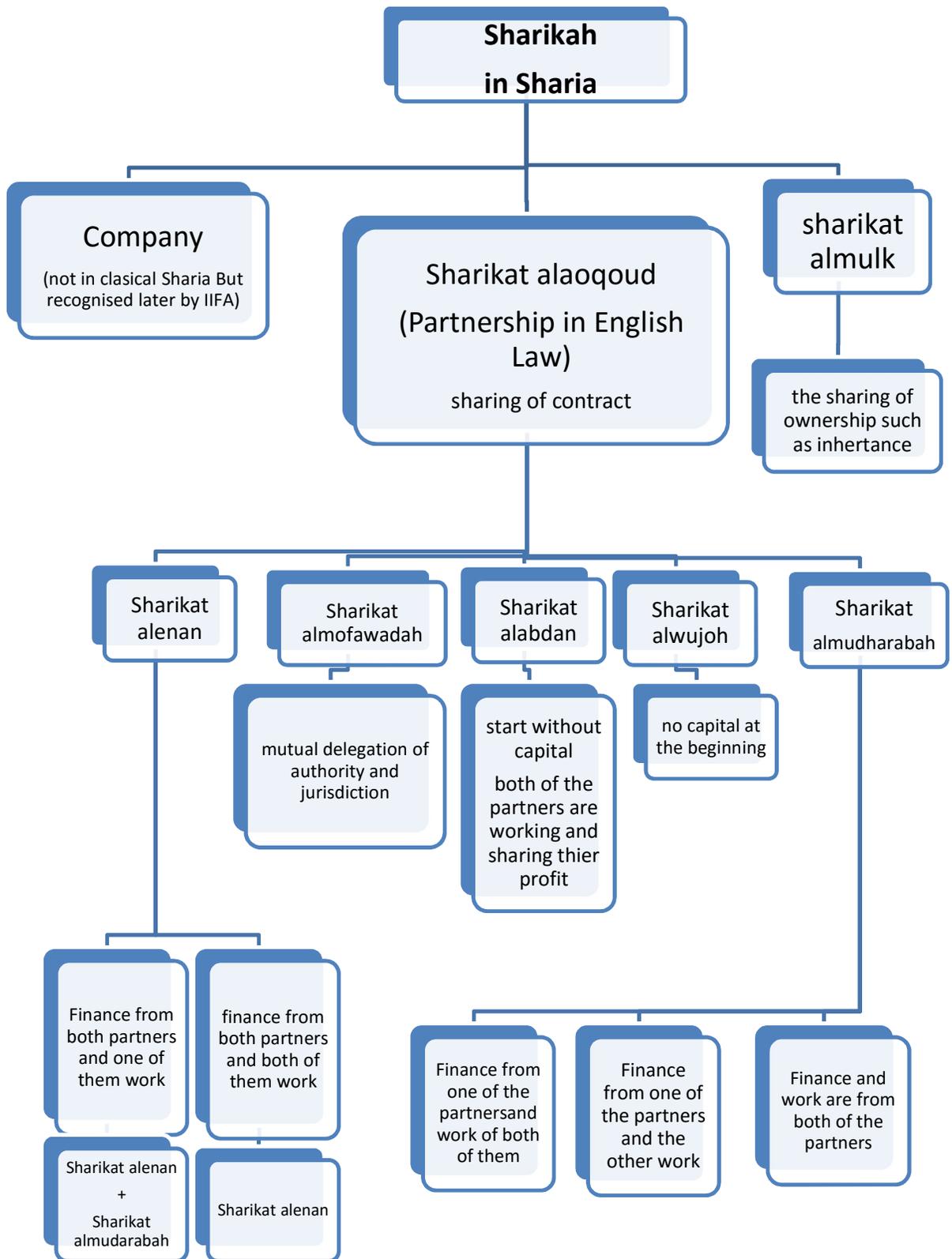
³⁸³ Ibid.

³⁸⁴ See: Article one in *Companies Law 1965* and Article three in *Companies Law 2015*.

³⁸⁵ M Almosa, *Alfiqh Almuyassar* (Dar Alwatan, Riyadh 2010) Page: 153.

School sees it as a contractual partnership (sharikat alaoqoud). Almudarabah in general is a partnership where one partner provides the capital, whereas the second one is the 'mudharib' or entrepreneur. The role of the entrepreneur (mudharib) is to generate a profit using the capital provided by the first party. The liability of any losses in sharikat almudharabah is with the investor, the first party, who provided the capital. On the other hand, the profit will be distributed according to the agreement between the partners. The **fifth type** is **sharikat almofawadah**, which is very similar to sharikat alenan, except both partners provide authorisation and agency for each other.³⁸⁶

³⁸⁶ Ibid. Page: 160. See also : Y Alqasim, 'Sharikat of fiqh: a legal and Sharia view' *Aleqtisadiyah* (Riyadh, 8 April 2010).



4.4.5 Profit and loss distribution

As the capital does not necessarily need to be equal, the profit and loss can be unequal as well. However, two schools of fiqh stipulate that “the ratio of distribution of profit must be agreed upon at the time of execution of the agreement, otherwise the contract will not be valid”.³⁸⁷

4.4.6 The liability of the partners in sharikah

Turning to the liability of the partners in all the sharikah types, there are many details about this contained in the fiqh sources. However, in general, the liability of the partner in sharikah is according to the proportion or the amount of his or her share of the whole investment.³⁸⁸ So, except for proven of negligence, misconduct or contract breaching situations, there is no liability of one of the partners in sharikah.³⁸⁹

4.4.7 The termination of sharikah

There are many conditions whereby the company reaches the point of termination, whether it is optional termination or not, as a sharikah contract could be described as a non-binding contract. Thus, the sharikah will be terminated if one of the following situations is reached:

³⁸⁷ M Ayub, *Understanding Islamic finance* (Wiley ; Chichester : John Wiley [distributor], Hoboken, N.J. 2007) Page: 316.

³⁸⁸ N H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 *European Business Organization Law Review* 3.

³⁸⁹ M Ayub, *Understanding Islamic finance* (Wiley ; Chichester : John Wiley [distributor], Hoboken, N.J. 2007) Page: 316.

The withdrawal (alensihab) is the first situation. Except if there is a time limit for the company or if the termination will cause damage that could harm the other partners, there is the right to withdraw and then the company will terminate.

Prevention of one of the partners (hajr) is the second situation. If exercising the legal power of one of the partners is prevented or prohibited with regard to his or her property because of reasons such as bankruptcy or insanity, this will cause the termination of the sharikah. This may be referred to as the absence of legal capacity.

The third situation is the case of death of one of the partners. When one of the partners of the company dies, the company is terminated. Therefore, the other partners do not have the right to act without the permission of the heirs.³⁹⁰

Expiration of the company contract is the fourth situation. So, if the sharikah is for a limited time, or in case of the company being for a specific purpose, the purpose of the sharikah has been achieved and therefore it expires.³⁹¹

The loss of company capital is the fifth situation. So, in the case of the sharikah capital being exhausted- all the capital or the most of it- this will cause the termination of the sharikah.

Lastly, deposing of one of the partners (alazl). In cases where one of the partners is considered to be inexpedient or inappropriate because of his or her misconduct or mismanagement, the partners have the right to depose them. If the sharikah is between

³⁹⁰ M Ayub, *Understanding Islamic finance* (Wiley ; Chichester : John Wiley [distributor], Hoboken, N.J. 2007) Pages: 318 and 319.

³⁹¹ M Almosa, *Alfiqh Almuyassar* (Dar Alwatan, Riyadh 2010) Page: 167.

two partners, it will be terminated, and if there are more than two partners, the rest of them could carry on with a new contract.

4.4.8 Sharikah rules and regulations

The rules and regulation of the company depend on the company (sharikah) type. However, there are some general regulations and rules of the sharikah. To begin with, the first rule is about the partners of the company. Any company to be constituted must have partners (muta'qidyn). Consequently, in order to sign the contract, the partners of the company (sharikah) must have what is called (alahlyah). In order to sign the contract of the company with free consent, the maturity and sanity of the company partners are required. Accordingly, alahlyah- the legal capacity of the partners- is one of the rules and regulations of the company.³⁹²

For the capital rules, unlike Hanafi, the other three schools of fiqh Hanbali, Maliki and Shafie, stipulate that the partners must provide liquid assets as capital and the value must not be ambiguous. In sharikah, the partners are agents of one another in the contractual partnership, as the partners have equality of rights and will.³⁹³

4.5 Management and responsibility from a Sharia perspective

As one of the most important aspects in life, money, is protected by Sharia. Moreover, conserving money is considered one of the five necessities for the human being in Sharia. This explains the verses from the Quran and ahadith from the Sunnah, which

³⁹² M Ayub, *Understanding Islamic finance* (Wiley ; Chichester : John Wiley [distributor], Hoboken, N.J. 2007) Page: 312.

³⁹³ M Almosa, *Alfiqh Almu'yassar* (Dar Alwatan, Riyadh 2010) Pages: 146 and 147.

mention money and transactions within the realm of the topic of money. For example, verse number 182 of Surat Albaqarah: “And eat up not one another’s property unjustly (in any illegal way e.g. stealing, robbing, deceiving, etc.), nor give bribery to the rulers (judges before presenting your cases) that you may knowingly eat up a part of the property of others sinfully”.³⁹⁴

There is no doubt that Sharia has a direct impact on the management of the GCC countries. Moreover, Abuznaid states “a Moslem administrator is more likely to be influenced in his thinking, behaviour, and lifestyle by his religious beliefs”.³⁹⁵ So, it may be necessary to understand such the influences upon management from a Sharia perspective.

Responsibility, on the other hand, is another important issue which plays a crucial role in corporate governance. The second section will deal with the legal root of responsibility from an Islamic prospective.

4.5.1 Management from a Sharia perspective

There is no doubt that human behaviour and social relations are impacted upon by religion. Hence, managers’ behaviour in Muslim countries definitely will be subject to direct influence from the religion - from the Sharia and fiqh, to be more specific.

³⁹⁴ Sûrat Albaqarah Verse 182 , Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

³⁹⁵ S Abuznaid, 'Islam and management: What can be learned?' (2006) 48 Thunderbird International Business Review 125.

Therefore, understanding the view of management in Islam could be very important in the context of corporate governance.

Undoubtedly, there is no comprehensive theory in Sharia about management. However, it can be seen very clearly that there are general guidelines which can be found in the main sources of Sharia: "one can cite certain Islamic perceptions and guidelines that could well be applied to management".³⁹⁶

4.5.1.1 Shura ‘consultation’

The meaning of shura in Sharia refers to exchanging views in order to draw the correct opinion and the most effective solutions and good decisions.³⁹⁷ Shura ‘consultation’ can be described as playing an important role in Sharia, as the holy Quran mentions and deals with consultation in the context of describing some of its good characteristics. Furthermore, the Prophet (pbuh) practiced consultation in his life by consulting his companions. The Caliphs that followed after him did so by practicing shura in their issues. However, there is no binding shura specific system as it left to ‘Ijtihad’.³⁹⁸

Interestingly, the name of chapter number 42 in the holy Quran is called Surat Alshura (The Consultation). Moreover, verse number 38 of the same Surah states that

³⁹⁶ S Abuznaid, 'Islam and management: What can be learned?' (2006) 48 Thunderbird International Business Review 125.

³⁹⁷ Information center of Majlis Ash-Shura, *Shura in Islam (Parliamentary practice) Saudi Arabia experience* (Majlis Ash-Shura, Riyadh 2003) Page: 5.

³⁹⁸ Information center of Majlis Ash-Shura, *Shura in Islam (Parliamentary practice) Saudi Arabia experience* (Majlis Ash-Shura, Riyadh 2003) Pages: 5 and 7.

“and who (conduct) their affairs by mutual consultation”.³⁹⁹ Likewise, verse number 159 of Surat Al-Imran also mentions consultation as it states: “and consult them in the affairs. Then when you have taken a decision, put your trust in Allâh, certainly, Allâh loves those who put their trust (in Him)”.⁴⁰⁰

From the above, it can be seen that there is a gap between theory and practice of shura in the Islamic countries nowadays. However, there are some examples across Islamic countries of practicing shura, regardless of the level of this practice. Taking Saudi Arabia as an example, there is what is called ‘Majlis Alshura’, which is the Shura Council that started from 1924 until the present day.

Practically, the corporate governance code of Saudi Arabia mentions shura in the corporate governance regulations Article 16, which deals with the meetings of the board, as it states in number 3: “When preparing a specified agenda to be presented to the Board, the Chairman should consult the other members of the Board and the CEO”.⁴⁰¹

4.5.2 Responsibility:

It is first necessary to explain the legal root of responsibility in Sharia. There are some texts that are stated as the main sources of Sharia which draw up a framework for

³⁹⁹ Sûrat Alshoura Verse 38 , Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

⁴⁰⁰ Sûrat Al-Imran Verse 159 , Available at: <http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

⁴⁰¹ *Corporate governance regulations 2006.*

responsibility in fiqh, and this may be described as one of the roots of responsibility in Sharia.

Indeed, one of the shorter texts from the Prophet (pbuh) states: “There should be neither harming ‘dharar’ nor reciprocating harm ‘dhiraar.’”. However, responsibility was not taken as a general theory in the early days of fiqh. The reason behind this is that ‘alqawa'id alfiqhiyah’ or ‘Jurisprudential Rules’ had not yet been viewed as an independent topic in the early days by fiqh scholars. Subsequently, the issues of responsibility are treated individually according to the specific incident.⁴⁰²

The responsibility issues in the early days of fiqh are very wide, with consideration of the owner’s right starting from the rights towards Allah and then the rights of the person. The first set of rights is subsequently divided into two categories according to the punishment. So, if the punishment will be in the hereafter – after the day of judgment- it could be considered as a moral responsibility; whereas if the punishment is to be meted out in lifetime and the hereafter, it could be described as criminal responsibility.

Secondly, there is the right of the person, which generally speaking is also divided into two rights. The first one is the financial right, such as the rights due under contracts. Secondly, there is personal right such as harming the person, which has two types according to whether it causes intentional or non-intentional harm.⁴⁰³ Moreover,

⁴⁰² H Yaqub, *Administrative responsibility in the absence of mistake: in the administrative system and Islamic jurisprudence* (Law & Finance Library, Riyadh 2012) Page: 29.

⁴⁰³H Yaqub, *Administrative responsibility in the absence of mistake: in the administrative system and Islamic jurisprudence* (Law & Finance Library, Riyadh 2012) Page: 30.

Alkhodiry stated that responsibility in the Islamic view “is extended, comprehensive, integrated and personal at the same time”⁴⁰⁴

There are many texts from the main sources of Sharia on this topic. However, the Prophet’s hadith narrated by Albukhari contains some of the main aspects of responsibility, for example: “Everyone of you is a guardian and everyone of you is responsible (for his wards). A ruler is a guardian and is responsible (for his subjects).” This hadith mentions the responsibility of some people, such as the man towards his family, then finishes with general responsibility: “Beware! All of you are guardians and are responsible (for your wards).”⁴⁰⁵

4.5.2.1 Jurisprudential rules (alqawa'id alfiqhiyah) and responsibility

The fact is that the early generations of Sharia scholars, such as the Prophet’s companions and the next generation, did not need al-Qawa'id al-Fiqhiyah (Jurisprudential rules), due to the knowledge they had and because the Arabic language was still in its pure state which made it easy to understand the main sources of Sharia texts.

This has caused the provisions on responsibility to be sporadic in the books written by these scholars. However, following that, some fiqh scholars noticed the importance of collecting and improving alqawa'id alfiqhiyah (Jurisprudential rules). In the view of Yaqub, the emergence of Alqwaed alfiqhiyah (Jurisprudential Rules) as a separate

⁴⁰⁴ M Alkhodairy, 'Management thought in Islam' in M Albourey and M Morsi (eds), *Management in Islam* (The Islamic Development Bank, Islamic research & training institute, Jeddah 2001) Page: 145.

⁴⁰⁵ Sahih Albukhary, Translator: M. Muhsin Khan. Available at: http://down1.islamhouse.com/data/en/ih_books/single/en_Sahih_Al-Bukhari.pdf.

subject made the responsibility issues clearer due to the focus paid by the scholars of alqawa'id alfiqhiyah.⁴⁰⁶

4.5.2.2 Alwakalah

Wakalah in Sharia is a contract between two persons where the principal is hiring someone as an agent to act on his or her behalf in the discharge of a certain duty. The contract of wakalah in Sharia, in order to be valid, must meet certain terms and conditions. These terms and conditions are for the wakalah in general.

The first set of terms and conditions of wakalah is about the 'principal' or the money owner: firstly, the capacity to act, for example with the money or shares and so on; secondly, the contentment, and so if the principal is forced to sign the contract of the wakalah, the contract is not valid.

The Second set, like the first set of rules, the first terms and conditions for the wakeel 'agent' is their legal capacity. The second condition is that the agent must know about the contract of the wakalah. Lastly, the wakeel must be indicated, as the contract of wakalah will not be valid if the wakeel is unknown.

The Third set, this set is for the object - money or shares for example. Firstly, at the time of the contract, the owner must own the thing, money or shares for example. Secondly, in general, most of the conduct of the wakeel must be known to the money owner in order to protect all the parties from disputes in the future.⁴⁰⁷

⁴⁰⁶ H Yaqub, *Administrative responsibility in the absence of mistake: in the administrative system and Islamic jurisprudence* (Law & Finance Library, Riyadh 2012) Page: 31.

⁴⁰⁷ AH Almojan, *Alwakalah In Islamic Sharia* (konoz Almarifah, 2001) Pages: 19 to 25.

4.5.2.3 Aldhman

In Sharia 'aldhman' is very close to the concept of responsibility. Moreover, 'aldhman' in some of its definitions reflects the concept of responsibility.⁴⁰⁸ There is no doubt that Sharia stresses the importance of protecting and conserving the five necessities for the human being. Certainly, one of them is money, by preventing anyone from taking another's money without their permission.⁴⁰⁹

4.5.2.4 The limit of the responsibility of the board of directors

From a Sharia point of view, the board of directors could be considered as a wakeel. Consequently, as a result of being wakeel, the limit of the responsibility of the board of directors depends on whether there has been negligence or encroachment by the board of directors or not. If so, generally speaking, the board of directors in this situation is 'dhaman'- they are responsible. In other words, there are two conditions to be met by the wakeel: First of all, adherence to the contract of the wakalah; secondly, treating the issues of the company as if they own it (such as the money or the shares). So if the board of directors is committed to these conditions there will be no dhaman.⁴¹⁰

There are some cases of negligence and infringement mentioned by Sharia scholars which could be important examples. One of the infringement (or encroachment) cases

⁴⁰⁸H Yaqub, *Administrative responsibility in the absence of mistake: in the administrative system and Islamic jurisprudence* (Law & Finance Library, Riyadh 2012) Page: 33.

⁴⁰⁹ There are many cases where the Judge in The Board of Grievances Administrative Court has mentioned 'aldhaman' from classic Sharia perspective such as the Administrative Court Case number 2121/3/G/Year 1429.

⁴¹⁰ H Almojan, *Alwakalah In Islamic Sharia* (konoz Almarifah, 2001) Page: 31.

is non-compliance with the limits stated in the contract. Another example is if the wakeel uses something belonging to the company for his or her own personal interest, like using the company car for his or her family. Lateness in selling or to purchase something for the company is also an issue; buying goods or shares, for example, at much more than the market price or selling at less than the market price.⁴¹¹

4.5.2.5 The Saudi Arabian example

The responsibility of the board of directors in Saudi Arabia will be addressed in chapter five. However, the next two paragraphs are just an attempt to shed some preliminary light on the relationship between companies law in Saudi Arabia and Sharia, as “Saudi Arabia, where the shari’a is the law, but even there it is supplemented by numerous ‘regulations’ enacted by the government”.⁴¹²

As a rule, in the case of Saudi Arabia, there is no conflict between companies legislation and Sharia, as there is a very clear relationship between them. As an example, the Companies Law mentions ‘Without prejudice to the requirements of Shariah’ in the Companies Law 1965, such as in Articles 2, 229 and 230 and ‘in accordance with Sharia principles’ such as in Article 11, 121 of Companies Law 2015.⁴¹³

The Saudi Arabian government has set up and adopted some regulations and rules that do not normally clash with Sharia. However, Aljabr argues that, the role of Sharia in

⁴¹¹ Ibid, page: 33.

⁴¹² N H.D. Foster, 'Islamic Commercial Law: An Overview (I)' (2006) 4 InDret: revista per a analisi del dret 384.

⁴¹³ *Companies Law 2015* and *Companies Law 1965*.

Saudi Arabia goes beyond rejecting the regulations which clash with Sharia law to the role of completing the provisions of the law in case of the absence of the texts of the law and to fill the gap in the legislation.⁴¹⁴

In summary, this section has dealt with the perspective of Sharia concerning management in order to understand how Sharia influences managers in the countries of the GCC, as the religion is more likely to have an impact on their conduct.⁴¹⁵ Shura is very important in this context, not only at the level of companies and corporate governance, as shura is one of the principals of ruling in Islam.

On the other hand, responsibility from the Sharia perspective is very important, so it is necessary to shed light on it in this context, in order to understand the legal root of responsibility in Sharia. Moreover, the relationship between the shareholders and the board of directors may be described as a wakalah in Sharia, which has a direct impact on the conduct of the board of directors and shareholders at the same time.

4.6 Reward and Delegation from a Sharia Perspective

Maximising profit for the benefit of shareholders is usually the most important goal for companies, and this can be achieved by using resources in the right way, according to the targets that the company has set. Moreover, there is a link between company profits and managerial reward, which could appear in the behaviour of the

⁴¹⁴ MH Aljabr, *Saudi commercial law* (Aldar Alwataniya, Riyadh 1996) Pages: 7 and 8.

⁴¹⁵ S Abuznaid, 'Islam and management: What can be learned?' (2006) 48 *Thunderbird International Business Review* 125.

managers in terms of the financial and interpersonal priorities.⁴¹⁶ The issue of rewards for board members could be described as a contentious and complicated issue due to its relation to the question of conflict of interests.⁴¹⁷

Therefore, the two sides need to be balanced, as it is in the interests of the company to attract top executives and provide rewards and incentives on the one hand, while protecting the rights and the interests of shareholders on the other hand.

Moreover, one of the most important issues is protecting all parties' rights by applying a set of rules and regulations; taking into account the moral dimension, which plays a crucial role in Sharia law.⁴¹⁸

The shortage in the connection between pay policies on the one hand and the strategy and performance of the company on the other hand results in three economic costs: diminished shareholder returns; weakened corporate governance, and reduced confidence in the corporate sector, according to the Impact Assessment BIS 0341.⁴¹⁹

Moving to the case of the United Kingdom, the Enterprise and Regulatory Reform Act 2013 gained Royal Assent on 25 April 2013.⁴²⁰ The Shareholder Votes on

⁴¹⁶ SA Baron, SJ Hoffman and JG Merrill, *When work equals life : the next stage of workplace violence* (Pathfinder Pub. of California, Oxnard, CA 2000) Page: 62.

⁴¹⁷ S AlBuqmi, *Shareholding Company in Saudi system: Comparative study with Islamic jurisprudence* (Umm Alqura University, Makkah 1986) Page: 321.

⁴¹⁸ L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' [2010] *Journal of Business Law* 126.

⁴¹⁹ For official comment see: Shareholder votes on directors' remuneration Parliament (9.5.12) cl BIS 0341.

⁴²⁰ The official UK Parliament website. 'Enterprise and Regulatory Reform Act 2013' (2013) <<http://services.parliament.uk/bills/2012-13/enterpriseandregulatoryreform.html>> accessed 3/5/2013.

Directors' Remuneration policy in this Act aims to provide shareholders "with the enhanced tools they need to challenge companies on directors' pay".⁴²¹ The largest listed companies in the United Kingdom have witnessed a quadrupling in CEO payments over the last decade. This is despite the fact that there is little proof concerning the connection between high payments to CEOs and shareholder returns, or whether the payment to the CEO is as a consequence of improved performance.⁴²²

The Enterprise and Regulatory Reform Act 2013 has inserted new sections into the Companies Act 2006 such as section 439A. Historically, prior to this Act, the 2002 Directors' Remuneration Regulation Report had introduced what had been described as the 'first extensive provision on directors' pay' to the Companies Act 1985 including the shareholders' non-binding vote. However, the outcome of the provisions that were incorporated later on to a large extent in the Companies Act 2006 was not as expected.⁴²³ The Enterprise and Regulatory Reform Act 2013 has strengthened these provisions, including section 439A of the Companies Act 2006 in which "vested shareholders with voting rights to vote on the remuneration report in the annual general meeting."⁴²⁴ Some researchers believe that the Enterprise and Regulatory

⁴²¹ For official comment see: Enterprise and Regulatory Reform (ERR) Bill Parliament (9.10.12) cl BIS 0352. See also: BIS Press Office. 'Enterprise and Regulatory Reform Bill receives Royal Assent' (2013) <<http://news.bis.gov.uk/Press-Releases/Enterprise-and-Regulatory-Reform-Bill-receives-Royal-Assent-68b9b.aspx>> accessed 3/5/2013.

⁴²² For official comment see: Shareholder votes on directors' remuneration Parliament (9.5.12) cl BIS 0341.

⁴²³ E Ndzi, 'Directors' Excessive Pay and Shareholder Derivative Action' (2015) 36 *Company Lawyer* 144.

⁴²⁴ E Ndzi, 'Policy Implications of the UK's Companies Act 2006 Provisions on Directors' Remuneration' (2015) 26 *International Company and Commercial Law Review* 364.

Reform Act has shifted from simply an advisory vote to a binding vote. Inserting Section 439A to the Companies Act 2006 "creates a new binding vote on pay policy; however, the non-policy elements of the directors' remuneration report remain subject to an advisory vote" will create some complications such as creating two types of shareholder votes: binding policy votes and advisory non-policy votes.⁴²⁵

4.6.1 Rewards from a Sharia Perspective:

4.6.1.1 Board of Directors' Rewards

The treatment of rewards from a Sharia point of view depend on the type of rewards, which through an analysis proffered by Albuqumy are divided into four cases. The first case is whether the reward is a salary or recompense for attending meetings for example; in this case, the member of the Board of Directors is considered to be a 'Wakeel bel ajr' which means he or she is applicable for the 'Ijarah' contract. Consequently, The rewards in this case are considered to be valid and legal from the perspective of Sharia.⁴²⁶

Secondly, if the rewards involve concrete advantages, such as housing Board members in apartments or houses, or if the rewards are something that is known, disciplined and free of obscurity, this is also considered to be an 'Ijarah' contract; which allows a wage, whether cash, concrete goods or a benefit. The question that needs to be asked in this context is what if the rewards are a percentage of the

⁴²⁵ P Wells, 'Executive Remuneration: Regulatory Reforms in UK Company Law' (2015) 31 International Journal of Law & Management 300.

⁴²⁶ S AlBuqmi, *Shareholding Company in Saudi system: Comparative study with Islamic jurisprudence* (Umm Alqura University, Makkah 1986) Page: 387.

earnings, which is the third case. The Fiqh ruling considers this case to be acceptable if this percentage is from the reserve.⁴²⁷

The fourth case is where the reward is a mixture of the three previous cases. In this instance, it is acceptable if it is a mix of salary, recompense for attending meetings or concrete advantages. However, the reward of a percentage of earnings should not be mixed with other rewards cases. The reason for that is the first cases are considered to be an 'Ejaarh' contract, whereas the reward of a percentage of the earnings is considered to be a 'Mudharabah' contract which means mixing them is mixing between 'Ejaarh' and 'Mudharabah'.⁴²⁸

4.6.1.2 Saudi Arabian situation, compatibility or conflict?

Like any part of the world, there is the need to regulate the relationship between stakeholders, and there is the possibility of a conflict of interest and practically, there is no guarantee that everyone behaves ethically in the Islamic commercial environment.⁴²⁹ The issue of directors' rewards in many countries is described as a contentious issue, including those applying Sharia as law, whether completely or partly.⁴³⁰ The corporate law of Saudi Arabia recognises the importance of protecting all the parties in the company. In order to provide an example of the relationship

⁴²⁷ Ibid, Page: 388.

⁴²⁸ S AlBuqmi, *Shareholding Company in Saudi system: Comparative study with Islamic jurisprudence* (Umm Alqura University, Makkah 1986) Page: 389.

⁴²⁹ M Almadani, 'The role of Sharia law in protecting minority shareholders in private companies' (2010) 21 *International Company and Commercial Law Review* 395.

⁴³⁰ B Tricker, *Corporate governance : principles, policies and practices* (2nd edn Oxford University Press, Oxford 2012) Page: 318.

between companies law in Saudi Arabia and Sharia, the next paragraphs are an attempt to briefly address the relationship in this context.

Article 74 of Saudi Companies Law 1965 and Article 76 of Companies Law 2015 have clarified the issue of rewards in detail. The law allows rewards to be given to the members of the Board of Directors. These rewards include: specified salary, a fee for attending the meetings, in take benefits, a certain percentage of the profits.⁴³¹ However, companies law allows the mixing of two or more of these rewards, which requires more detail, as mentioned above in the fourth case, to be acceptable from a Fiqh stance.⁴³² However, the Companies law mentions that this must not prejudice against the requirements of Shariah, which places this issue under criticism.

Two articles in the corporate governance regulations of Saudi Arabia deal with remuneration. One of them is article 15 which is about the ‘Nomination and Remuneration Committee’; this became mandatory on all companies listed on the Exchange at the beginning of 2011, after the resolution issued by The Board of the Capital Market Authority. The other one is article 17, which deals with ‘Remuneration and Indemnification of Board Members’. Moreover, article 17 of the corporate governance regulations in Saudi Arabia states the same article as in the companies law: “The Articles of Association of the company shall set forth the manner of remunerating the Board members; such remuneration may take the form of

⁴³¹ MH Aljabr, *Saudi commercial law* (Aldar Alwataniya, Riyadh 1996) Page: 337.

⁴³² S AlBuqmi, *Shareholding Company in Saudi system: Comparative study with Islamic jurisprudence* (Umm Alqura University, Makkah 1986) Page: 389.

a lump sum amount, attendance allowance, rights in rem or a certain percentage of the profits. Any two or more of these privileges may be conjoined”.⁴³³

4.6.2 Delegation

4.6.2.1 Delegation from a Sharia point of view

Undoubtedly, unless prejudiced by the requirements of Sharia, the Sharia perspective is not to prevent any regulations that contribute towards regulating any aspects of life, including company management. Moreover, as Almdani has indicated, Sharia rules and principles “does not mean that there is no space for governments to regulate human activity whenever there is a public interest in doing so”.⁴³⁴

First of all, it is important to understand that managing the company is one of the rights of all the partners in most types of companies in Sharia, except ‘sharikat al mudharaba’. However, it is acceptable if the partners delegate the management to some of them or to another party. The reason behind the right to manage the company for all partners is that the Fiqh scholars consider ‘sharikah’ to be a ‘wakalah contract’ in most of the Islamic schools.⁴³⁵

Indeed, nowadays, companies vary in terms of the number of shareholders and implementing the basic contract of sharikah in Islamic jurisprudence. Consequently,

⁴³³ *Corporate governance regulations 2006* .

⁴³⁴ M Almadani, 'The role of Sharia law in protecting minority shareholders in private companies' (2010) 21 *International Company and Commercial Law Review* 395.

⁴³⁵ S AlBuqmi, *Shareholding Company in Saudi system: Comparative study with Islamic jurisprudence* (Umm Alqura University, Makkah 1986) Page: 370.

the question to be asked in this context is: is there room and capacity for Sharia and Islamic jurisprudence to absorb these types of companies?

Therefore, due to the huge numbers of partners in some companies nowadays, it is not acceptable to say that all the partners have the right to manage and direct the company, and the shareholders give their right to the Board of Directors' members by appointing them to direct the company. Sharikat al mudharabah in Islamic law is similar to the modern corporation nowadays and the notion of separation of ownership and control can be found in al mudharabah principles also.⁴³⁶

It is a fact that, except for 'sharikat al mudharaba', Sharia and Islamic jurisprudence do not mention the system required to appoint a manager or Board of Directors for a company. However, the Hanbali School of Islamic jurisprudence accepts mixing 'mudharabah' and 'enan' sharikah, which is applicable if the Board of Directors are shareholders in the company. On the other hand, if the Board of Directors' members are not shareholders, the Board of Directors is considered to be 'wakeel'.⁴³⁷

To sum up, delegation as a concept is close to 'wakalah' in general. So generally speaking, delegation is acceptable in Sharia concerning the right to appoint a 'wakeel' to work on behalf of him or her.

⁴³⁶ N H.D. Foster, 'Islamic perspectives on the law of business organisations: Part 2: the Sharia and Western-style business organisations' (2010) 11 *European Business Organization Law Review* 273.

⁴³⁷ S AlBuqmi, *Shareholding Company in Saudi system: Comparative study with Islamic jurisprudence* (Umm Alqura University, Makkah 1986) Page: 370.

4.6.2.2 The Saudi Arabian case

Corporate governance regulations issued in 2006 mention delegation in article 11 which deals with the responsibilities of the Board:

Part (a): “Without prejudice to the competences of the General Assembly, the company’s Board of Directors shall assume all the necessary powers for the company’s management. 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. The Board of Directors shall avoid issuing general or indefinite power of attorney”.

Part (e): “The Board of Directors shall determine the powers to be delegated to the executive management and the procedures for taking any action and the validity of such delegation. It shall also determine matters reserved for decision by the Board of Directors. The executive management shall submit to the Board of Directors periodic reports on the exercise of the delegated powers”.⁴³⁸

Moreover, the Saudi Arabian Companies Law which was issued in 1965 deals with delegation in article 73 and the new 2015 Companies Law in Article 75.⁴³⁹ Delegation in Saudi Arabian Companies Law is compatible with Fiqh in general.⁴⁴⁰

⁴³⁸ *Corporate governance regulations 2006* .

⁴³⁹ *Companies Law 1965*.

⁴⁴⁰ S AlBuqmi, *Shareholding Company in Saudi system: Comparative study with Islamic jurisprudence* (Umm Alqura University, Makkah 1986) 381.

4.6.4 Conclusion

To sum up, this section has attempted to shed light on two important subjects, which are rewards and delegation from the perspective of Islamic law and Fiqh. As can be seen above, there is the possibility and capacity within Sharia law to adapt to modern concepts. The prospective of Sharia in this context is important to understand the influence of Sharia on all parties involved , taking Saudi Arabia as a case as the sharia is the law.⁴⁴¹

The relationship between pay policies and the strategy and performance of the company is very important, as shortfalls between them could result in economic costs, as well as weakened corporate governance and reduced confidence in the corporate sector. Practically, as can be seen above, the Companies Law and corporate governance regulations in Saudi Arabia provide details of reward and delegation. However, it cannot be assumed that all cases presented are compatible with the Sharia point of view, which has resulted in criticisms being levelled towards this approach.

With regard to Sharia, it is fair to say that the 2015 Companies Law has some aspects that have been amended in order to be more compatible with Sharia. It can be seen very clearly that all debt securities issuances are required to be compatible with Sharia. Article 121 of the new law has stated that the company must bear in mind Sharia provisions of debt when issuing debt securities.⁴⁴² Moving on to the issue of remuneration, article 76 of Companies Law 2015 clarifies the issue of rewards in

⁴⁴¹ N H.D. Foster, 'Islamic Commercial Law: An Overview (I)' (2006) 4 InDret: revista per a analisi del dret 384.

⁴⁴² *Saudi Company Law 2015*.

details. The new feature is that the new companies law states in article 76 that the directors' annual compensation (including attendance fee and salary) must not exceed 500,000 SAR. However, Companies Law 2015 has the same article as the 1965 version regarding the issue of mixing two types or more of rewards⁴⁴³, but in the view of Albuqumy, the reward of a percentage of earnings should not be mixed with other rewards to be compatible with Sharia.⁴⁴⁴

From the previous discussion, it could be fair to say that the 2015 Companies Law has solved some of the conflicts with Sharia in the 1965 such as Article 9 of 1965 regarding the partner's share in the profits or losses which has been replaced with Article 11 of 2015 law to be compatible with Sharia. Moreover, the 2015 Companies Law has stated more than once the phrase of 'in accordance with Sharia principles' such as in Article 11, 121 which indicate the intention of making the new law more compatible with Sharia principles. However, one issue is that the 2015 Companies Law has excluded the Sharia sharikah types from the new law unless it has the form of any of the new law company types as stated in Article 3.⁴⁴⁵

⁴⁴³ Article 74 of *Saudi Company Law 1965* stated the types of rewards as: specified salary, a fee for attending the meetings, in take benefits, a certain percentage of the profits, or a combination of two or more of these benefits.

⁴⁴⁴ S AlBuqmi, *Shareholding Company in Saudi system: Comparative study with Islamic jurisprudence* (Umm Alqura University, Makkah 1986) Page: 389.

⁴⁴⁵ *Companies law 2015*.

4.7 Waqf and corporate governance

The previous sections have discussed some crucial issues that are related to Sharia in the context of corporate governance, including the Sharia perspective of corporate governance; Sharia and adaptation, and Sharikah types in Sharia. Likewise, management, responsibility, reward and delegation from a Sharia perspective have been covered as well in order to examine the Saudi legal system which has Sharia as the supreme law of the state. From this point, the following section is an attempt to find out if there is an example from Sharia heritage that can be used to show how Sharia deals and governs the issues of relationships between the parties involved in issues that to some extent are similar to the relationship between parties involved in corporate governance and companies nowadays.

Issues in waqf like managers' obligations, accountability and responsibility, will be examined to discover some relationships and links between Sharia and corporate governance in terms of some of the shared principles and mechanisms, and what the views of Sharia scholars are on this important matter. For example, regarding the issue of separate legal personality, the *Salomon v Salomon & Co Ltd* could be described as the first case that confirmed the separate legal personality principle in English law.⁴⁴⁶ But others suggest that it merely confirmed an idea that was widely understood. Interestingly, there is an argument that the issue of separate legal entity

⁴⁴⁶ *Salomon v Salomon & Co Ltd* [1897] A.C. 22 (HL). See: S Mohanty and V Bhandari, 'The Evolution of the Separate Legal Personality Doctrine and Its Exceptions: A Comparative Analysis' (2011) 32 *Company Lawyer* 194.

was recognised by scholars of Sharia in waqf years before the *Salomon*.⁴⁴⁷ Although there is no principle of 'separate legal entity' similar to what can be found in Common law, Sharia scholars have treated the institution of waqf as what is known nowadays as a 'separate legal entity', as the waqf institution itself could own a property. So, if the waqf money has been used to buy property, the property will be owned by the waqf institution and not become part of the waqf directly.⁴⁴⁸

It is a fact that the waqf foundations have over the past years witnessed the development and growth of capital, and the income of some waqf indicate the importance of supervision and governance mechanisms. The efforts of Sharia scholars to develop the waqf system, include developing its principles, the control system, and the power distribution between the waqf parties. The increasing number of wealthy Muslim countries, in parallel with the background of philanthropy in these countries, has increased the importance of waqf and its structure, with "increased resources being held on terms that seek to comply with the requirements of Islamic law"⁴⁴⁹. So, the following section will attempt to shed light on waqf -in brief- in the context of Sharia, in order to discover some relationships and links between Sharia and corporate governance in terms of some of the shared principles and mechanisms.⁴⁵⁰

⁴⁴⁷ *Salomon v Salomon & Co Ltd* [1897] A.C. 22 (HL).

⁴⁴⁸ Z Zuryati, M Yusoff and A Azrae, 'Separate Legal Entity under Syariah Law and Its Application on Islamic Banking in Malaysia: A Note' (2009) 6 *International Journal of Banking and Finance* 139.

⁴⁴⁹ P Stibbard, D Russell and B Bromley, 'Understanding the waqf in the world of the trust' (2012) 18 *Trusts & Trustees* 785.

⁴⁵⁰ Waqf regulations are depending on the Muslim country law. See for example: UA Oseni, *Towards the Effective Legal Regulation of WAQF in Nigeria: Problems and Prospects* (Rochester 2009).

4.7.1 Overview and definition of waqf

The definition of waqf in Islamic law (Sharia) can be described as the detention of the property of origin, and the profit of this property to be used for a charitable purpose.⁴⁵¹ In other words, waqf in Sharia has been defined as “The detention of the corpus from the ownership of any person, and the gift of its property or usufruct either presently or in the future to some charitable purpose.”⁴⁵²

In the Quran, Verse 92 of Surat Albaqrah mentions the root of Waqf in Sharia, as it states: “By no means shall you attain Al-Birr (piety, righteousness - here it means Allâh’s Reward, i.e. Paradise), unless you spend (in Allâh’s Cause) of that which you love; and whatever of good you spend, Allâh knows it well”⁴⁵³. On the other hand, there are also some hadiths that could be used as that basis of waqf, as they urge people to do something that will last during the life of the person, and afterwards, as an ongoing charity. One such hadith is narrated by Muslim in his Sahih: “When a man dies, his acts come to an end, but three: recurring charity, or knowledge (by which people) benefit, or a pious son who prays for him (for the deceased).”⁴⁵⁴

Moving on to the purpose of the waqf, there are many reasons and aims for it in the scope of it becoming bigger over the years. Stibbard, Russell and Bromley suggest

⁴⁵¹ O Masqawi, *Waqf system and its legal and sharia provisions* (Dar Alfikr, Damascus 2010) Page: 73.

⁴⁵² P Stibbard, D Russell and B Bromley, 'Understanding the waqf in the world of the trust' (2012) 18 *Trusts & Trustees* 785 .

⁴⁵³ Sûrat Albaqarah Verse 92 , Available at:

<http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?TabID=4&SubItemID=1&l=eng&t=eng&SecOrder=4&SubSecOrder=1>.

⁴⁵⁴ Sahih Muslim : Book 013, Hadith Number 4005.

that, there are many aims of waqf in Islamic law such as religious aims; education; helping the poor, needy and orphans; providing for persons in prison, and improving health services.⁴⁵⁵

4.7.2 The importance of waqf

Waqf plays a crucial role due to the advantages which will be gained by society if it is controlled and managed in the right way and for the purposes of the establishment of it. There are many examples of waqf from the early days of Sharia until now, starting from the Prophet Muhammad (pbuh) and some of his companions, followed by Umar bin Alkhatib who was the second Caliph after the Prophet (pbuh).⁴⁵⁶ The importance of the waqf is to meet the essential needs of society. There are many examples of waqf, such as funding health care, education, libraries, research and constructing roads.⁴⁵⁷

Historically, some historians have suggested that there is a link between the emergence of charitable trusts and the concept of waqf. Waqf can be described as being more similar to a charitable trust than a charitable company in many respects, according to Thomson. However, the reasons for using ‘charitable company’ by some Islamic organisations in the UK are because of the attractive proposition of benefiting from being a legally recognised entity, and the executive body has limited liability. However, the structure of a ‘charitable company’ makes the administration more

⁴⁵⁵ P Stibbard, D Russell and B Bromley, 'Understanding the waqf in the world of the trust' (2012) 18 *Trusts & Trustees* 785.

⁴⁵⁶ A Lamin, *Waqf and the danger of its extinction on the charity work* (Dar al-kalimah, Cairo 2012) Page: 26.

⁴⁵⁷ *Ibid*, page: 36.

complicated due to the fact that the organisation will be subjected to both charity law and company law requirements.⁴⁵⁸

4.7.3 Legal perspective of waqf

The legal root of waqf in Sharia is not only founded in the two main sources of Islam- the Quran and Sunnah- as there is “Ejmae” (consensus) about the waqf and “Qiyas” (analogy). Legally, in Sharia through waqf, the founder no longer has ownership of the property, and generally, the property which is transferred to a waqf involves an irrevocable transfer. Whereas in the common law trusts, the right to revoke is reserved for settlors, which means a greater flexibility.⁴⁵⁹ On the other hand, from a Sharia viewpoint, there are some terms and conditions for the waqf to be valid. Next paragraph attempts to set out some of the terms and conditions of waqf in Islamic law.

First of all, the legal capacity of the owner is essential, and the fact that the ‘endowment’ must be from the owner him/herself. The waqf must be for an unlimited time, so if it is for a specific period of time, it cannot be described as a ‘waqf’. Moreover, for the waqf to be valid, it must involve profitable property in order to achieve the purpose of it.⁴⁶⁰

⁴⁵⁸ A Thomson, 'Islamic charitable trust' (2000) 144 Solicitors Journal 32,34.

⁴⁵⁹ P Stibbard, D Russell and B Bromley, 'Understanding the waqf in the world of the trust' (2012) 18 Trusts & Trustees 785.

⁴⁶⁰ O Masqawi, *Waqf system and its legal and sharia provisions* (Dar Alfikr, Damascus 2010) Page: 140.

4.7.4 Governance of waqf

The system of waqf was developed throughout the early three centuries of Islam and gained the interest of the scholars, as the Prophet Muhammad (pbuh) could be described as the first to practice waqf. The following paragraphs are an attempt to show some of the elements of waqf, taking into account the principles of corporate governance.

First of all, it is important in the context of the Waqf governance to understand the power level of the waqf owner. So, in terms of appointing the beneficiaries, the waqf owner, the 'waqif', could be described as having a "wide degree of discretion" besides the power to control the waqf manager such as appointing and removing him.⁴⁶¹

An equally significant aspect of the waqf governance is the manager of the waqf. Islamic jurisprudence gives the manager of waqf (Nather alwaqf) the very important duty of care. The manager of the waqf here could be described as the trustee and his role is "very similar to that of a trustee under UK law"⁴⁶². Fiqh during past centuries established some rules and conditions to be met by the person who will become a trustee or manager of the waqf; therefore, there are some obligations and tasks that must be done by the manager as well as there being limitations placed on his or her

⁴⁶¹ Ibid.

⁴⁶² A Thomson, 'Islamic charitable trust' (2000) 144 Solicitors Journal 32,34.

acts. Moreover, there is the limitation of the liability of the waqf manager. Furthermore, the salary of the manager of the waqf is also discussed in the fiqh.⁴⁶³

To start with, generally, there are four terms required for the manager to have this position, including being sane, an adult, honest and having the ability required for this kind of work. Thus, the manager of a waqf (Nather alwaqf) must have the legal capacity to manage the waqf and deal with its affairs correctly.⁴⁶⁴

Another, significant factor in the governance of the waqf is the Waqf manager's obligations. Clearly, for the sake of maintaining the waqf, the waqf's manager has to do everything in order to maintain the waqf and take care of its issues. The next paragraph is an attempt to shed light on some of the obligations of the waqf manager.

Firstly, the implementation of the terms and conditions is very important, as the manager must comply with the terms and conditions set out by the waqf owner. Therefore, none of the terms or condition can be neglected or violated, except in some circumstances which will be clarified in a later part of this section.⁴⁶⁵

The waqf manager must stand on the rights of the waqf during any judicial litigation. Also, the waqf manager has an obligation to maintain the waqf, including the

⁴⁶³ O Masqawi, *Waqf system and its legal and sharia provisions* (Dar Alfikr, Damascus 2010) Page: 225, 241. See also A Bik and W Ibrahim, *Encyclopedia of waqf from the four islamic schools* (Azhar Library for Heritage, Cairo 2009) Page: 210.

⁴⁶⁴ O Masqawi, *Waqf system and its legal and sharia provisions* (Dar Alfikr, Damascus 2010) Page: 220. See also K Alshabib, *Alnatharah (managment) on waqf* (The Kuwait Awqaf Public Foundation, Kuwait 2006) Page: 166.

⁴⁶⁵ A Lamin, *Waqf and the danger of its extinction on the charity work* (Dar alkalimah, Cairo 2012) Page: 59. See also A Bik and W Ibrahim, *Encyclopedia of waqf from the four islamic schools* (Azhar Library for Heritage, Cairo 2009) Page: 210.

restoration and maintenance to keep the waqf in good condition in order to maximise the benefit of the waqf. The payment of the debt of the waqf is more important than the payment to the waqf's objectives, such as the poor people, so the waqf manager must use the profit of the waqf to pay any debts. Consequently, the manager of the waqf must operate the waqf and use its benefits for the appointed objectives unless there are debts, or if there is a need for real maintenance of the waqf.⁴⁶⁶

Obviously, the actions of the waqf manager must be for the sake and for the benefit of both the waqf and the waqf's beneficiaries, taking into account the terms of the waqf's owner. There are some acts which are prohibited for the waqf manager, such as favouritism; therefore, the waqf manager must not lease the waqf to him/herself or to his or her relatives, as this act could put him or her in a position of suspicion.

Likewise, for the sake of the waqf, the manager must not take a loan and pay back the debt from the waqf- except in case of necessity- as this action could lead to putting the waqf's profits at risk for the creditor's interests. The act of placing the waqf as a mortgage could put the waqf at risk of loss of the waqf. Moreover, the prices of the waqf's products must be at the same price as in the market for the same product. Finally, except for the beneficiaries, loaning the waqf is prohibited.⁴⁶⁷

⁴⁶⁶ K Alshabib, *Alnatharah (management) on waqf* (The Kuwait Awqaf Public Foundation, Kuwait 2006) Page: 166.

⁴⁶⁷ Ibid, Page:166. See also A Bik and W Ibrahim, *Encyclopedia of waqf from the four islamic schools* (Azhar Library for Heritage, Cairo 2009) Pages: 210 to 212.

4.7.4.1 Accountability and the Responsibility of the waqf manager

Due to the fact that usually the waqf manager is one person and working alone in most of the waqfs, it is generally accepted that not everybody has good conduct, and not everyone has the skills required for management. Consequently, it is necessary to follow up and supervise the work of the waqf manager. The waqf manager must be honest and faithful concerning the waqf. On the other hand, he or she is responsible for dereliction according to the general principles of this responsibility. Moreover, the waqf manager must provide an annual statement for the judiciary.

Thus, the logical question is: who should supervise the waqf manager's work and actions? In Sharia, the fiqh scholars stated the Judge to be the supervisor, whether alone or by appointing a trust supervisor. Appointing a trust supervisor by the Judge is allowed in **three cases**, which are founded in Sharia Jurisprudence. In short, **the first case** is where the waqf manager is a weak manager, which causes the waqf management to reach an unsatisfactory situation. The judge in this case should appoint a trust supervisor. **Secondly**, in the case of a waqf manager coming under suspicion, but where there is no evidence, appointing a trust supervisor by the Judge is also advised. **Finally**, if the waqf's owner has appointed an eligible manager who fulfilled the full terms and conditions on being the waqf manager, but then lost some of them later, the judge in this case must appoint a supervisor to protect the rights of both the owner of the waqf and the waqf. ⁴⁶⁸

⁴⁶⁸ O Masqawi, *Waqf system and its legal and sharia provisions* (Dar Alfikr, Damascus 2010) Page: 241. See also A Bik and W Ibrahim, *Encyclopedia of waqf from the four islamic schools* (Azhar Library for Heritage, Cairo 2009) Page: 193.

Moving to the accountability levels, there are two tiers of accountability in a waqf. The first tier is from the judge to the owner, and the second tier is from the beneficiaries the nather of waqf if they are the appointees of the waqf owner.

Moving to one of the major issues in this context, the salary of the waqf manager. Indeed, the salary of the manager should be given the right priority in order to avoid corruption and to provide more transparency. There is no doubt about this if the waqf owner has determined a salary for the waqf manager. However, if there is no salary mentioned, the judge should give the waqf manager a salary equal to a similar job, as giving more could infringe upon and breach the rights of the waqf's beneficiaries.⁴⁶⁹

Dismissing the manager of the waqf is also an important issue to be considered in this context. It is the waqf owner's right to appoint or to dismiss the manager of the waqf. The judge also has the right to dismiss the waqf manager in some cases, such as due to betrayal or dishonesty. For example, if the waqf manager acts in way that leads to some loss of the waqf, or uses the waqf for his or her own benefit, or does not follow the terms of the waqf owner. On the other hand, there are some reasons for the dismissal of the manager of waqf manager which are beyond the will of all parties. For example, if the waqf manager is unable to do his or her job for reasons such as mental health problems or due to death.⁴⁷⁰

⁴⁶⁹ O Masqawi, *Waqf system and its legal and sharia provisions* (Dar Alfikr, Damascus 2010) Page: 225.

⁴⁷⁰ A Bik and W Ibrahim, *Encyclopedia of waqf from the four islamic schools* (Azhar Library for Heritage, Cairo 2009) Page: 222.

4.7.4.2 Is there a capacity to develop a governance mechanism?

Finally, this section has illustrated waqf within the framework of Sharia in order to examine the links between Islamic law and the principles of corporate governance. Therefore, it may be possible to understand from the waqf example, the capacity of Islamic law to develop a regime for governance as “scholars developed jurisprudence with respect to the creation, management, and administration of waqf progressively”⁴⁷¹. Like corporate governance, the waqf system has provided a mechanism to protect the rights of all parties involved in the waqf institution; these arrangements contain mechanisms of disclosure and transparency. If the waqf institution has a board of directors, or even one manager, the system of waqf shows the ability of issuing mechanisms that illustrate the functions and responsibilities of the manager or the board, as well as audit roles. As mentioned earlier, scholars have treated the institution of waqf as what is known nowadays as a 'separate legal entity'. Regarding liability, nather alwaqf has a limited liability as negligence is the basis of liability. Moreover, in waqf, at the time of a conflict of interests, the priority is the waqf's interests. From the previous sections it is fair to say that the efforts of Sharia jurists have led to developing a system, rules and regulations that govern an institution, and that generate and maximise profits.

There are other examples from Western jurisdictions that represent some aspects that are similar to some extent to the waqf approach in Sharia jurisdiction. Benefit corporations in the USA provide an example of a legal entity with accountability and transparency, more so than the other entities. Benefit corporations are subject to

⁴⁷¹ P Stibbard, D Russell and B Bromley, 'Understanding the waqf in the world of the trust' (2012) 18 *Trusts & Trustees* 785 .

additional requirements compared to standard companies, with more consideration given to stakeholders than investors. In this kind of company, not only is maximising the shareholders' value the goal, as it is a new approach that has seen growing interest from investors who seek to balance profits with societal benefits. In other words, benefit corporations provide a solution for shareholders who have the purpose of maximising their profits without losing control of their mission of addressing social and environmental concerns.⁴⁷²

4.8 Conclusion

This chapter has discussed some important aspects of Sharia in relation to corporate governance, and it has been made clear that corporate governance as a concept is not essentially strange to Sharia.⁴⁷³ It has been explained in section two how, although certain rules and principles of Sharia already exist, there is room to produce new rules and regulations as long as they do not breach the Sharia, corporate governance regulations for example. Moreover, providing for this does not violate Sharia- Sharia supports procedures that protect the rights of all parties, which is one of the most important aims of corporate governance. This chapter has shown that, although the closest model of corporate governance to Sharia is the stakeholder model, it is a more comprehensive view due to the ethical values involved.⁴⁷⁴

⁴⁷² M Rahim, 'The rise of enlightened shareholder primacy and its impact on US corporate self-regulation' (2014) 25 International Company and Commercial Law Review 409.

⁴⁷³ 'Islamic finance in the spotlight' (2009) Banker, Middle East . Available at <http://search.proquest.com.ezproxy.lancs.ac.uk/docview/232390090?accountid=11979>.

⁴⁷⁴ RA Kasri, 'Corporate Governance: Conventional vs. Islamic Perspective' (2009) SSRN 11.

There are some theories of business that are based on religious and ethical principles such as Quaker theory.⁴⁷⁵ The nature of corporate governance from an Islamic point of view is shaped by two aspects. One of them is that all of life's aspects are covered by the sovereignty of Sharia, and the Islamic principles of finance and economic issues.⁴⁷⁶ This chapter has identified justice, responsibility, accountability and transparency as principles of Sharia in the context of corporate governance. The fact that business ethics and morals are paid great attention in Sharia may explain the increasing trend towards Sharia business systems nowadays.⁴⁷⁷ Moreover, the number of customers who are keen to have business transactions that are compatible with Sharia is an increasing trend. Harsani, points out that the demand for Islamic-compliant finance is increasing as a result of Muslim population increases in Western countries.⁴⁷⁸ This, accompanied with the globalisation of the business world nowadays, makes attracting customers from all over the world another motivation and marketing strategy. Finally the Sharia approach with the prohibition of certain transactions such as *riba*, *gharar* and *maisir* has attracted the attention of some researchers in the shadow of the crises that the world is witnessing nowadays. Sharia finance could contribute to the prevention of such crises. In the view of Buitter, nowadays, the business world is characterised by being risky, but fixed financial

⁴⁷⁵ E Sahle, 'An Investigation of Early Modern Quakers' Business Ethics' (Economic History working paper series 216/2015, The London School of Economics and Political Science, London 2015).

⁴⁷⁶ M Lewis, 'Islamic Corporate Governance' (2005) 9 *Review of Islamic Economics* 5.

⁴⁷⁷ L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' [2010] *Journal of Business Law* 126.

⁴⁷⁸ H Harasani, 'Analysing the Islamic Prohibition on Riba: A Prohibition on Substance or Form' (2013) 27 *Arab Law Quarterly* 289.

commitments debt could be a bad financing choice, which makes the application of Islamic finance principles a solution: "in particular a strong preference for profit-, loss- and risk-sharing arrangements and a rejection of 'riba' or interest-bearing debt instruments."⁴⁷⁹

The chapter has covered the scope of Sharia, its sources, Islamic jurisprudence and objectives, in order to explore the ability of Sharia to adapt and absorb new concepts. The ability to adapt to new concepts such as corporate governance is very important for the law. However, it has been argued that in the case of Sharia this has not been considered until recent times.⁴⁸⁰ This chapter has shown that sharikah in Sharia has two main types, which are Sharikat amlak and sharikat alaoud, and both of them are divided into several types of sharikah. Therefore, understanding the Sharia point of view concerning sharikah is crucial in order to analyse the relationship between all parties involved in the company.

It is a fact that Saudi companies law includes several types of companies which differ in name from the Sharikah types mentioned in Sharia. The Companies Law 1965 states in article two section A the names of these companies, including general partnership; limited partnership; joint venture; joint-stock corporation; partnership limited by shares; limited liability partnership; company with variable capital; and cooperative company. On the other hand, the Companies Law 2015 has edited down

⁴⁷⁹ W Buiters, 'Islamic Finance Principles to Restore Policy Effectiveness' (The Financial Times LTD 2009) Available at: <<http://blogs.ft.com/maverecon/2009/07/islamic-finance-principles-to-restore-policy-effectiveness/#axzz4429eoPjd>> accessed 29/3/2016.

⁴⁸⁰ N H.D. Foster, 'Islamic Commercial Law: An Overview (I)' (2006) 4 InDret: revista per a analisi del dret 384.

the types of companies by deleting the cooperative company, Partnership limited by shares and company with variable capital. However, the new law has added Holding Company and one person Limited liability Company. However, regarding the argument that Saudi Arabia's Companies law does not contain the Islamic law names of sharikah, this may be responded to by two answers. First of all, all of these companies that are included in companies law do not conflict with Islamic sharikah types, and all of them can be adapted; also, the origin of each can be found in one of the Islamic law's sharikah types. Moreover, the Companies Law states in article two: "Without prejudice to such companies known in Islamic jurisprudence."⁴⁸¹

Sharia may impose constraints upon corporate governance in ways not found in the West. Riba, gharar and maisir are prohibited transactions in Sharia, and this chapter has addressed them in brief in the context of Sharia. Despite the fact that there are some prohibited transactions with regard to Sharia in companies and banks within the GCC countries including Saudi Arabia, all Islamic banks and institutions, and nearly all the conventional banks, have Sharia groups or Sharia supervisory boards. The results of this chapter indicate the importance of these boards remaining independent. This chapter has also shown that Sharia groups do not clash with the standards of corporate governance if the management of the Islamic organisation remains independent.⁴⁸²

The relationship between the Board of Directors and the shareholders from a Sharia perspective is significant due to the fact that, practically, there is no guarantee that

⁴⁸¹ *Saudi Companies Law 1965.*

⁴⁸² M Casper, *Sharia Boards and Sharia Compliance in the Context of European Corporate Governance* (Rochester 2012).

everyone will display ethical behaviour in any cultural context, including the Islamic business environment.⁴⁸³ This chapter has addressed the issues of reward and delegation from a Sharia point of view, which is also very important in this context. Consequently, section five illustrates the rewards of Board of Directors from a Sharia perspective, and illustrates that this case depends on the type of rewards, which are divided into four cases. This section has shown that the reward of a percentage of earnings should not be mixed with other reward cases in Sharia. However, Saudi Arabian Companies Law and corporate governance regulations allow the mixing of these cases, which places this issue under criticism.

This chapter has also shown that treating the contract between the director and shareholders as a ‘wakalah’ contract is important in order to distinguish the acceptable cases of reward and delegation. It is clear that modern companies have more complicated issues compared with companies back in the 14th century. One implication of this chapter is the possibility that Sharia jurisprudence is able to absorb these types of companies. To sum up, it is clear that the principles of corporate governance are not strange to Sharia, as they are included separately in the sources of Sharia. Moreover, Abu-Tapanjeh contends that “the call for principles of corporate governance is not something new and alien to Islam”.⁴⁸⁴

And so, this chapter has found that in general there is no clash between Sharia and the new concept of corporate governance, which means the Saudi issuance of corporate

⁴⁸³ M Almadani, 'The role of Sharia law in protecting minority shareholders in private companies' (2010) 21 *International Company and Commercial Law Review* 395.

⁴⁸⁴ A M Abu-Tapanjeh, 'Corporate governance from the Islamic perspective: A comparative analysis with OECD principles' (2009) 20 *Critical Perspectives on Accounting* 556.

governance regulations in 2006 was a correct step in the right path as there is a room for the Saudi Arabian legal system for adaptation. Having covered the main issues of Sharia that related to corporate governance in general make it an important issue to examine the Saudi Arabian legal and institutional framework of corporate governance in order to promote an attractive business environment. So, Chapter five will now move on to consider the issue of the Saudi Arabian legal system. The discussion will cover some important issues in the context of corporate governance laws and regulation frameworks, including the legal institutions and authorities' role, such as executive and legislative authorities and the judicial authority. These issues, alongside the recent legal system reforms have a direct impact on the business environment of Saudi Arabia and the GCC in general.

5. Chapter five: Saudi Arabian corporate governance: the legal and regulatory framework

5.1 Background of Saudi Arabian legal system

Corporate governance is a relatively new challenge in a relatively new state. The first official regulations issued in Saudi Arabia occurred only ten years ago, and the Kingdom of Saudi Arabia was only founded in 1932. It is a crucial requirement to have a regime for the establishment and operation of companies, which is significant for economic development and for promoting an attractive business environment.

There are several factors that play crucial roles and impact on the business environment and economic development. Examining the authority of the state and the legislative tools are very important for an evaluation of the current rules and regulatory framework of corporate governance in Saudi Arabia. Also, the power of the courts to impose sanctions and enforce laws is a critical issue. Moreover, the current position in Saudi Arabia is interesting and characterised as witnessing a crucial changing of roles between the judicial authorities. There is no doubt that the new laws and the rapid changing of roles on the legal scene will cast a shadow over the current rules and regulatory frameworks of corporate governance in Saudi Arabia, which therefore will impact on the business environment. For example, recently, the Supreme Council of Judicial and the Diwan Al Madhalim 'Board of Grievances' signed a document for moving the commercial courts from the Administrative judiciary to the General judiciary. Resolving this document involved a process of around a year, which could indicate the speed of decision making. Moreover, in 2014, the jurisdiction of investigation and prosecution of Article 31, 49 and 50 moved from

the Capital Market Authority to the Bureau of Investigation and Public Prosecution. Furthermore, the legislative process or the court system plays a crucial role in this context, which will be reflected in the business environment. Courts play a major role in the context of corporate governance, so needless to say, the institutional framework such as an independent judicial system that works efficiently is a safeguard for applying the concept of corporate governance in order to be effective.⁴⁸⁵

Jurisdictions that have investment frameworks that serve the interests of shareholders will take the lead in the race to gain the trust of investors.⁴⁸⁶ Consequently, investors need a clear vision of the judicial authority in order to increase confidence in safe investment. Thus, an effective institutional framework will contribute towards effective corporate governance, which therefore will attract both local and foreign investors. There is a need for a clear vision of the judiciary, whether it is a general court or administrative court or quasi-judicial committees. There is also a need to shed light on the quasi-judicial committees, which specialise in the capital market, and to differentiate between them and the other jurisdictions

5.1.1 Overview of Saudi Arabia

The year 1938 witnessed a remarkable new event, which changed the face of Saudi Arabia and the Gulf states forever. On the fourth of March of that year, Well Number Seven (which is located in Dammam) unveiled the largest source of crude oil in the

⁴⁸⁵ <http://iefpedia.com/arab/wp-content/uploads/2011/07/الشركات-حوكمة1.pdf>.

⁴⁸⁶ B R. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan Via Toronto' (1999) 10 *Duke Journal of Comparative and International Law* 5.

world.⁴⁸⁷ A few years before that, in 1932, King Abdulaziz issued a royal decree concerning the announcement of the Kingdom of Saudi Arabia's creation, after the completion of the uniting of the main regions of the Arabian Peninsula. These regions include Najd, the central region where the capital city Riyadh is located; Al Hijaz, the western region where the two Holy cities of Mecca and Madinah are and where the Islam was revealed early in the Seventh century; and the Eastern region where crude oil was found later on.

In fact, this new country 'Saudi Arabia' could be described as the third Saudi state, as some historians have mentioned. The first Saudi state ruled from 1744 until 1818 as it was destroyed by the Ottoman Empire. The second state started around 1824 and lasted until the beginning of the final decade of the nineteenth century when the father of King Abdulaziz was forced to move with his family to Kuwait between 1891 and 1892.

The question to be asked here is what is the importance of this historical overview in the context of corporate governance's legal and regulatory framework in Saudi Arabia and the GCC states? This historical overview is very significant in order to shed light on and to recognise the religious and legal background of Saudi Arabia - the largest economy and country within the GCC members. Therefore, the first Saudi State (1744-1818) was established after the agreement between Mohammed Bin Saud (the founder of Saudi State) and Sheikh Mohammed Bin Abdulwahab, who was an Islamic religious scholar. Remarkably, there are many articles and books that have been

⁴⁸⁷ The drilling on Well No. 7 was made by a foreign company from the United States of America known as the Standard Oil Company of California SOCAL. See: M Norton, *Well Done, Well Seven* (Aramco, Saudi Arabia 1988).

written about Mohammed Bin Abdulwahab and his Islamic point of view.⁴⁸⁸ From this point, the historical deal between Imam Muhammed bin Saud and Sheikh Mohammed bin Abdulwahhab could be described as the cornerstone to Sharia becoming the law of the state and forming the legal framework of the first Saudi state, and this is reflects in the second and current state, the Kingdom of Saudi Arabia.

It is a fact that Islam as a religion and Islamic Sharia emerged in the Arabian peninsula many centuries before the existence of any of the current GCC countries nowadays, including Saudi Arabia. However, this could be disputed, as some opinions claim that Sharia lost its sovereignty during certain periods in some parts of the Muslim world, including some parts of the Arabian Peninsula before Muhammed bin Abdulwahab.⁴⁸⁹ Moreover, Muhammed bin Abdulwahab has been described as a ‘reformer’ by some researchers.⁴⁹⁰ The lowest depth of decrepitude that the Muslim world sunk to was in the eighteenth century, which was followed by Mohammed bin Abdulwahhab’s movement in what could be described as the beginning of a great revival according to Lothrop Stoddard.⁴⁹¹ This summary of the historical background illustrates the relationship between Sharia and Saudi Arabia that is reflected in many of life’s aspects nowadays, including the legal and regulatory frameworks of corporate governance and the business environment.

⁴⁸⁸ L Stoddard, *The new world of Islam* (C. Scribner's sons, New York 1921) Page 21.

⁴⁸⁹ The Arabian Peninsula contains nowadays the GCC countries and Yemen.

⁴⁹⁰ See for example: L Stoddard, *The new world of Islam* (C. Scribner's sons, New York 1921. Page: 22.

⁴⁹¹ Ibid page: 21.

Moreover, the importance of this chapter in the context of this thesis is reflected in several significant issues. In order to examine the corporate governance regulations in a country such as Saudi Arabia, there is a need to shed light on the main aspects of the corporate governance regulations frameworks such as religion, society, the legal system, and related authorities and institutions. There are several factors that contribute and have an impact on the corporate governance regulations in such a developing country. For example, the government system - democratic or absolute monarchy- will absolutely influence the environment. On the other hand, the judicial authorities and court system also have a direct impact when handling issues related to companies and corporate governance. Also, the regulatory tools that are used for the issuance of corporate governance regulations and to deal with other related issues are very important to be examined in this context, such as Royal orders, Royal decrees and Subsidiary Regulations. Institutions that have regulating powers are quite different to Western style institutions and also need to be observed in order to show the current regulating powers that are related to corporate governance. Finally the new courts' structure and reform is a very important issue that contributes to corporate governance enforcement on the one hand and the business environment on the other.

5.1.2 The complexity of Saudi society and culture

Definitely, there are many reasons that explain the need for corporate governance regulations, and there are many causes of 'corruption' for example appearing in any country. However, the situation of weak institutions as well as economic rents generated by government policies, can be described as providing a situation where corruption can flourish. The World Bank has explained the reasons for corruption are

permanently contextual, which includes the social history of a country, political developments, bureaucratic traditions and the policies of the country.⁴⁹²

Certainly, some of these causes can be seen very clearly in the context of the GCC states. However, the complexity of the GCC and Saudi culture could define some of the previous causes, as well as another point of view, as a result of using different standards and having a different culture. The differences between standards from a Western viewpoint and the GCC states in terms of culture, could play a crucial role in the legal and regulatory framework of corporate governance. For example, Saudi Arabian culture takes the family or in-group ideas as the basis for loyalty, whereas the United States is macro-level based on cultural ideas.⁴⁹³

Generally speaking, values in the GCCs in particular, and Arab countries in general, are influenced by four factors in the view Hickson and Pugh, including Islam, tribal traditions, the Western quest for oil, and foreign rule. However, these influences vary depending on the country, especially in the GCC countries' case. Furthermore, these changes create variations in cultures and ethics between these countries, and a capacity for convergence and divergence.⁴⁹⁴

⁴⁹² Poverty Reduction and Economic Management The World Bank, 'Helping Countries Combat Corruption: The Role of the World Bank' (The World Bank, Washington 1997).

⁴⁹³ C J Robertson, A A Diyab and A AKahtani, 'A Cross-National Analysis of Perceptions of Corporate Governance Principles' (2013) 22 International Business Review 315.

⁴⁹⁴ D John. Hickson and D S. Pugh, *Management Worldwide : The Impact of Societal Culture on Organizations around the Globe* / (Penguin, 1995) Page: 194.

It may be clear to the observer that the complexity of Saudi culture will definitely have an impact on the business environment on the one hand and the rules and regulations framework on the other hand. It is very important to shed light on the tribal and extended families system of the Gulf States, especially when dealing with corporate governance regulations and the business environment. Furthermore, personal relationships may go beyond natural relationships to become an obstacle in the way of law enforcement.⁴⁹⁵

Therefore, personal relationships could be described as playing a crucial role in Saudi society. Moreover, rather than thinking in institutional terms, generally speaking, Saudi people focus on the officials of the institutions when dealing with the institutions that have an impact on their lives.⁴⁹⁶ Moreover, infringement of the law could occur if some people are able to escape from the consequences of their acts. The situation of Saudi Arabian society with its high degree of business interconnections, and the tribal relationships that are characterised by high standards of strength, have been discussed above. So for these reasons, and for other reasons such as the high attention that is paid by the government to the possible reaction of the society when setting new rules and regulations, it may be difficult for the agencies of the Government such as the Capital Market Authority 'CMA' to enforce the law

⁴⁹⁵ P Menoret, *The Saudi Enigma : A History* (Zed, 2005) Page: 100.

⁴⁹⁶ M Field, *The Merchants : The Big Business Families of Saudi Arabia and the Gulf States* (Overlook Press, 1985, 1984) Page: 95.

and regulations that are related to the business environment in general, as well as other aspects of law enforcement in the country in general, by taking quick steps.⁴⁹⁷

Taking an example from Saudi Arabian corporate governance regulations Article Two, when listing the examples of ‘an infringement of such independence’ of the ‘independent member’, it states that: “He/she is a first-degree relative of any board member of the company or of any other company within that company’s group”. At first glance, this looks like a very convenient exception in a general context. Moreover, the same Article has defined the first degree relative as father, mother, spouse or children. However, the social and cultural issues in the Saudi Arabian context, and the GCC states in general, taking into account the previous paragraph’s discussion, may present this exception from another perspective. Furthermore, limiting the restriction on relatives to the first degree only may be problematic in this context and should be extended wider than the first degree relative to cover more relatives such as cousins, as the previous paragraphs have shown.

Thus, not including the nephews and cousins in this Article could be considered as insufficient. The reason for that, according to Almu'taz, is that many cases of infringement come from this degree of relative. Almu'taz’s opinion is to extend the relative degree to include the fourth degree of relatives in the business environment of Saudi Arabia in order to be like the regulations for certified public accountants. Moreover, Almu'taz goes beyond this to suggest that some of the weak points of the corporate governance regulations could be avoided if the regulations took into

⁴⁹⁷ P Menoret, *The Saudi Enigma : A History* (Zed, 2005) Page: 100.

account the reality of the local business environment, rather than copying the regulations that are suitable for application in other countries.⁴⁹⁸

5.1.2.1 The Ulama's impact

The historical agreement between the founders of the first Saudi state, Muhammed bin Saud and Sheikh Muhammed bin Abdulwahab, could be described as the root of the agreement to have Sharia as a law for the young state.⁴⁹⁹ The observer can notice that this understanding has continued during the second Saudi state and applies to the current Saudi Arabia. Moreover, leading the monarchy still remains under the responsibility of the family of the founder of the first Saudi State, in the other hand leading the Islamic institution, is still with Sheikh Muhammed bin Abdulwahab's family.⁵⁰⁰

Therefore, as some sections have shown⁵⁰¹, Sharia could be described as the national law of Saudi Arabia, taking into account the ability and flexibility of 'fiqh'- Islamic jurisprudence- to adapt new rules and regulations. However, it is a fact that, generally speaking, there is a lack of codified Sharia principles, which could be due to several reasons, as the next paragraphs will show.

⁴⁹⁸ E Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

⁴⁹⁹ This issue has been discussed at the first section of this chapter. 'Ulama' is an Arabic word to describe the scholars, which in this context means the scholars of Sharia.

⁵⁰⁰ For example: Sheikh Salih Al-alSheikh is the Minster of Islamic affairs and Sheikh Abdulaziiz Al-alSheikh is the head of the Permanent Committee for Islamic Research and Issuing Fatwas.

⁵⁰¹ See section 5.1.3 .

The quest for the judicial reform started early, including during the early days of the new Kingdom and the first King. For example, in the year of 1973, King Faisal - the third King - asked the Permanent Committee for Islamic Research and Issuing Fatwas to give their opinion on codifying and obliging judges to implement the codified rulings in court, and there were a several opinions regarding this issue. However, the majority of the 1973 Committee members have the opinion not to codify.⁵⁰² There were seven reasons behind the resistance, as has been described in the Permanent Committee for Islamic Research and Issuing Fatwas decision in details. Remarkably, reason number three of the Committee's decision mentions the experiences of neighbouring countries including Egypt and Kuwait. This experience of codifying Sharia in these countries has lead to applying civil codes of other origins such as Western law and leaving Sharia principles to regulate only some areas of law such as inheritance law and family law. Obviously, this means Sharia is no longer the main source of law- it is only one of many law sources.⁵⁰³ Sfeir goes beyond that to describe this concern as follows: “[they] feared the expansion of civil jurisdiction would only come at the expense of Sharia courts”.⁵⁰⁴

To sum up, the impact of religious scholars is clear, as the previous paragraphs have shown. There is the example of resistance from some Ulama and Sheikhs during the early days of the third Saudi State. The resistance could be described as being quite

⁵⁰² Decision Number 8' (1991) Permanent Committee for Islamic Research and Issuing Fatwas.

⁵⁰³ See Permanent Committee for Islamic Research and Issuing Fatwas decision.

⁵⁰⁴ GN Sfeir, 'The Saudi Approach to Law Reform' (1988) 36 The American Journal of Comparative Law 729.

strong in challenging the government. However, the lack of principles for the codification of Sharia does not return to ideological reasoning only, but it could return to political reasons as well. Finally, the example of common law principles in England shows that Saudi Arabia is not the only country in the world in regard to the codified law of obligations.⁵⁰⁵

5.1.3 Saudi Arabian legal system

Saudi Arabia may be described as having a sophisticated legal system. This unique system is a result of many factors that play important roles in shaping this legal system, such as religion, community and politics. Unlike Western law, religion and law in Saudi Arabia are not separate from each other due to the fact that Sharia is not only a system or law but also a religion. Therefore, some researchers suggest that in Saudi Arabia, using Sharia is more appropriate than 'Qanun' the Arabic term for 'law', because of its secular connotations.⁵⁰⁶ Some scholars avoid using 'Qanun', the Arabic term for 'law', and they use 'nitham' instead. Koraytem believes that the companies law of Saudi Arabia is mainly subject to 'nitham', which means the

⁵⁰⁵ There is an interesting argument by Professor John Makdisi which is worth noting in the context of sharing the same attributes of Sharia and common law not being codified. He goes beyond that to argue that, as the Normans conquered the Emirate of Sicily, they inherited Islamic legal administration from there. Then, the Norman conquest reached England, so Makdisi suggests that the transplanting and adaptation of some medieval Islamic laws and jurisprudence by legal institutions for fundamental common law institutions from Islam was through Sicily. Makdisi also provides examples of the legal interaction between Sharia and common law; analogy (Qiyas), for instance, is similar between Sharia and common law. Another example is the Islamic contract 'Aqd', as in the classical Maliki Sunni school and Royal English contract, it is to be protected from the action of debt. See: Makdisi J, 'The Islamic Origins of the Common Law' (1999) 77 North Carolina Law Review 1635.

⁵⁰⁶ B Al-Haddab and GV Puig, 'The protection of minority shareholders in the Gulf Cooperation Council' (2013) 13 Journal of Corporate Law Studies 123.

regulations which one of the Kings has promulgated.⁵⁰⁷ Moreover, using the term 'law' in the context of Saudi Arabia and Sharia could be described as problematic at first glance.⁵⁰⁸ By and large, writing about this matter can be a sensitive issue- in the context of Saudi jurists as well as the population- because of the religious aspects of Saudi law according to Koraytem.⁵⁰⁹

Moving to the issue of codification in Saudi Arabian judicial system. Clearly, the legislative system is very important element in the context of corporate governance framework. The fact that the legal system in Saudi Arabia is not codified has caused a lack of clarity and hard to predict of the judgment. Definitely, there is a huge impact on the business environment especially for foreign investors. Usually, foreign investors are studying the mechanism of litigation of the country before investing. Interestingly, the Judicial Law of 1975 has recognised the Judicial Precedents whereas the new Judicial law 2007 has deleted this. Although practically the Judicial Precedents in Judicial law 1975 have not been used effectively, it was a good feature of the previous law. Instead, the Judicial Law 2007 has established the Judicial principles that will be set up by the supreme court. However, it has been argued that this new approach will work only with big impact and will not be effective to fill in

⁵⁰⁷ T Koraytem, 'The Islamic Nature of the Saudi Regulations for Companies' (2000) 15(1) Arab Law Quarterly 63.

⁵⁰⁸ B Al-Haddab and GV Puig, 'The protection of minority shareholders in the Gulf Cooperation Council' (2013) 13 Journal of Corporate Law Studies 123.

⁵⁰⁹ T Koraytem, 'The Islamic Nature of the Saudi Regulations for Companies' (2000) 15(1) Arab Law Quarterly 63.

the legislative gaps.⁵¹⁰ On the other hand, Alhussain believes that, the legislators in Saudi Arabia ‘love’ issuing new systems. Alhussain’s argument is that, the ‘excessive codification approach’ in Saudi Arabia could lead to the misuse of the codification, which lead to what he described as a possible corruption environment.⁵¹¹

5.1.3.1 Saudi Arabia and Sharia as the Law of the State

There is no doubt that Saudi Arabia is one, if not the only, country using Sharia as the law of the state.⁵¹² The judicial system applies Sharia in all courts, including the Supreme Court. Moreover, the law of the judiciary which was issued in 1975 by Royal Decree No (M/64) states in Article 1 that: “Judges are independent and, in the administration of justice, they shall be subject to no authority other than the provisions of Shari’ah and laws in force. No one may interfere with the Judiciary”.⁵¹³

However, it is worth mentioning that there is a very important argument in this context about certain transactions that could be described as contrary to Sharia principles, even though Sharia is still the paramount and primary law. It is a fact that there are some transactions allowed in Saudi Arabia such as Riba in some of the

⁵¹⁰ Riyadh Economic Fourum, 'Study of the Evolution of the Judicial System, the Strengths and Areas of Development, Motivation and Its Impact on the National Economy' 2015 Riyadh Economic Fourum.

⁵¹¹ S Alhussain, 'The Excessive Use of Codification: An Influential Factor in the Emergence of Administrative Corruption' (rowaq 2012) <<http://rowaq.org/?p=352>> accessed 1/2/2016.

⁵¹² There are several countries are using Sharia for some aspects of law. For example, many Arab countries including GCC, and some Asian countries, including Malaysia. However, Saudi Arabia using Sharia as the law of the state. First of May 2014 witnessed the first stage of Sharia implementation in Brunei within a plan of three years.

⁵¹³ *The Law of the Judiciary* 1975.

conventional financial institutions. This has a direct impact on the business environment and its framework. In the view of Marar, for the sake of economic transformation, the Saudi Arabian government is trying to form what he describes as a ‘dualistic legal system’ which is like a two edged sword. The positive impact of this system is on the financial transactions and system. However, it could raise some obstacles to the establishment of a market economy framework on the other hand.⁵¹⁴

5.1.3.2 The monarchy system and the King’s role

It is very important to shed light on the political system and the governmental system, which forms one of the cornerstones of the legal and regulatory framework of the Gulf cooperation council. Unlike democratic systems, the GCC states, including Saudi Arabia, use different systems. Saudi Arabia, the largest country in the GCC, could be described as an absolute monarchy system. The King is the head of the state and the Prime Minister is the head of the Council of Ministers.⁵¹⁵

The fact that the Arabian Peninsula, where Saudi Arabia and the GCC countries are located, is the region where the religion of Islam emerged, means that for many Muslims around the world, this part of the world is considered to be the protector of Islam and the custodian of the Grand Mosques at Makkah and Almasjid Alnabawi at Madinah. This issue is significant to show the root of the implications of Sharia in this new country in this particular region of the Middle East- Saudi Arabia. Consequently,

⁵¹⁴ AD Marar, 'Saudi Arabia: the duality of the legal system and the challenge of adapting law to market economies' (2006) 19 Arab Law Quarterly 91 .

⁵¹⁵ A Al-Gilani, 'Reforming the National Framework for Environmental Policies in Saudi Arabia' (1999) 42 Journal of Environmental Planning and Management 253.

as Islam is important for the people of the Arabian Peninsula, King Abdulaziz Al-Saud, the founder of the third Saudi state, had a vision to include Islam as an essential element of his initiative.⁵¹⁶

Subsequently, King Abdulaziz succeeded in gaining his people's support in adopting the system of 'Albayah' to legalise the inauguration of the monarchy system. The allegiance system 'Albayah' is the current system used in Saudi Arabia for the transition between one King to the next. Article six of the basic law of governance states that "citizens shall pledge allegiance to the King on the basis of the Book of God and the Sunnah of his messenger, and on the basis of submission and obedience in times of hardship and ease, fortune and adversity".⁵¹⁷

However, King Abdullah- the previous king- has introduced a new system for 'Albayah' to make the process of Kingship transition easier, as this issue is very sensitive for Saudi Arabian internal and external diplomatic affairs.⁵¹⁸ The Law of the Pledge of Allegiance Commission which was issued in 2006 has legitimacy through the Royal order A/135, which differs from the Royal decree as an indication of the importance of this law.⁵¹⁹ One more point to be mentioned in this context is that the royal order states that the provisions of this law should not be implemented with the current King and Crown Prince.

⁵¹⁶ See: P Menoret, *The Saudi Enigma : A History* (Zed, 2005) Page: 95 for more details.

⁵¹⁷ *The Basic Law of Governance* (1992).

⁵¹⁸ King Abdullah Bin Abdulaziz Alsaud 1924-2015 was the sixth King of the Kingdom of Saudi Arabia.

⁵¹⁹ *The Law of the Pledge of Allegiance Commission* (2006).

The allegiance system 'Albayah' and the system of the state have had an impact in the context of corporate governance and the business environment. These two important factors will contribute towards the effectiveness of the legal and regulatory framework. The clarity of the system will attract international investors and will give more confidence to local investors as well. The legislative power of the state authorities will also be reflected in the making of new laws, and enforcement issues.

5.1.3.3 The Basic law of governance

The fact that there is no written constitution in Saudi Arabia is due to several factors, including ideological and historical reasons. Moreover, the population is not used to a constitution or 'dustor' and "the government has always maintained that the Constitution of Saudi Arabia is the Koran".⁵²⁰ Moreover, the Government has used 'the Basic law of governance' 'Alnitham Alasasy' instead of the constitution. Article 1 of the 'the Basic law of governance' states that: "the constitution shall be the Book of God and the Sunnah (Traditions) of His Messenger".⁵²¹ Abanamay returns to the absence of a formal legislative body and the inconsistency to Sharia, claiming "it is perceived as inconsistent with a shari'ah-based legal system, since shari'ah is regarded as the highest law. Only God is the supreme legislature, human beings can only interpret God's law, not make their own".⁵²²

⁵²⁰ R. Aba-Namay, 'The Recent Constitutional Reforms in Saudi Arabia' (1993) 42 *The International and Comparative Law Quarterly* 295, *The Basic Law of Governance* (1992).

⁵²¹ *The Basic Law of Governance* (1992).

⁵²² R. Aba-Namay, 'The Recent Constitutional Reforms in Saudi Arabia' (1993) 42 *The International and Comparative Law Quarterly* 295.

The basic law of governance was issued by Royal order no (A/90) on the 1st of March 1992 by King Fahad, the fifth King of the current Saudi state. This law contains 83 Articles in nine parts, including the system of governance, economic principles, rights and duties of the authority of the state, financial affairs and auditing agencies. The basic law of governance clarifies the roles and the relationship between the monarchy, judiciary and legislative institutions.⁵²³

The question that needs to be asked in this context is what is the relative status of the current authority bodies in Saudi Arabia, such as Majlis Alshura, the Consultative Council and 'Hea'at Alkhobara' the Bureau of Experts at the Council of Ministries? Definitely, one of their tasks and powers is to "Prepare draft laws and their required studies, in cooperation with the agency concerned with each law".⁵²⁴ The answer is that all these regulatory authorities contain expert members in many fields, which definitely includes Sharia scholars, in order to make sure that these regulations are compatible with Sharia principles, as the following sections will explain.⁵²⁵

The previous discussion has raised an important question in the context of the evaluation of the current rules and regulatory framework of corporate governance in Saudi Arabia, and in the context of promoting an attractive business environment. For foreign investors, 'the Basic law of governance' which has been used in Saudi Arabia

⁵²³ *The Basic Law of Governance* (1992).

⁵²⁴ Bureau of Experts at the Council of Ministers, 'Bureau of Experts' (2014) <<http://www.boe.gov.sa/ViewStaticPage.aspx?lang=en&PageID=4>> accessed 28 April 2014.

⁵²⁵ Although certain rules and principles of Sharia already exist, there is room to produce new rules and regulations as long as they do not breach the Sharia as Chapter four has shown. See section 4.3 .

instead of 'constitution' is an important issue when considering investing in Saudi Arabia, as it clarifies the roles and the relationship between the monarchy, judiciary and legislative institutions.

5.1.3.4 Dualistic legal system

The Saudi Arabian legal system could be described as containing three different elements at the same time- ambiguity, contradiction and developments.⁵²⁶ Keeping the classical principles of Sharia as the supreme law, and the nature of the Saudi cultural structure on the one hand, with the need to keep up with new world institutions and commercial developments on the other hand, may be causing what can be referred to a dualistic legal system. Marar, for example, refers to what he describes as a 'dualistic legal system' in the economic transformation that the Saudi government is undertaking.⁵²⁷

The description that is provided by Vogel may clarify the issues around the Saudi Arabian legal system to some extent. Vogel has described the legal systems in most Islamic states, other than Saudi Arabia, as being bifurcated into two parts. The first one is man-made positive based law; the second is based on Islamic law. In these countries, Islamic law- the second part- is relatively narrow in scope, supplementary and exceptional. On the other hand, in Saudi Arabia's case, the two sides are reversed: "Saudi Arabia also has a dual legal system, but the relative roles of the two sides are

⁵²⁶ GN Sfeir, 'The Saudi Approach to Law Reform' (1988) 36 *The American Journal of Comparative Law* 729.

⁵²⁷ AD Marar, 'Saudi Arabia: the duality of the legal system and the challenge of adapting law to market economies' (2006) 19 *Arab Law Quarterly* 91.

reversed. The Islamic component of the legal system is fundamental and dominant. The positive law, on the other hand, is subordinate, constitutionally and [narrower] in scope.”⁵²⁸

The status of the current dualistic legal system could be described as creating a cloud of uncertainty for foreign investors who have recently been allowed to invest in the capital market, ‘Tadawul’. The jurisdiction for the disputes of the capital market is not the general courts, or even the administrative courts, as there is a quasi –judicial committee that specialises in these kind of cases, which is the Committee for the Resolution of Securities Disputes (CRSD).

The dualistic legal system could be described as challenge or a hindrance for the Saudi authority; therefore, the next section will review the legal and political authorities and the religious institutions that contribute towards shaping the legal and regulatory framework of corporate governance in Saudi Arabia. The 1992 basic law of governance has outlined the Authorities of the State in part six, and Article 4 divides the authorities in the Saudi State into three authorities: the Judicial Authority, Executive Authority and Regulatory Authority, and it states that the King is their final authority.⁵²⁹ The importance of this discussion is that these institutions play a crucial role, which influences the business environment of Saudi Arabia. The discussion will cover the King’s role, the Council of Ministers, the Bureau of Experts at the Council

⁵²⁸ FE Vogel "Islamic Governance in the Gulf: A Framework for Analysis, Comparison and Prediction," in *The Persian Gulf at the Millennium: Essays in Politics, Economy, Security and Religion*, ed. Gary G. Sick and Lawrence G. Potter (New York: St. Martin’s Press, 1997), Pges: 276.

⁵²⁹ *The Basic Law of Governance* (1992).

of Ministers, 'Majlis AlShura' Consultative Council, as well as a discussion covering the judicial authorities.

5.2 Authorities of the State

Saudi Arabia and the rest of the GCC countries have suffered from the recent crisis like many other developing countries around the world, and this can be seen in the stock market recession. The question to be asked in this context is whether the quality of corporate governance systems and its legal and institutional frameworks could have contributed towards the prevention of the crisis. To a large extent, poor corporate governance is considered to be one of the most significant factors that contributed to financial crisis.⁵³⁰ There are many empirical evidences around the world revealed the 'inherent flaws' in the nowadays corporate governance practices and Saudi Arabia is no exception, which add more responsibility on regulatory authorities for corporate governance regulations enforcement "to eradicate or at least mitigate the inherent flaws and regain the trust of stakeholders, especially the shareholders".⁵³¹ On the other hand, the development of the business environment and corporate value will benefit and flourish from a good corporate governance system.⁵³² So, there is a need to briefly illustrate the main aspects of related authorities that has an impact on the corporate governance.

⁵³⁰ D Arsalidou and M Krambia-Kapardis, 'Weak Corporate Governance Can Lead to a Country's Financial Catastrophe: The Case of Cyprus' [2015] *Journal of Business Law* 361.

⁵³¹ S Ahmad and R Omar, 'Basic Corporate Governance Models: A Systematic Review' (2016) 58 *International Journal of Law and Management* 73.

⁵³² Rafael La Porta and others, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113.

First of all, Article 44 of the basic law of governance has divided the authorities in the State into three authorities, which are: the Judicial Authority, Executive Authority and Regulatory Authority. The same Article has stated that 'The King shall be their final authority'.⁵³³ The next section will shed light on these authorities in the context of corporate governance's legal and regulatory frameworks.

The Royal Order is considered to be the highest and the most powerful regulatory tool in the Kingdom of Saudi Arabia. This is due to certain factors regarding this regulatory tool. First of all, the Royal Order is the King's mere will, as the head of the state, directly and individually, and it is not constrained by any legal or judicial authority. Moreover, a Royal Order considered to be effective once published. Generally speaking, a Royal Order usually is an instrument for enacting new legislation such as the 1992 Basic Law of Governance and the 2006 allegiance law.

The Royal Decree also reflects the will of the king. However, in the Royal Decree situation, it is meant to approve the issue which has been presented to the Council of Ministers and the Shura Council, and a decision on that topic is issued. Thus, a Royal order does not need approval, whereas a Royal Decree needs approval from the Council of Ministers. Moreover, the Royal Decree could be described as the second Saudi regulation category. The reason for this is that the power of this legal instrument is gained by the Council of Ministers as a legislative authority. According to Amin, the Royal Decree could be the way to bridge the gap more quickly between traditional legal and moral concepts and the modern requirements of Saudi Arabia.⁵³⁴

⁵³³ *The Basic Law of Governace* (1992).

⁵³⁴ S. H. Amin, *Middle East Legal Systems* (Glasgow : Royston, 1985) Page: 315.

For the Companies Law 2015 and the capital market law 2003, Royal Decrees have been used.⁵³⁵

The subsidiary regulations are normally used by some government agencies to explain the application and give instructions on existing laws and regulations and explain them in detail. The main difference between the subsidiary regulations and other laws and regulations is that subsidiary regulations can be issued by any of the governmental agencies, including the two legislative institutions - the Council of Ministers and The Consultative Council - if they are authorised for this action. Unlike laws proposed by legislative institutions, there is no need for the King or the Council of Ministers approval.⁵³⁶ The importance of subsidiary regulations is being the instrument of corporate governance regulations 2006 issuance.⁵³⁷

5.2.1 Saudi legislative bodies

5.2.1.1 Majlis Alshura ‘The Consultative Council’s’ legal and Sharia background

Although Saudi Arabia could be described as having an absolute monarchy, there are two others institutions that have regulating powers besides the King, as mentioned previously. The first institution of the regulatory system is Majlis Alshura ‘the

⁵³⁵ For the Companies Law 2015, the Royal Decree No. (M/3) dated 28 / 1 / 1437 H and Council of Ministers Resolution No. (30) dated 27 / 1 / 1437 H. For the capital market law, Royal Decree No. M/30 dated 2 / 6 / 1424 H and Council of Ministers Resolution No. 91 dated 16 / 4 / 1424 H.

⁵³⁶ A. Awwad, *Legal Regulation of the Saudi Stock Market : Evaluation, and Prospects for Reforms* (University of Warwick, Warwick 2000).

⁵³⁷ Issued by the Board of Capital Market Authority Pursuant to Resolution No. 1/212/2006 dated 21/10/1427AH (corresponding to 12/11/2006) based on the Capital Market Law issued by Royal Decree No. M/30 dated 2/6/1424AH.

Consultative Council'. The other regulatory system's institution is the Council of Ministers. However, being the head of the Council of Ministers, the King has the right for proposals to be accepted or refused.⁵³⁸

The situation concerning the monarch's approval of new laws is a little similar at first glance in both Saudi Arabia and the UK, as in the UK's case, it is true that during the process of a Bill becoming an Act of Parliament, it needs Royal Assent. However, unlike Saudi Arabia, Royal Assent in the UK 'is a formality as in practice it is not withheld'.⁵³⁹ From this point, the differences between the parliament systems in Western legal systems such as the United Kingdom and Saudi Arabia can clearly be seen. Unlike the UK parliament, all the members of Majlis Alshura are appointed by the King, as stated in Article 3 of Shura Council Law'.⁵⁴⁰ Moreover, the UK Parliament is not only responsible for introducing new legislation and approving new laws, unlike Saudi Arabia, the Parliament is the supreme legal authority in the UK.

Moving on to the role and the power of 'Majlis Alshura', Article 15 states that "The Shura Council shall express its opinion on the general policies of the State referred to it by the President of the Council of Ministers".⁵⁴¹ It is a fact that this does not include every issue in the country, as the Council has the right to exercise only four issues

⁵³⁸ *The Basic Law of Governance* (1992).

⁵³⁹ The United Kingdom Parliament official website, 'About the Parliament: Legislation' (<<http://www.parliament.uk/about/how/role/legislation/>> accessed 12 August 2014).

⁵⁴⁰ The Consultative Council 'Majlis Alshura' Shura Council Law' was issued by Royal Decree No. A/91 on the 1st of March 1992.

⁵⁴¹ *The Law of the Shura Council* (1992).

specifically. In the context of corporate governance rules and regulations and its legal framework, the Shura Council has the right to review and provide suggestions about laws and regulations, international treaties and conventions and concessions, as part (b) shows, and to interpret laws, as shown in part (c).⁵⁴²

Article 23 deals with the process of proposing a new draft law or an amendment to a law already in force, which must be done by at least ten members of the Council, and then this proposal has to be submitted to the Chairman of the Council who submits the proposal to the King. The resolutions of Majlis Alshora go to the King- the President of the Council of Ministers- to be referred to the Council of Ministers for consideration, as Article 17 states.⁵⁴³ The King has the power for the approval whether the opinions concur between the two Councils or not. If the two Councils concur, the resolutions need the King's approval to come into force. In the case of variance, the king "may decide whatever he deems appropriate".⁵⁴⁴

There are some debates about several issues of Alshura Council. One of the criticisms is about the way of selecting the members of the council who are appointed by the King. However, Article three and four stated some terms and restrictions for the candidate to be appointed. The members appointed by the King are chosen amongst "scholars, those of knowledge, expertise and specialists" as stated in Article three. Moreover, Article four stated that the member must be known for uprightness and competence. There is an effort to reform the Shura Council as it can be seen from the

⁵⁴² Ibid.

⁵⁴³ This article was amended by the Royal Order (A / 198) dated 02/10/1424 AH.

⁵⁴⁴ *The Law of the Shura Council* (1992).

Royal Order number A/44 which has included women in the membership of Shura Council, and the representation of women shall not be less than (20%) of members number.⁵⁴⁵

It is worth mentioning in this context that the majority of Alshura members voted in favour of the draft of the new Companies Law five years ago in 2011. Notably, it can be seen from the companies law 2015 that recommendations from Alshura members have been added to the new companies law 2015, for example Article 95 regarding cumulative voting and Article 76 about the directors' remuneration.⁵⁴⁶

5.2.1.1.1 The relationship between the Consultative Council ‘Majlis Alshura’ and Sharia

Article 1 of Shura Council Law clarifies the relation between Shura Council Law and Sharia in detail. This section will analyse this relationship, and it highlights in brief the main issues of Shura that are related to the context of this thesis. To start with, it is very important to mention that Shura is a Sharia concept, as Chapter two has shown.⁵⁴⁷ There is a complete Surah (verse) in the Quran that deals with consultation issues, and there are some Hadiths (Prophetic sayings) as well that deal with this concept as well.⁵⁴⁸ Furthermore, the law of the Shura Council starts its articles with a sentence that goes beyond clarifying the relationship between Sharia and Shura to

⁵⁴⁵ Ibid.

⁵⁴⁶ *Companies Law* 2015.

⁵⁴⁷ Some of the Shura issues has been discussed in chapter four 4.5.2.1.

⁵⁴⁸ Sûrat Ash-Shûra (The Consultation) XLII.

show the root of Shura in Islamic law, “In compliance with Allah Almighty words”⁵⁴⁹ which is then followed by stating two verses from the Quran:

“[Those who respond to their Lord, and establish regular prayer; who (conduct) their affairs by mutual consultation; who spend out of what we bestow on them for sustenance]”⁵⁵⁰ and “[It is part of the Mercy of Allah that thou dost deal gently with them. Wert thou severe or harsh-hearted, they would have broken away from about thee : so pass over (their faults), and ask for (Allah's) forgiveness for them; and consult them in affairs (of moment). Then, when thou hast taken a decision, put thy trust in Allah. For Allah loves those who put their trust (in Him)]”.⁵⁵¹

“And following His Messenger Peace Be Upon Him (PBUH) in consulting his Companions, and urging the Muslim Nation to engage in consultation. The Shura council shall be established to exercise the tasks entrusted to it, according to this Law and the Basic Law of Governance while adhering to Quran and the Path (Sunnah) of his Messenger (PBUH), maintaining brotherly ties and cooperating unto righteousness and piety.”

Article 1 also mentions the consulting of the Prophet (PBUH) with his Companions and urging the Nation to engage in consultation.⁵⁵² The end of Article 1 clarifies

⁵⁴⁹ *The Law of the Shura Council* (1992).

⁵⁵⁰ Sûrat Ash-Shûra Verse 38 , Available at: http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?nSora=42&l=arb&nAya=1#42_1.

⁵⁵¹ Sûrat Âl-‘Imrân, Verse 159, Available at: http://qurancomplex.gov.sa/Quran/Targama/Targama.asp?nSora=3&l=arb&nAya=159#3_159.

⁵⁵² *The Law of the Shura Council* (1992).

more: “The Shura Council shall be established to exercise the tasks entrusted to it, according to this Law and the Basic Law of Governance while adhering to Quran and the Path (Sunnah) of his Messenger (PBUH), maintaining brotherly ties and cooperating unto righteousness and piety.”⁵⁵³ Moreover, Article 1 shows the first sources of legislation in Sharia which are Quran and Sunnah, Article 2 emphasises more about the other sources of legislation in Sharia: “The Shura Council shall hold fast to the bond of Allah and adhere to the sources of Islamic legislation.”⁵⁵⁴

5.2.1.2 Majlis Alwozara ‘The Council of Ministers’

The second authority that could be described as the most important among the organised bodies and agencies of Saudi Arabia, is the Council of Ministers of Saudi Arabia ‘Majlis Alwozara’. As mentioned in previous sections, the King is the head of the Council of Ministers. It is clear that the importance of the Council of Ministers in Saudi Arabia is based on the crucial role that this Authority plays, which has a direct impact on the business environment. Furthermore, the executive and legislative powers that the Council of Ministers hold as a state body could explain the potency of this Authority.⁵⁵⁵ Moving on to the law of the Council of Ministers, the law was issued in 1993 by Royal Order no. A/13 dated the 20 August 1993 containing 32 Articles replacing the 1958 law of the Council of Ministers. This law clarifies the Council of Ministers’ definition and the members’ responsibilities and authority. It is

⁵⁵³ Ibid.

⁵⁵⁴ See chapter four, for more details about the sources of legislation in Sharia.

⁵⁵⁵ F Farsy, *Modernity and Tradition : The Saudi Equation* (London ; New York : Kegan Paul International ; New York, NY, USA : Distributed by Routledge, Chapman & Hall, 1990) Page: 42.

worth pointing out that the role of the Council of Ministers at its establishment was as an advisory body for the King after the establishment in 1953 of Royal Decree No.5/19/4288. However, the role has been maximised remarkably, and five years later its establishment was confirmed by the Crown Prince and Prime Minister, Faisal bin Abdulaziz, who became the King in 1984. The changes that have been done to the Council of Ministers has transformed the Council of Ministers from being an advisory body to not only an executive, but an administrative and legislative body, as the responsibilities of the Council of Ministers now includes authorisation to legislate.⁵⁵⁶

The approval of the King is needed for resolutions to become final, as stated in Article seven. Appointing, reinstating and resignations of the members of the Council of Ministers is one of the King's roles and accepted by Royal Order.

Moving on to the Power of the Council of Ministers, drawing up the state affairs is one of this council's responsibilities, as well as having executive authority. However, Article 19 states that the Council of Ministers is subjected to Shura Council law and the Basic Law of Governance provisions; the same Article states that the Council of Ministers has the power to review the Shura Council resolutions.

Regarding the situation of companies' boards, Article six of the law of the Council of Ministers states that the members of the Council of Ministers may not engage in any commercial or financial activities or accept board membership in any company.⁵⁵⁷

⁵⁵⁶ M Hanson, 'The Influence of French Law on the Legal Development of Saudi Arabia' (1987) 2 Arab Law Quarterly 272.

⁵⁵⁷ *Law of the Council of Ministers* (1993).

5.2.1.2.1 Bureau of Experts at the Council of Ministers

One of the most important government agencies in Saudi Arabia is the Bureau of Experts at the Council of Ministers: 'Hea'at Alkhobara'. The Bureau of Experts at the Council of Ministers may be described as the legal arm of the government, or the focus of the regulations and the royal decrees and orders for more than six decades.⁵⁵⁸

Reviewing the tasks and powers of the Bureau of Experts shows the importance of the role that is played by this agency in the context of corporate governance, and the rules and regulations framework in general. According to the official website of the Bureau of Experts, the second task and power is to "prepare draft laws and their required studies, in cooperation with the agency concerned with each law". Likewise, the power of the Bureau of Experts includes the current laws by proposing amendments and reviewing the existing laws.⁵⁵⁹ As mentioned in previous sections, the Bureau of Experts- as with some others agencies- contains experts from many fields, including Sharia, in order to maintain compatibility with Sharia principles.⁵⁶⁰

⁵⁵⁸ B Alkhorayif, 'Bureau of Experts at the Council of Ministers Is the Royal Orders and Decrees for Six Decades' *Asharq Al Awsat* (London) <<http://classic.aawsat.com/details.asp?section=43&article=629132&issueno=11903#.VDR8jL5N3Hj>> accessed 28 April 2014.

⁵⁵⁹ Bureau of Experts at the Council of Ministers, 'Bureau of Experts' (2014) <<http://www.boe.gov.sa/ViewStaticPage.aspx?lang=en&PageID=4>> accessed 28 April 2014.

⁵⁶⁰ It is worth mentioning here that the first president of the Bureau of Experts at the council of ministers was Shikh Salih Alhussain who was a Sharia scholar.

5.2.2 Judicial Authority

Efficient institutional frameworks include an independent judicial system that could be described as a safeguard for effectively implementing corporate governance.⁵⁶¹ The role of courts and power of imposing sanctions and enforcing laws are critical issues in the context of corporate governance and, therefore, the business environment. The fact that Saudi Arabia is presently witnessing a critical exchanging of roles between the judicial authorities is adding more importance in the context of this thesis and the implementation of effective corporate governance.⁵⁶²

Before discussing the Saudi Arabian judicial authority, it is worth including a brief historical overview, as the judicial system has witnessed remarkable changes during the last century. Just after the establishment of the Kingdom of Saudi Arabia in 1932, the western region of Saudi Arabia was still applying Ottoman law, which uses the Hanafi School of Fiqh in courts.⁵⁶³ King Abdulaziz, during the early years of his reign, agreed to keep Ottoman law in the western region. However, issuing the regulations of 'Sharia courts situations and formations' has replaced Ottoman law, allowing judges to use the four Islamic schools of jurisprudence. A few months later, King Abdulaziz issued a royal order to use the Hanbali school of jurisprudence in all courts. However, the royal order allows judges to use the other three Islamic schools

⁵⁶¹ A Darweesh, *Hawkamat Alsharikat Wa Dawr Majlis Aledarah* (UAB - Union of Arab Banks, 2007) Page: 61.

⁵⁶² The commercial courts have been moved from the Administrative judiciary to the General judiciary on 22 Mar 2016.

⁵⁶³ See chapter four 4.3.2 for more information about the four Islamic schools: Hanafi, Maliki, Shafi'i and Hanbali.

of jurisprudence- Hanafi, Shafei and Maliki- in case of it being in the interest of the public.⁵⁶⁴ After that, many systems and regulations were introduced to regulate the judicial system up until 2007, as the following paragraphs will show. ⁵⁶⁵

5.2.2.1 The Court system

Investors need a clear vision of the judicial authority in order to increase confidence in safe investment. The legislative process and the court system plays a crucial role in this context, which will be reflected in the business environment. Furthermore, the institutional framework such as an independent judicial system that works efficiently is a safeguard for applying the concept of corporate governance in order to be effective.⁵⁶⁶ The commercial courts has been moved from the Administrative judiciary to the General judiciary as Diwan Al Madhalim 'Board of Grievances' has just signed a document for the moving.⁵⁶⁷ On the other hand, the jurisdiction of investigation and prosecution of Article 31, 49 and 50 moved in 2014 from the CMA to the Bureau of Investigation and Public Prosecution. So, there is a need to shed a light -in brief- on the main features of the court system in Saudi Arabia as the following sections will show.

⁵⁶⁴ A Al-Ghadyan, 'The Judiciary in Saudi Arabia' (1998) 13 Arab Law Quarterly 235.

⁵⁶⁵ The Supreme Judicial Council official website, 'Overview of the History of the Judiciary in the Kingdom of Saudi Arabia' (The Supreme Judicial Council 2014) <<http://www.scj.gov.sa/index.cfm?do=cms.conArticle&contentid=1144&categoryid=385>> accessed 19/9/2014.

⁵⁶⁶ A Darweesh, *Hawkamat Alsharikat Wa Dawr Majlis Aledarah* (UAB - Union of Arab Banks, 2007) Page: 61.

⁵⁶⁷ Justice Minster and Chairman of the Board of Grievances have signed the document in Riyadh on 22 Mar 2016.

5.2.2.1.1 The previous courts' structure

The basic law of governance is very clear about taking Sharia as the constitution of Saudi Arabia and taking Sharia principles as the foundation for the systems according to fiqh "jurisprudence". Furthermore, the basic law of governance also states that courts from all degrees are the responsible for handling cases. However, the fact that the 1975 law of judiciary which was issued by the Royal decree no. (M/64) is about forty years old makes the reform of the judiciary system a matter of urgency. It is worth mentioning that until recently, there were a few types of courts in the Saudi court system. **Sharia courts 'almahakim alshareiah'** are one of these types which handled civil and criminal cases. Under the 1975 law of judiciary, these types of "Courts shall have jurisdiction to decide with respect to all disputes and crimes, except those exempted by law".⁵⁶⁸ Sharia courts consist of four types (A): The Supreme Judicial Council (B): The Appellate Court (C): General Courts (D) Summary Courts.

Another example of court types in the Saudi court system is **the Board of Grievances 'Diwan Almadhalim'** which is an administrative court system. Diwan Almadhalim is linked to the King directly. The Board of Grievances' judges apply the relevant statutes, established commercial customs and contract terms in addition to Sharia.⁵⁶⁹ Al-Ghadyan think that even though the origin of it is not known, the Board of Grievances is deeply rooted in Islamic judicial history as a result of the expansion of Islamic land, which meant the Caliphs were unable to deal with the number of

⁵⁶⁸ *The Law of the Judiciary* (Saudi Arabia 1975).

⁵⁶⁹ *Law of the Board of Grievances* (2007).

complaints received.⁵⁷⁰ The importance of the Administrative Court system ‘Diwan Almadhalim’ is that, it is the court that dealing with the business cases in Saudi Arabia.

As a consequence of the Ulama’s impact- as mentioned in previous sections- the early attempts by the government to regulate the business environment through the Commercial Court Regulations has been faced by opposition from the ‘Ulama’, which has resulted in a lack of implementation of this regulation.⁵⁷¹ The reason for the rejection by religious scholars and judges is due to several reasons, including that they think these regulations are not compliant with Sharia sources, and it regulates some forbidden transactions according to the judges’ Islamic interpretation.⁵⁷²

Consequently, another type of courts in the Saudi court system has been developed- **the Quasi-Judicial Committees-** which are for the cases outside the ‘almahakim alshareiah’ Sharia courts system. The quasi-Judicial Committees include many administrative committees that do not depend on ‘almahakim alshareiah’ Sharia courts systems and have judicial powers. It is a fact that there was opposition to the implementation of the Commercial Court Regulation by the Sharia courts judges. As mentioned above, the reason for the Sharia courts judges’ unwillingness to apply the new Government regulations was “fearing that they may contain provisions that are

⁵⁷⁰ A Al-Ghadyan, 'The Judiciary in Saudi Arabia' (1998) 13 Arab Law Quarterly 235.

⁵⁷¹ *Commercial Court Regulation* (1931).

⁵⁷² See: G Sfeir, 'The Saudi Approach to Law Reform' (1988) 36 The American Journal of Comparative Law 729.

not in strict compliance with the Shari'a Law".⁵⁷³ On the other hand, the fast growth of the business environment has caused a gap in the Saudi judicial system which needs to be filled by an alternative solution. Accordingly, through the issuing of a Royal Decree by the King, the Ministry of Commerce and Industry has assumed jurisdiction over some commercial legislation, which allowed the Ministry of Commerce to establish Quasi-Judicial Committees such as the Commission for Settlement of Banking Disputes.

An example of Quasi-Judicial Committees is the Committee for the Resolution of Securities Disputes, which is a very important player in the context of the Capital Market and the Capital Market Authority. CRSD is a professional and specialised body with the role of resolving disputes, and it has been entrusted by the Capital Market Law to solve disputes in the capital market. Article 25, paragraph (a) of the Capital Market Law delegates power and enables CRSD to carry out its duties. Therefore, CRSD has the power to investigate and settle complaints and suits, as well as impose sanctions and issue a decision awarding damages. CRSD contains specialised members in the fields of transactions, financial markets, and financial and commercial matters, as well as securities cases specialists. CML has illustrated the jurisdictions of CRSD, such as reviewing claims against decisions taken and the procedures adopted by CMA or the Exchange Market; moreover, the investors'

⁵⁷³ A Al-Ghadyan, 'The Judiciary in Saudi Arabia' (1998) 13 Arab Law Quarterly 235.

complaints relating to the CML and its implementing of regulations as well as CMA and the Exchange Market regulations.⁵⁷⁴

However, there are arguments around several critical issues regarding the Quasi-Judicial Committees, such as the issue of independence. Some committees combine the task of the prosecution and the lawsuit and enforcement at the same time, which detracts from the principle of independence for those committees. It is a fact that the mechanism of applying the royal decree has excluded the Banking Committee, the Capital Market Authority, and customs committees. However, there is a need to accelerate the process of new specialised courts to replace the Quasi-Judicial Committees based on Royal Decree No. (M / 78) dated 19/9/1428 H to improve the judicial system. Although there have been huge steps towards the right path, it can be seen very clearly that the judicial system is witnessing a slowdown in the process of reforming and improving its system, which in some parts has a direct impact on corporate governance regulations and its legal frameworks. From the previous discussion, it can be noticed that it has now been more than nine years since Royal Decree No. (M / 78), and some Quasi-Judicial Committees are still working.

5.2.2.1.2 The new courts' structure and reform

The rapid growth of the business environment of Saudi Arabia needs to be accompanied by an effective legal system which must be updated to regulate new legal changes in the business sector. It is very important in the context of corporate governance legal and regulatory framework and its impact on the business

⁵⁷⁴ For more details see the official website of the Committee for the Resolution of Securities Disputes. Available at: <http://www.crsd.org.sa> . Accessed at 27/3/2016.

environment to keep the legal system updated and effective, especially when dealing the new business cases and transactions. Consequently, updating the courts' structure and improving the legal environment was something inevitable in Saudi Arabia. The roadmap for these improvements resulted in the cancelling of the 1975 (M/64) law of Judiciary and the introduction of the 2007 law of Judiciary which was issued by Royal decree no (M/78).⁵⁷⁵

It is a fact that the new law contains many of the same articles from the previous law. However, the new law is characterised by many new features that could be described as fundamental changes which have reshaped the whole system. Therefore, the following paragraphs are an attempt to examine and discuss the most important new features of the 2007 law of Judiciary.⁵⁷⁶

Firstly, Article 9 of the law has rearranged and organised the court structure. This shows the keenness of the new system concerning the multiplicity and variety of the courts. **Secondly**, the new law emphasises the unifying of the judiciary in the various courts by establishing a Supreme Court to supervise the correct application of the principles of Sharia and the regulations in Saudi Arabia. **The third feature** concerns the principle of litigation on two levels through the adoption of the appeal system. This means an important guarantee for justice as this new system gives the chance to review the sentence by a higher degree court that has more judges who have more experience than the first degree court judges. **Fourthly**, there is the realisation of the

⁵⁷⁵ See: T Alshubaiki, 'Developing the Legal Environment for Business in the Kingdom of Saudi Arabia: Comments and Suggestions' (2013) 27 Arab Law Quarterly 371 for more information.

⁵⁷⁶ See : *The Law of the Judiciary* (1975) and *The Law of the Judiciary* (2007).

principle of specialisation of the courts and inside the court itself, such as the criminal court, personal status court and labour court. **Finally**, the multiplicity of courts of one type in the regions of Saudi Arabia, facilitate litigation by making the courts closer to the litigants.⁵⁷⁷The following paragraphs will shed light on the new courts system as part three of the 2007 law of judiciary. Chapter one of the law states the type of the courts as three main courts, which are: 1- the Supreme Court 2-the Appellate Courts 3-First degree Courts. ⁵⁷⁸

The Supreme Court is located in the capital Riyadh, and the president of the court is appointed and deposed by Royal Order. The jurisdiction of the Supreme Court includes supervising the application of Islamic law 'Sharia' and supervising the regulations that are issued by the King, which should not violate Sharia; it also reviews the cases that have been seen by the Appellate Courts. Thus, there is one more important issue that is stated in Article 13 regarding the jurisdiction, which allows the Supreme Court to make general principles on issues that are related to the judiciary.

Moving to **the Appellate Courts**, Article 15 illustrates the jurisdiction of the Appellate Courts. The 1975 Law of Judiciary states that “some of the Court’s panels may hold all or part of their hearings in another city, or have branches established in other cities, if public interest so requires”. However, the 2007 law of judiciary adds a very important issue by stating that every region in Saudi Arabia will contain one

⁵⁷⁷ *The Law of the Judiciary* (Saudi Arabia 1975).

⁵⁷⁸ See: Ayoub. Al-Jarbou, 'The Saudi Board of Grievances: Development and New Reforms' (2011) 25 Arab Law Quarterly 177.

Appellate Court or more. Article 16 has divided the Courts of Appeal circuits into five circuits.

Chapter 4 has tackled the **first-degree courts** in detail. This court includes a-General courts b- criminal courts c- Personal Status courts d- Commercial Court e-Labour courts. It is very clear from this Article that the government is truly intending to reform the judicial system by restoring some of the Quasi-Judicial Committees back under the judicial law's umbrella.⁵⁷⁹

5.2.2.1.3 The reform of the judicial system

Issuing the new Law of Judiciary in 2007 was the cornerstone of King Abdullah's project to develop the judiciary system. The project involves cooperation between many governmental sectors including some ministries and the Bureau of Experts at the Council of Ministers. As mentioned above, many steps have been taken since 2007, including specialised courts being established within the general judiciary. Furthermore, many regulations have been issued, such as the Law of Procedure Before Sharia Courts and the Law of Criminal Procedure. Another issue is codifying the 2007 law, and the aim is to start the process to codify Sharia Law as a step on the reform path. In terms of the Court System in Saudi Arabia, the 2007 Law has a target for unifying the Saudi Court System.⁵⁸⁰

The importance of the previous sections in the context of this thesis stems from several main factors. There is a need to understand and examine the complexity of

⁵⁷⁹ See Article 9 of *The Law of the Judiciary* (1975).

⁵⁸⁰ Z Al-Sudairy, 'The Constitutional Appeal of Sharia in a Modernizing Saudi State' (2010) 2 Middle East Law and Governance 1.

Saudi society and culture as it has a direct impact on corporate governance regulations and the application of them, bearing in mind the fact that the corporate governance regulations in Saudi Arabia have benefited from several jurisdictions and supranational institutions. This means there is a need to examine the current society and culture on the one hand and the legal system and the authority of the state on the other, in order to evaluate the current corporate governance regulations. This is significant in order to understand whether it is suitable for application in Saudi Arabia or not, as the corporate governance regulations have been influenced by foreign jurisdictions.

On the other hand, unlike the UK, the fact that the CMA is a Saudi governmental body makes examining the political and the governmental system and the authorities of the state in Saudi Arabia such an important element, due to the impact on both corporate governance regulations and the business environment at the same time. Likewise, the instrument that is used to issue laws and regulations such as Royal Order, Royal Decree and subsidiary regulations are very important to differentiate between the powers, and to gain a general overview of the current system as that will impact on corporate governance regulations.

Saudi legislative bodies are very important in the context of corporate governance, as these institutions have regulating powers. Majlis Alshura ‘the Consultative Council’ for example deals with many issues related to corporate governance and companies law such as the CMA, remuneration, and IPO, in many regular sessions. Moreover, Majlis Alshura has recently demanded the CMA be quick in the process of listing the Saudi Capital Market in the MSCI (Emerging Markets Index). Majlis Alshura has also demanded that the Capital Market Authority disclose the twenty largest owners of

each of the companies listed on the market, and the Council has called on the Capital Market Authority to work on consolidating the culture of governance and the importance of adhering to its principles and rules among senior executives and members of corporate boards.⁵⁸¹ Thus, there is a need to present a brief introduction to understand its role, especially due to the fact that the decisions of Majlis Alshura are not compulsory, and all its members are appointed by the government.

5.3 Saudi Companies Law

One of the early movements towards supervising the trade and business market in the early days of Saudi Arabia involved issuing ‘Commercial Court Law’. It is a fact that Commercial Court Law, which was issued in 1931, was to some extent insufficient and incapable of coping with the growth of business and the number of companies following the oil discovery during and after King Abdulaziz’s era.⁵⁸² Moreover, in order to maintain and regulate their business relations, some businessmen as individuals have adopted certain regulations and laws from neighbouring countries, such as Egypt. However, this situation has caused a lot of confusion in the business market in Saudi Arabia, which has caused the government to become unable to administer and control the market as it should. Under these circumstances, the need

⁵⁸¹ See: Majlis Alshura session number 24 dated 2 of March 2016.

⁵⁸² About one year before the completion of uniting of the main regions of Saudi Arabia, the name of the state was the Kingdom of Alhijaz and Najd.

for new laws and rules was the reason behind issuing the Saudi Companies Law as stated at the Explanatory Memorandum of the Companies law.⁵⁸³

Despite the fact that issuing the Companies Law 1965 was because of the insufficiency and incapability of the 1931 Commercial Court Law, it could be argued that 1965 Saudi Companies Law is suffering from some of the same symptoms that Commercial Court Law suffered from.⁵⁸⁴ Moreover, some researchers claim that because of the huge developments in the business environment and the companies sector, the 1965 Companies Law still has issues around insufficiency in meeting the need for legislation, and the government must step forward to pay more attention to this issue.

First of all, before analysing Saudi Companies Law, it would be better to clarify certain issues regarding some confusion that may appear when discussing Saudi Companies Law from a Western perspective. Obviously, the root of these issues could be as a result of certain factors. To begin with, the systematic factors which appear with a Sharia background while comparing Saudi Companies Law and Western Companies Laws may be a problem. Secondly, there are linguistic issues as a result of translating between Arabic and English. Hence, the following paragraphs should clarify the translation and the meaning of ‘sharikah’ and ‘company’ in the Saudi

⁵⁸³ *Companies law* 1965. See also: The Bureau of Experts at the Council of Ministers website, 'Companies' <www.boe.gov.sa/ViewSystemDetails.aspx?lang=1&SystemID=236&VersionID=48> accessed 1\3\2014.

⁵⁸⁴ Companies in Saudi Arabia prior to the issuance of the 1965 version of the Companies law was subjected to the Commercial Court Law 1931, which has only few articles regarding the issues of companies. There was a need for updating the regulation frameworks to cope with the growing of the business sector.

Companies Law in the context of corporate governance's regulatory and legal framework.⁵⁸⁵

Chapter four has shown that the Saudi Companies Law translates the Arabic term 'sharikah' as company. However, it is very important in the context of a Saudi Arabian corporate governance legal and regulatory framework to clarify the meaning of sharikah and company in more detail in order to recognise the general meaning of sharikah as an Arabic term on the one hand, and whether sharikah could reflect the legal meaning of 'company' in Western law on the other hand. The reason behind that is to avoid the possible confusion that could arise while dealing with Western companies law. It is worth mentioning that this potential confusion has drawn the attention of some researchers in the field of Sharia and Western law.⁵⁸⁶

Officially, the English copy of Saudi Companies Law 1965, translated as 'Sharikah' into 'company' directly which not accurate to some extent. Moreover, Article 1 of this law has defined 'sharikah' in an Arabic copy of the law using the same definition of 'company' as in the English version: "a contract under which two or more persons undertake to participate in an enterprise for profit, by contributing a share in the form of money or work, with a view to dividing any profits (realized) or losses (incurred) as a result of such enterprise".⁵⁸⁷ At first glance, this quick preview suggests that there

⁵⁸⁵ See chapter four 4.4 for sharikah in Sharia.

⁵⁸⁶ See: N H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 European Business Organization Law Review 3.

⁵⁸⁷ *Companies Law* 1965.

is no issue and makes it seem like there are no problems if ‘sharikah’ is translated directly into ‘company’. However, trying to view ‘sharikah’ as ‘company’ from all dimensions in the context of Sharia, Arabic language and Western law, could result in problematic confusion, as the next paragraph will show.

Linguistically, Sharikah has many meanings in the Arabic language. However, the basic meaning of ‘sharikah’ in Arabic is “sharing”, according to the Academy of the Arabic language and one of the meanings in Arabic is: a contractual partnership between two or more in order to implement a shared business.⁵⁸⁸ However, in the context of Sharia, the definition of sharika is partnership, and partnerships under Sharia may be of two kind, non – contractual (Sharikat alamlak) and contractual partnership (Sharikat Aluqod). On the other hand, partnership and corporation in Western Law are two separate concepts.⁵⁸⁹

Foster stated that the basic meaning of sharikah is sharing, and it can be used in more cases than Western style partnerships.⁵⁹⁰ Sharikah could be used in all sorts of circumstances including shareholder relationships, and connoting cooperation; a degree of mutual aid, and a joint economic interest. Foster argues that it could be misleading to translate sharika as ‘partnership’ or even 'company' because of the absence of a legal personality in the sharia system. However, the Saudi Companies

⁵⁸⁸ Arabic Language Academy, *Almojam Alwaseet* (4 edn Alshoroq, Cairo 2004)Page: 480.

⁵⁸⁹ G Bilal, *Business Organizations under Islamic Law* (Harvard University, Cambridge, Massachusetts 1999) .See also Chapter two page 41 for more details.

⁵⁹⁰ N H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 *European Business Organization Law Review* 3.

Law 1965 states in article 2 that: “such companies are known in Islamic jurisprudence”⁵⁹¹. Moreover, many researchers have referred to the sharikah 'company'. However, it may be better to avoid using 'partnership' in order to prevent confusion with these types of companies in the U.K.

The fact is that Sharia gives the same treatment, whether it is a commercial transaction or civilian, and whether the person is a trader or not. This is due to the 'Fiqh' treating the cases without considering the nature of the case or the person. Moreover, as mentioned before, Sharia has no ‘legal personality’ for business organisations (in discussions of classical Sharia). However, this concept is not completely strange to Sharia and can be found in Sharia jurisprudence, even though it does not have the same name, and it is accepted by Sharia scholars by using the fiqh and ‘Ijtihad’ tools analogy 'qiyas' public interest 'masaliha mursalah' and istihsan for example.⁵⁹² Moreover, the term sharikah as a ‘company’ with legal personality and limited liability has been adapted and recognised by International Islamic Fiqh Academy which means there is no clash with Sharia.⁵⁹³

5.3.1 Overview of Saudi Companies Law

The question of the importance of issuing new laws, rules and regulations to monitor the relations between all parties engaged in the business environment in GCC countries may be answered by the figures and data on the size of companies and

⁵⁹¹ *Companies Law* 1965.

⁵⁹² *Ibid.*

⁵⁹³ International Islamic Fiqh Academy: decision number 130 (4/14). Available at: <http://www.fiqhacademy.org.sa/qrarat/14-4.htm>.

business organisations. As the previous paragraphs have shown, there was a revolution in all aspects of life which accompanied the oil discovery in the GCC countries. Moreover, the Saudi Stock Market has around 156 listed companies - more than 60 of them listed during the last six years. The Capital Market Authority has a target of listing around 200 companies by the beginning of 2017.⁵⁹⁴

The number of companies and business organisations in Saudi Arabia alone was more than 889,000 by the end of 2010. Interestingly, this means one company or business organisation for around 21 Saudi citizens who work in this sector.⁵⁹⁵ Remarkably, approximately 90% of these companies are family companies⁵⁹⁶, which is about 20% above the international average.⁵⁹⁷ Moreover, in 2013 more than 66 billion was the investment in family companies in Saudi Arabia, which equals about 10% of the GDP of Saudi Arabia. Consequently, the Ministry of Commerce received calls in 2013 to change from Family Company to Closed Joint Stock Company in order to stabilise and control the consequences that could occur after the death of the founders, or in

⁵⁹⁴ S Alboqomi, 'Saudi Arabia set a target to reach 200 listed companies in the capital market in 2017' *Alsharq Alawsat* (London Financial section) Available at: <<http://www.aawsat.com/details.asp?section=6&article=733339&issueno=12625#.U1cPfMdBwsl>> accessed 3/3/2014.

⁵⁹⁵ Alriyadh, 'The number of companies and organisations in Saudi Arabia i' *Arriyadh* (Riyadh Financial section <<http://www.alriyadh.com/725418>> accessed 3/2/2014.

⁵⁹⁶ Family business will be discussed in more details in following chapter.

⁵⁹⁷ '90% of recorded companies in Saudi Arabia are family business' *Aljazeera* (Riyadh Finance <<http://al-jazirahonline.com/2012/20120521/ec11156.htm>> accessed 3/4/2014.

case of disputes between them.⁵⁹⁸ Therefore, the need for issuing new laws, rules and regulations is a matter of urgency to regulate the relations of all parties engaged in the business environment.⁵⁹⁹

During the period of the third King of Saudi Arabia, Saudi Companies Law was issued in 1965 by royal decree number (M/6) by King Faisal Bin Abdulaziz. This law gained its legitimacy from Royal Decree No. (M/6) dated 22/3/1385H (corresponding to 22/7/1965AD) and the Council of Ministers Resolution No. (185) dated 17/3/1385H (corresponding to 17/7/1965AD).⁶⁰⁰

The Saudi Arabian 1965 Companies Law had 234 articles in fifteen sections. Whereas there are 227 Articles in the new 2015 Companies Law.⁶⁰¹ In contrast, there are over 1300 in the UK Companies Act 2006, which indicate the huge gap between the degree of regulation in the Companies Law in Saudi Arabia and the UK Companies Act.⁶⁰²

To sum up, as mentioned in the previous paragraphs, there are many issues regarding the 1965 Companies Law, as well as the fact that this law is more than five decades old. However, the new 2015 Companies Law version has reformed some issues which

⁵⁹⁸ S Albogomi, 'Ministry of Commerce and Industry calls to shift from family business to Closed Joint Stock Company' *Alsharq Alawsat* (London Financial section) <<http://www.aawsat.com/details.asp?section=6&issueno=12545&article=723254#.U1cWccdBwsm>> accessed 3/2/2014.

⁵⁹⁹ It is worth mentioning –in this context- that there is a conference has been held in Jeddah, Saudi Arabia 24 May 2014 about corporate governance for family companies.

⁶⁰⁰ *Saudi Companies Law* 1965.

⁶⁰¹ *Companies Law* 2015.

⁶⁰² *UK Companies Act* 2006.

described as a step forward towards the reformation. The next sections in this chapter are an attempt to shed light on the Saudi Arabian judicial system in general, as well as tackling the issues and arguments of Companies Law and analysing them critically.⁶⁰³

5.3.2 The root of Saudi Arabian Companies law

Moving to the root of Saudi companies law, the important question to be asked in this context is where have the Saudi Arabian legislators adopted these rules and regulations from? This question also raises other issues around Sharia and the capacity for the adoption of new rules and regulations from other systems.⁶⁰⁴ Clearly, adopting positive rules has been a tool used by legislators in Saudi Arabia, either from the law used in the West, such as English or the French law, or from neighbouring Arab countries who have more advanced legal systems - Egypt for example.⁶⁰⁵ The argument in this context is whether these laws and legal systems are still in accordance with the Sharia principles, as this is considered to be the Kingdom of Saudi Arabia's supreme law.

The world, including Saudi Arabia, is witnessing rapid changes in all of life's aspects nowadays, including the emergence of new transactions and issues that are accompanying economic growth. These issues raise many questions in the context of Saudi Arabia, the law, and Sharia; therefore, the potential for Sharia to adapt is

⁶⁰³ See: T Koraytem, 'The Islamic Nature of the Saudi Regulations for Companies' (2000) 15 Arab Law Quarterly 63.

⁶⁰⁴ See chapter four 4.3.

⁶⁰⁵ B Al-Haddab and GV Puig, 'The protection of minority shareholders in the Gulf Cooperation Council' (2013) 13 Journal of Corporate Law Studies 123.

definitely one of the most important questions that need to be asked. The ability of the law to adapt to changes is one of the most important determinants of financial development, according to Ahmed, who claims that “Adaptability underscores the formalism of laws and the ability of legal traditions to evolve”.⁶⁰⁶ Thus, to what extent, if at all, can Sharia adapt to new concepts, transactions and rules and regulations? The previous chapter has shown in detail the ability of Sharia law to adopt new rules and regulations that are not contrary to the principles of Sharia.⁶⁰⁷

To some extent, the rules that form Saudi companies law rely heavily on French law.⁶⁰⁸ Actually then, Egyptian companies law could provide a bridge for Saudi companies law to Code de commerce of France, as Egyptian companies law itself revolves around French law.⁶⁰⁹ Koraytem believes that analysing the types of companies within Saudi Arabian companies law 1965 reveals that they are influenced by and quite similar to those under French law. For example, 'Sharikah that masuliah mahdodah' are limited liability companies in Saudi Arabian Companies Law 1965 and can be compared to *Société à responsabilité limitée* in French law. However, there are many differences between these two laws, such as the minimum number of partners and the obligation of a public notary for authentication of the contracts. Even so, these differences cannot necessarily be described as primary. In fact, Koraytem goes

⁶⁰⁶ H Ahmed, 'Islamic law, adaptability and financial development ' (2006) 13 Islamic Economic Studies 79.

⁶⁰⁷ See chapter four 4.3.

⁶⁰⁸ B Al-Haddab and GV Puig, 'The protection of minority shareholders in the Gulf Cooperation Council' (2013) 13 Journal of Corporate Law Studies 123.

⁶⁰⁹ Ibid.

beyond the idea of ‘influence’ in order to describe the similarities between Saudi Arabian Companies Law 1965 and French law in its version prior to 1966. Koraytem states that the Saudi Companies Law 1965 “seems in fact to have copied almost word for word” the French law, with adaptations made in a way that makes it compatible with Islam, as some elements show.⁶¹⁰ Finally, the Companies Law 1965 considered to be the base of 2015 version which means the same legal root as well.

5.3.3 The compatibility with Sharia principles

Moving on to Sharia, in the context of the legal and regulatory framework of Saudi Arabia, it is worth mentioning that Sharia in Saudi Arabia still holds a unique place, as it covers the state's constitution, common law, as well as being the sole formal source of political legitimacy. Moreover, according to one commentator, Sharia politics in Saudi Arabia goes beyond being a one strand or subject inside politics, as "shari'a is implicated in all politics".⁶¹¹

It may be a challenge for the Saudi Arabian authorities to incorporate new rules and regulations in a way that these regulations are not contrary to the principles of Sharia, particularly in country like Saudi Arabia which can be described as being very conservative. In this context, so far, the results reveal some success, but there are still more efforts that must be made to improve the situation.

⁶¹⁰ T Koraytem, ‘The Islamic Nature of the Saudi Regulations for Companies’ (2000) 15(1) Arab Law Quarterly 63.

⁶¹¹ FE Vogel, 'Shari'a in the politics of Saudi Arabia' (2012) 10 The Review of Faith & International Affairs 18.

Puig and Alhadab see the issue in a positive light, as they consider the Saudi Companies Law 1965 -which is the base of 2015 version- as being an "obvious example of the adoption of positive rules to govern certain economic activities" within the framework of Sharia, and this does not contravene the Islamic spirit of the law.⁶¹² Moreover, Koraytem asserts, "The Saudi experience is an example of the incorporation of Western legal concepts into the Sharia in a country usually and rightly qualified as very conservative".⁶¹³ However, Esmaili sees the adoption of new rules and regulations in Saudi Arabia as creating a parallel modern system of law caused by the new world's institutions and commercial developments "in matters not subject to specific Shari'ah rules".⁶¹⁴ From the previous argument it appears that the adoption of rules from other jurisdictions to govern business affairs could be a shortcut that saves time in the high speed race towards investment and finance. This process could close the gap between business environments becoming more updated and being able to deal with new concepts. Given that globalisation is making the world nowadays as akin to a small village, this means there is a need to keep updated with new concepts and business transactions, otherwise it will be like betting on the wrong horse. However, like the UK, efforts towards corporate governance, including establishing committees that contain scholars from various fields such as Sharia, finance and business, would be a solution to address certain issues and problems and

⁶¹² B Al-Haddab and GV Puig, 'The protection of minority shareholders in the Gulf Cooperation Council' (2013) 13 *Journal of Corporate Law Studies* 123.

⁶¹³ T Koraytem, 'The Islamic Nature of the Saudi Regulations for Companies' (2000) 15(1) *Arab Law Quarterly* 63.

⁶¹⁴ H Esmaili, 'On A Slow boat towards the rule of law: The nature of law in the Saudi Arabian legal system' (2009) 26 *Arizona Journal of International & Comparative Law* 48.

generate new ideas. This is due to the fact that there are some points that need to be considered to be more compatible with the supreme law and society.

To sum up, the influence of Sharia on Saudi Companies Law is very clear. There is some evidence and some examples from the 1965 and 2015 Companies Law's articles. For example, after stating the types of companies that the Companies Law 1965 applies to, Article 2 states that "Without prejudice to such companies known in Islamic jurisprudence." Also, Articles 229 and 230 in section 13 mention sanctions "Without prejudice to what is required under the provisions of the Islamic regulations".⁶¹⁵ The 2015 Companies Law has solved some of the conflicts with Sharia in the 1965 such as Article 9 of 1965 which has been replaced with Article 11 of 2015 law to be compatible with Sharia. Moreover, the 2015 Companies Law has stated more than once the phrase of 'in accordance with Sharia principles' such as in Article 11, 121 which indicate the intention of making the new law more compatible with Sharia principles. However, one issue is that the 2015 Companies Law has excluded the Sharia sharikah types from the new law unless it has the form of any of the new law company types as stated in Article 3.⁶¹⁶ However, the impact of Sharia on Saudi Companies Law 1965 does not explain some issues concerning Saudi Companies Law 1965. Moreover, some researchers believe that characterising Saudi Companies Law according to the context of Sharia may be difficult. Finally,

⁶¹⁵ The Bureau of Experts at the Council of Ministers website, '*Companies Law*' (1965) <www.boe.gov.sa/ViewSystemDetails.aspx?lang=1&SystemID=236&VersionID=48> accessed 1\3\2015.

⁶¹⁶ *Companies law* 2015.

Koraytem concludes “one of the most Westernised aspects of Saudi law is not contradictory to Islamic law without being literally Islamic”.⁶¹⁷

5.3.4 The need for effective companies law

It is quite clear for the observer to notice the rapid shifts that the Saudi Arabian business environment has witnessed over recent decades, accompanied by political and social changes; alongside the developments that the government is trying to foster in the context of laws and regulations to make the business environment more attractive to foreign investors. Obviously, joining the World Trade Organisation may be seen as one of the most important events, and a major step towards not only attracting foreign investors, but embracing them.⁶¹⁸ Thus, there are some indications that the Saudi legal system is shifting towards “a system with more modern legal institutions and significantly modern legal principles.”⁶¹⁹ And issuing the new Companies Law 2015 could prove that.

There is a legislative gap as a result of the insufficiency of the legal system in Saudi Arabia. This is due to the newness of the commercial judicial authorities on the one hand, and the huge developments in the business environment in a short time in the

⁶¹⁷ T Koraytem, ‘The Islamic Nature of the Saudi Regulations for Companies’ (2000) 15(1) Arab Law Quarterly 63.

⁶¹⁸ The General Council of the World Trade Organisation successfully adopted Saudi Arabia’s terms of accession on the 11th of November 2005. See: The World Trade Organisation official website, ‘Kingdom of Saudi Arabia and the WTO’ (The World Trade Organisation 2005) <http://www.wto.org/english/thewto_e/countries_e/saudi_arabia_e.htm> accessed 1 May 2014.

⁶¹⁹ H Esmaili, ‘On A Slow boat towards the rule of law: The nature of law in the Saudi Arabian legal system’ (2009) 26 Arizona Journal of International & Comparative Law 48.

other hand.⁶²⁰ Saudi Arabia is not an exception among the Middle East and Muslim countries in adopting new regulations, and modernising its legal system. However, Saudi Arabia has its unique way of doing things. Therefore, the need to expand business relations, alongside economic conditions, means "statutory enactments have succeeded in supplementing a substantial segment of the traditional legal structure without, however, abrogating any of the rules of the shari'ah".⁶²¹

5.3.5 Saudi Companies Law 2015

The fact that the 1965 Companies Law had not been changed for over 50 years means it is fair to say that it was out of date to some extent. Despite the very long process of issuing the new 2015 law, it can be seen very clearly that the Ministry of Commerce has made a good effort to draft the new law with better and updated features. From the first glance, the new law has corrected and updated the relevant institutional bodies, such as the Capital Market Authority. Moreover, it can be seen that the 1965 Law used to refer the responsibility to the Minister of Commerce rather than the Capital Market Authority, as the 2015 Law does.

One significant feature of the 2015 Companies Law is solving the clash between the Capital Market Law 2003 and the Companies Law 1965 when dealing with shareholding companies. The Companies Law 2015 describes in several articles the responsibilities of the Capital Market Authority and the responsibilities of the

⁶²⁰ S Aljobran, *The Board of Directors in Joint-stock Corporation in Saudi law : A comparative study with the laws of GCC States, Lebanon, Egypt, Syria, Jordan and Iraq* (Al-Halabi, Lebanon 2006).

⁶²¹ GN Sfeir, 'The Saudi Approach to Law Reform' (1988) 36 *The American Journal of Comparative Law* 729.

Ministry of Commerce. Moreover, the Companies Law 2015 addresses some issues that used to slow down companies through the bureaucratic process. For example, the Ministry of Commerce website has been made more efficient and active and given more importance.

Noticeably, the 2015 Companies Law has edited the types of companies by deleting Cooperative Companies, Partnerships limited by shares, and companies with variable capital. However, the new law has added instead Holding Companies and one person Limited Liability Companies.

The fact that the 2015 Companies Law has solved some of the conflicts with Sharia in the 1965 law, such as Article 9 of 1965 which has been replaced with Article 11 of 2015 law to be compatible with Sharia. Moreover, the 2015 Companies Law states more than once the phrase: 'in accordance with Sharia principles', such as in Article 11, 121 which indicates the intention of making the new law more compatible with Sharia principles. However, one significant issue is that the 2015 Companies Law has excluded Sharia sharikah types from the new law, unless they take the form of any of the new law types, as stated in Article 3.

The legislator has given the authorities, whether the Capital Market Authority or the Ministry of Commerce, the power of intervention in some cases, and the formation of a temporary committee containing experienced and competent individuals to supervise the company's management, in the event that the General Assembly is unable to elect the board of directors of the company.

Regarding the issue of rewards and remunerations, the new law has set up the highest amount of reward to not exceed 500,000 Saudi Riyal. Article 76 of the new law has

stated that if one member of the board has been absent three times without a rightful reason, his or her membership of the board will be cancelled.

It can be seen that the sanctions have been toughened more, the 1965 law for example used to have a penalty that did not exceed 20,000 Saudi Riyal and no more than one year in prison, whereas the 2015 law has increased these penalties to 5,000,000 Saudi Riyal and prison sentences can reach up to five years.

5.4 Conclusion

This chapter has described critically the main Saudi institutions, including those that have legislative powers. Clearly, reviewing the distinguishing characteristics of the Saudi legal system and the main authorities of the state reveals that there are overlaps between them. This could cause an environment of uncertainty and legal confusion that will have a direct impact on corporate governance regulations, and then the business environment of Saudi Arabia. There are huge efforts being made by the government to attract foreign investors, which can be seen through SAGIA ‘Saudi Arabian General Investment Authority’. According to SAGIA, Saudi Arabia is the largest economy in the MENA region. In terms of “fiscal freedom”, Saudi Arabia is ranked 5th and the 3rd in terms of the most rewarding tax system in the world. However, the situation of the business environment could impact upon these attempts.⁶²²

⁶²² 'Saudi Arabian General Investment Authority Official Website' (2014) <<http://www.sagia.gov.sa>> accessed 1\9\2016.

The previous sections have discussed the ‘Ulama’ religious scholars’ impact, as the example of codification of Sharia law has shown. Undoubtedly, the Ulama play a crucial role in terms of being the interpreters of the Sharia sources that Saudi Arabia have as law, and legitimising the government’s actions. Moreover, to a large extent, the Ulama have played an important role in the successful improvement of the Saudi legal system. In the view of Almajid, the reason for some obstacles to legislative bills and regulations by ‘traditional forces’, which includes the Ulama, can “to some extent be attributed to ex ante stances taken before such laws and proposals were examined”.⁶²³ Accordingly, the involvement of the Ulama in legislative circles discussions is very significant, as this participation will solve the problem of rejection of new legal solutions.⁶²⁴

There are many factors that together have created what can be called ‘legal confusion’ for foreign investors and for Saudis as well. The dualistic legal system, for example, is one of the factors that could cause chaos. Therefore, it may be true to describe the ‘legislative powers’ as ‘scattered’ between the King, the Consultative Council, the Council of Ministers and the Supreme Judicial Council. Therefore, the path of reforming the legal system has witnessed a remarkable and huge step, through the 2007 Royal decrees, towards developing and improving the judicial system.

⁶²³ F. Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Sabir Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 236.

⁶²⁴ Ibid.

The important role played by institutional investors has been recognised in the new OECD principles 2015 as principle number three has been dedicated to the issue of Institutional investors, stock markets and other intermediaries “The share of equity investments held by institutional investors such as mutual funds, pension funds, insurance companies and hedge funds has increased significantly, and many of their assets are managed by specialised asset managers.”⁶²⁵ Generally speaking, the UK's institutional investors are of four types: pension funds, insurance companies, mutual funds and sovereign wealth funds. In comparison, there are three key players who invest in the Capital Market in Saudi Arabia: the Public Investment Fund (PIF) who used to be supervised by the Ministry of Finance, the Public Pension Agency, and The General Organization for Social Insurance. There is also another institutional investor, which is the Saudi banks, as they work in the Saudi stock market via their investment funds. According to Alarabiya, in August 2015, around 33% of the market value of the shares issued on the Saudi market of listed companies were owned by one of the funds and institutions of the government, which is more than 606 billion Saudi Riyal. The Public Investment Fund was the first investor among the governmental institutions, with around 387.7 billion SAR, followed by the General Organization for Social Insurance with 115.7 billion SAR, and the Public Pension Agency with around 50 billion SAR.⁶²⁶ It can be seen from the Saudi Arabian Capital Market Authority Strategic Plan that the future vision for between 2015 and 2019 will be more towards

⁶²⁵ *OECD principles of corporate governance 2015.*

⁶²⁶ Alarabiya official website, 'The Saudi Government Investments in the Stock Market Is 606 Billion Riyals' (Alarabiya 2015) <<http://www.alarabiya.net/ar/aswaq/financial-markets/2015/08/20/606.html>> accessed 1/11/2015.

the expansion of the institutional investment base in the Capital Market.⁶²⁷ In the context of institutional investors in the United Kingdom, the UK Stewardship Code 2012 has dealt with a number of areas of good practice for institutional investors.⁶²⁸ Issuing the Stewardship Code shows the special attention being paid towards institutional investors -as a key player- who holding voting rights in UK companies. On the other hand, it can be seen very clearly that in the Saudi Arabian legal and regulatory framework, there is a lack of attention paid to institutional investors, and there are no special regulations or guidelines.

Due to their investment behaviour, institutional investors in the Polish experience have been considered popular by Bohla and Brzeszczyński as a factor in destabilising stock prices. On the other hand, institutional investors could collectively add more efficiency to the stock market by countering the irrational behaviour displayed in the sentiment of individual investors.⁶²⁹ To some extent, the developments in the Saudi capital market are similar to the 1994 - 2003 Polish experience, which shows the importance of this context. There is no doubt that the results of a certain country cannot be copied to others due to the specific circumstances, on the one hand, and the different mechanisms of institutional investors from one country to another, on the other hand. However, there are some lessons that can be learnt from the Polish

⁶²⁷ CMA, 'Capital Market Authority Strategic Plan: From 2015 to 2019' (Capital Market Authority, Riyadh 2014).

⁶²⁸ *Stewardship Code 2012*.

⁶²⁹ M Bohl and Janusz Brzeszczyński, 'Do Institutional Investors Destabilize Stock Prices? Evidence from an Emerging Market' (2006) 16 *Journal of International Financial Markets, Institutions and Money* 370.

experience concerning the role of institutional investors in the Saudi context. First of all, institutional investors generally speaking could contribute towards a reduction in the volatility of the shares of listed companies. Secondly, institutional investors could increase the market effectiveness more than individuals' contributions, according to the advice from research, studies and investment information available to institutional investors.⁶³⁰

The importance of these issues in this chapter is very clear. Reforming the legal framework of corporate governance is very important for the economy to prosper, and it is a key issue which has a direct impact on the business environment. However, about six years have passed since 2007, and the question still to be asked is: with the slow reforming progress, will the observer see the results soon?

⁶³⁰ M Aljadeed, 'Institutional Investors and Fluctuation of Prices' *Aleqtisadyah* (Riyadh Opinion <http://www.aleqt.com/2009/10/02/article_282277.html> accessed 1/9/2015.

6. Chapter six: Saudi Arabian corporate governance system

6.1 Introduction

The previous chapters have shown the influence of Sharia over many aspects of the current Saudi legal and regulatory framework of corporate governance. On the other hand, the UK system of corporate governance has gained a great deal of international recognition to large extent. Moreover, it can also be seen that Company Law in Saudi Arabia and the rest of the Gulf states includes some aspects of Western influence.⁶³¹ Vice versa, the UK is intending to boost some areas of the business sector to make it compatible with principles of business according to Sharia standards.⁶³² These are some of the motivations for taking Sharia and the UK corporate governance system as the basis for evaluating the Saudi system.

Moving to the Saudi Arabian context, there are several institutional bodies that participate in the supervisory task of the Saudi stock exchange where listed companies are registered, bearing in mind that listed companies are the main target of corporate governance regulations. In fact, the 'game roles' have changed dramatically in the Saudi market over the last few decades, and the players' positions have also changed. Therefore, the different tiers of the institutional framework will be examined

⁶³¹ F Facchini, 'Economic Freedom in Muslim Countries: An Explanation Using the Theory of Institutional Path Dependency' (2013) 36 *European Journal of Law and Economics* 139.

⁶³² F Manjoo, 'Is London Ready to Become a Financial Hub of Islamic Finance?' (2016) 37 *Company Lawyer* 69. See also: R Wigglesworth and E Moore, 'Cameron aims to boost Islamic finance' *Financial Times* (London 29 October 2013).

in this chapter, including the Ministry of Commerce, Saudi Arabian Monetary Agency and Capital Market Authority.

On other other hand, when examining the corporate governance legal and regulatory framework, there is important legislation to be considered, such as the Capital Market Law (CML) and corporate governance regulations; the importance of these laws depends on the extent of the impact on corporate governance issues in Saudi Arabia and on the business environment. There is no doubt that corporate governance regulations and CML can be described as two of the most important steps towards reforming and improving the current situation of the Saudi legal framework and, therefore, the business environment.⁶³³ Thus, the next chapter will shed light on the main issues regarding these laws, with a specific focus on corporate governance regulations in the light of Sharia and the UK system of corporate governance.

6.2 Saudi Stock Exchange's Regulatory Authorities

August 2003 witnessed a remarkable event in the context of the Saudi Stock Exchange and corporate governance in Saudi Arabia in general. Noticeably, the capital market after this year, has started a new era, accompanied by an exchange of roles and change in capacities between Regulatory Authorities. Another crucial point is that the 2003 Capital Market Law was issued on the establishment of the Capital Market Authority, as Article 4 states. This new authority has reshaped the framework of the market as it is been given the responsibility of issuing the rules and regulations

⁶³³ See: J Beach, 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 *Stanford Journal of International Law* 307.

as well as applying the CML provisions.⁶³⁴ Thus, the Capital Market Law 2003, which has been given approval by Royal decree number (M/30), could be described as the law that has reshaped the capital market significantly, as the following sections will discuss.⁶³⁵

6.2.1 Ministry of Commerce and Industry

In the context of corporate governance and the Saudi Stock Market, the Ministry of Commerce and Industry could be described as a key player, especially before the introduction of the Capital Market Authority. In terms of publicly listed companies, through a Royal decree, the Ministry of Commerce and Industry has the judicial, executive and legislative power.⁶³⁶ Moreover, it is clear that, the Ministry of Commerce and Industry in Saudi Arabia has always had the supervisory lead and responsibility over business and commerce. The 1965 Companies Law gave full power to the Ministry of Commerce and Industry over the stock market prior to the introduction of the CML.⁶³⁷ However, the stock market was simple and the companies were fewer, which made the control and the governance much easier. Subsequently, the market witnessed growth and more IPOs, which added more complexity to the market, as noted in 1984. Thus, this was the reason for introducing a pack of

⁶³⁴ *Capital market law 2003.*

⁶³⁵ B Gouda, 'The Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003' (2012) 18 *Annual Survey of International & Comparative Law* 115.

⁶³⁶ See the Royal decree no: M/6 for more details.

⁶³⁷ *Companies Law 1965.*

structural reforms, including transferring some of the responsibilities to ‘SAMA’ the Saudi Arabian Monetary Agency after the formulation of a new committee by the government for the sake of developing and regulating the market. This committee included the Ministry of Commerce, the Ministry of Finance and National Economy and the Saudi Arabian Monetary Agency.⁶³⁸ Therefore, after the takeover by SAMA of capital market issues, the Ministry of Commerce no longer had the responsibility of regulating the IPOs and related issues. However, there is still one role that the Ministry of Commerce plays in the context of the capital market, which is the incorporation of listed companies.⁶³⁹

6.2.2 Saudi Arabian Monetary Agency

Another player in the legal and regulatory frameworks of corporate governance in Saudi Arabia is the ‘Saudi Arabian Monetary Agency’ SAMA, which was established in 1952.⁶⁴⁰ There are many roles and functions played by SAMA, including the Government’s banking affairs; issues of the national currency, the ‘Saudi Riyal’; foreign exchange reserves management; the supervision of commercial banks that

⁶³⁸ Saudi Stock Exchange (Tadawul) Official website, 'Tadawul' (2015) <http://www.tadawul.com.sa/wps/portal!/ut/p/c0/04_SB8K8xLLM9MSSzPy8xBz9CP0os3g_A-ewIE8TIwODYFMDA08Tn7AQZx93YwN3I_3gxCL9gmXHRQCI_IsB/> accessed 3/1/2015.

⁶³⁹ Ministry of Commerce, 'Minstrel Resolution No 4825 Dated 2008' (2008) <<http://mci.gov.sa/LawsRegulations/SystemsAndRegulations/CompaniesSystem/Pages/16-20.aspx>> accessed 1/5/2016.

⁶⁴⁰ See: J Beach, 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 *Stanford Journal of International Law* 307.

work in Saudi Arabia, and promoting the financial system's growth.⁶⁴¹ In other words, SAMA is the central bank of the Kingdom of Saudi Arabia. However, as discussed in the previous chapter, for certain reasons the government has avoided the name 'central bank' as it is associated with some transactions that are prevented in Sharia such as (usury) 'Riba', as is the experience of some neighbouring countries such as Egypt.⁶⁴² Moreover, the English version of the official website of SAMA states that "The Saudi Arabian Monetary Agency (SAMA), the central bank of the Kingdom of Saudi Arabia" even though the Arabic version and the official name of SAMA is Saudi Arabian Monetary Agency.⁶⁴³

From the previous point, SAMA has an important role in the context of corporate governance's regulatory framework. Moreover, SAMA introduced a draft of corporate governance insurance regulations in 2014. In fact, there is cooperation between SAMA and CMA in order to improve the conditions of related issues, including regulating corporate governance. SAMA is in charge of the legal framework over Saudi banks and insurance companies in Saudi Arabia, which reinforces its important role in the context of this thesis.⁶⁴⁴

⁶⁴¹ SAMA, 'The Official Website of the Saudi Arabian Monetary Agency' (2016) <<http://www.sama.gov.sa>> accessed 1/2/2016.

⁶⁴² See chapter four 4.4.1 and chapter five 5.1.2.1 for more details.

⁶⁴³ SAMA, 'The Official Website of the Saudi Arabian Monetary Agency' (2015) <<http://www.sama.gov.sa>> accessed 12/2/2016.

⁶⁴⁴ *Draft of Insurance Corporate Governance Regulation* (Riyadh 2014).

In the context of corporate governance and the stock market in Saudi Arabia, SAMA began its role in 1984. The stock market growth has increased dramatically due to certain factors including the growth of the number of investors accompanied by many IPOs, which has added more complexity to the market, as mentioned in the previous section. So, the fact that the market was facing difficulty being supervised by one entity means it has been replaced by a new one. Therefore, until 2003, SAMA was the government agency responsible for regulating and monitoring market activities. However, the Ministry of Commerce and Industry during this period of time was still the regulatory body and shared some responsibilities with SAMA as a part of the ministerial committee.⁶⁴⁵ The fact that there are three bodies that share the responsibility of supervising stock market activities makes it an environment where it is possible for conflict to occur between the jurisdictions. Therefore, to facilitate coordination between the bodies, two committees have been set up at a high level to prevent any possible conflict, which are the Ministerial and the Supervisory Committee.⁶⁴⁶

Regarding the above mentioned issues, SAMA has an important role to play in the context of corporate governance and the business environment of Saudi Arabia. It is not secret that there are two types of banks in Saudi Arabia, the Islamic banks who use principles of Sharia to govern all its operations and conventional banks with some transactions that considered to be against some Sharia principles such as ‘riba’. However, SAMA is the supervisor of all the commercial banks that work in Saudi

⁶⁴⁵ Royal Decree No.1230/8.

⁶⁴⁶ The 1983 ministerial committee included: 1-the ministry of commerce and industry 2-the ministry of finance and 3- Monetary Agency SAMA.

Arabia and still has the original jurisdiction to exercise over banks' activities. Since Islamic banks are new- to some extent- and have more and more new issues, the area requires more attention from SAMA. Sharia boards have the responsibility for supervising the transactions of Islamic banks, and these boards vary from one bank to another. There are some issues in that these boards are contributing one way or another to the issues of company's law, corporate governance and the business environment. For instance, the same names of the members of the Sharia group in one bank can be found in many other banks, given the fact that there are many qualified scholars and experts in a country like Saudi Arabia where there are many Sharia colleges and Islamic universities. Consequently, the rewards of Sharia boards differ if there are more names in this field. A further question concerns the independence of the members of the Sharia board, who could be members of other banks at the same time. Indeed, there is a need to have special arrangements from SAMA to activate the supervisory and regulatory role for both Islamic and conventional banks.⁶⁴⁷

6.2.3 Capital Market Authority

The aftershocks that were caused by the dramatic collapse of Enron, WorldCom and others have reached many parts of the world, and definitely, that includes the GCCs and Saudi Arabia in particular. These failures of US companies have played a crucial role in the US concerning legislative and regulatory reforms such as the Sarbanes-Oxley Act of 2002 as a rapid response from the American Congress, followed by the

⁶⁴⁷ See chapter four for more details.

governance guidelines from the New York Stock Exchange.⁶⁴⁸ Hence, the legal reforms are there to ensure and regain trust in the business environments and capital markets, and are a matter of priority not only in Saudi Arabia and the rest of the GCC countries but for the whole world. However, the collapse of US companies was not the only reason for the call for rapid reform as there are other factors in Saudi Arabia. As mentioned previously, there is more than one regulatory authority for the Capital market, which caused a dual regulatory structure. The dual structure situation was one of the strongest factors that caused the stock market to underperform before the launch of the CMA in 2003.⁶⁴⁹ There were some calls from writers to learn a lesson from the United States' companies collapse. There was a call for the acceleration of the establishment of an authority to supervise and manage the capital market, which preceded the establishment of the Capital Market Authority in 2003.⁶⁵⁰ Despite the fact that the capital market, even before 2003, was one of the most developed automated systems among the markets in the Middle East, the capital market environment was characterised by some features that can cause difficulties.⁶⁵¹ It can

⁶⁴⁸ See: S S. Rehman, 'Are New Rules of Law Needed for Us Corporate Governance?' (2008) *International Business Law Journal* 797. And: J W. Salacuse, 'Corporate Governance in the New Century' (2004) 25 *Company Lawyer* 69.

⁶⁴⁹ F. Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 276.

⁶⁵⁰ A Alharthi, 'Accelerating the Establishment of the Saudi Capital Market Authority Is Urgent Necessity' *Alsharq Alawsat* (London Financial section <<http://archive.aawsat.com/details.asp?issueno=8435&article=141347#.VQiktCnVv0d>> accessed 5/2/2016.

⁶⁵¹ H T. Azzam, *The Emerging Arab Capital Markets* (Kegan Paul International, 1997) Page: 143.

be seen that there was an absence of detailed regulations to govern the market. There was a genuine necessity for some more rules to govern the capital market, including the regulations on full disclosure of information, preventing conflicts of interest, and more transparency and fairness.⁶⁵²

One of the reasons that make the Saudi Market the biggest among the GCC countries is the numbers, which exceed four million investors who have invested billions of Saudi Riyals in the capital market. However, this profile is about to change as the Saudi investors have been joined by foreign investors in the last few months as the government plans to allow foreign institutions to invest in the Saudi capital market.

The race towards attracting the international investment has made the convergence of corporate governance more important in the Saudi Arabian context. Moreover, the Anglo-American model could be described as dominating the attention of both countries and firms in the same time when considering adopting and implementing international standards of best practices. Actually, that means that corporate governance practices are becoming similar more and more all over the world "Companies are even going so far as to subject themselves to higher governance rules in order to attract investment".⁶⁵³ Indeed, foreign investors will demand effective corporate governance systems, which indicate the importance of the critical

⁶⁵² A Alharthi, 'Accelerating the Establishment of the Saudi Capital Market Authority Is Urgent Necessity' *Alsharq Alawsat* (London Financial section <<http://archive.aawsat.com/details.asp?issueno=8435&article=141347#.VQiktCnVv0d>> accessed 5/2/2016.

⁶⁵³ S Morley, 'The Subject Matter, Form and Process of Convergence and the Ever-Increasing Role of the Foreign Investor' (2016) 37 *Company Lawyer* 71.

evaluation of the current rules and regulatory framework of corporate governance in Saudi Arabia in order to promote an attractive business environment, which therefore will be attractive for the foreign investors.

In fact, at the first half of 2015, the capital market has been opened to foreign investors as the Saudi Council of Ministers has decided to allow foreign institutions to engage in direct investment from 2015.⁶⁵⁴ Noticeably, the Saudi capital market is the last among the GCC countries to be opened up to foreign investment. The Saudi capital market has witnessed some changes and reforms during the past two decades. However, the government's decision to open the Saudi capital market and to allow foreign institutions to invest could be one of the most important reforms that the Saudi Market has witnessed.⁶⁵⁵ The CMA has published the 'Draft Rules for Qualified Foreign Financial Institutions Investment in Listed Shares' in order to obtain comments and critiques from the public before issuing the final draft officially.⁶⁵⁶ The question to be asked in this context concerns the capability of the financial instruments of the government like the CMA to issue enough arrangements and measures to prevent any drawbacks that could appear after opening the capital market and making sure the lessons of other countries like the 1997 Asian capital markets crises has been learnt.

⁶⁵⁴ The approval of the Council of Ministers at 21 July 2014.

⁶⁵⁵ Z Aldibas, 'What Is the Next Stage after Opening the Saudi Market to Foreign Investment?' *Alhayat* (London Financial <<http://alhayat.com/Opinion/Writers/3793535/ماذا-بعد-فتح-بعض-السوق-السعودية-السوق-فتح-بعد-ماذا>> accessed 1/2/2016).

⁶⁵⁶ CMA, *Draft of the Regulations of the Investment of Eligible Foreign Financial Institutions in Listed Companies* (CMA, 2014).

Moving to the legal origins of the Capital Market Authority, the CMA was established by the Royal Decree (M/30) in 2003, as mentioned previously. However, the effort from the government to produce new regulations to govern the capital market started earlier during the eighties due to the fact that the capital market is expanding and has been witnessing remarkable changes since the unofficial establishment during the fifties. Additionally, from just one joint stock company "Arab Automobile" in the 1930's, and about 14 companies in 1975, the economic expansion has increased the number to nearly 170 nowadays.⁶⁵⁷ However, this is still under the appropriate number of companies in comparison to the Saudi Market, which is definitely one of the biggest markets in the region. Taking the example of Western markets to illustrate the gap, the London Stock Exchange includes more than 2400 companies, more than 3000 Securities- excluding Debt- and more than 18000 debt securities.⁶⁵⁸

The importance of the CMA in the context of this thesis is the crucial role that is played by the CMA in corporate governance due to its legal powers as a government instrument that intends to protect the investors, enhance the efficiency and transparency of the market, as well as achieve justice. The CMA could be described as an independent government organisation linked directly to the Prime Minister, the King, and it has its own administrative, legal and financial independence. Moving to

⁶⁵⁷ Saudi Stock Exchange (Tadawul) Official website, 'Tadawul' (2015) <<http://www.tadawul.com.sa/>> accessed 1/2/2016.

⁶⁵⁸ London Stock Exchange official website, 'Companies and Securities' (London Stock Exchange plc 2015) <<http://www.londonstockexchange.com/statistics/companies-and-issuers/companies-and-issuers.htm>> accessed 1/2/2016.

the CMA's board, all the five commissioners who are assigned to sit on the board of the CMA are appointed by Royal Decree.⁶⁵⁹

Turning now to the question of the relationship between the CMA and the corporate governance regulations, the CMA is the government authority that is responsible for the corporate governance of the companies listed on the capital market. Therefore, in 2006, the CMA introduced corporate governance regulations. It must also be noted that the process of issuing the 2006 corporate governance involved many steps prior release, as the CMA had several issues to deal with before, in order to make the regulations suitable and beneficial for local application, taking into account the legal and regulatory frameworks on the one hand, and cultural factors on the other hand. First of all, the **first stage** of the arrangements goes back to 2005 as the CMA board formatted the team which started reviewing and studying the international principles of corporate governance, such as the Organisation for Economic Co-operation and Development (OECD), both international and regional experiences, the United Kingdom, the United States of America, Malaysia, Singapore and Oman. Moreover, the development team has reviewed and studied local companies' best practice of governance. The **second stage**, after the approval of the draft of corporate governance regulations for consultation by the CMA board, the CMA included asking for feedback and consultation from the public by making the draft available on the official website of the CMA. Also, one of the arrangements was to hold meetings with some of the related parties, the Ministry of commerce and the Council Saudi Chambers of Commerce for instance. **Finally**, on 11 November 2006, the CMA

⁶⁵⁹ *Capital Market Law 2003.*

issued the corporate governance regulations after the issuance of the CMA board, which was accompanied by appreciation for the public contribution at the press release.⁶⁶⁰ The experience of the consultation was very beneficial as more than 42 joint stock companies sent their comments. Additionally, the 'Hawkamah Institute' has provided an assessment of corporate governance in the Gulf in cooperation with the IIF- the Institute of International Finance.⁶⁶¹

The CMA's duties and authorities can be divided into **seven** main functions as stated by the Capital Market Law: First of all regulating and developing the capital market as well as boosting suitable standards and techniques for all the capital trade operation institutions involved. Secondly, protecting both public and investors from unfair and unsound practices such as inside information trading, fraud, cheating and manipulation. Thirdly, maintaining the important elements of securities transactions, for example fairness, efficiency and transparency. Fourthly, in terms of transactions for securities risk reduction, developing and improving measures that are related. Fifthly, monitoring, regulating and developing the issuance of securities and under-trading transactions. Sixthly, regulating and monitoring the activities of the Capital

⁶⁶⁰ Capital Market Authority, 'CMA Experience in Seeking Public Consultation for Corporate Governance Regulations' (International Finance Corporation IFC 2006) <http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/corporate+governance/news/events/menacg_codes2> accessed 29\2\2016.

⁶⁶¹ A Ahmed, 'An Examination of the Principles of Corporate Governance from an Islamic Perspective: Evidence from Pakistan' (2011) 25 Arab Law Quarterly 27. Hawkama Institute for Corporate Governance is based in Dubai and aims to advance corporate governance reform in the region. See: <http://www.hawkamah.org/>.

Market Authority's entities that work under the CMA. Lastly, regulating and monitoring the full disclosure of information related to securities and issuers.⁶⁶²

It is possible to say that a new era of the Saudi stock market has started since the establishment of the CMA. Moreover, the establishment of the CMA has ended the old period of possible duality in order to supervise and regulate the market between the Ministry of Commerce and SAMA. Briefly, it can be said that the CMA has made interesting efforts in order to issue corporate governance regulations. Although it may be true that the CMA has tried to implement comprehensive arrangements in order to provide regulations that reflect what the business environment's needs are, taking into account the legal and regulatory framework, however, the obstacles and challenges could lead to a negative impact on the business environment. Furthermore, it has been more than eight years since the issuing of the corporate governance regulations, for example, and interestingly, only six Articles from the regulations are mandatory- half of them are partly mandatory- which could raise questions about the effectiveness of the regulations, which will be discussed in more detail in the following sections.⁶⁶³

6.3 Capital market laws and regulations

6.3.1 Capital market law

Recent changes in the size of the Saudi business environment on the one hand, and the capital market and its legal and regulation frameworks on the other hand, have heightened the need for new laws for the capital market. Remarkably, until 2003, the

⁶⁶²Article 5 of the 2003 *Capital Market Law* .

⁶⁶³ *Corporate Governance Regulation* 2006.

1965 Companies Law was the jurisdiction that governed corporate issues relating to stock companies, as well as dispersed circulars and ministerial resolutions.⁶⁶⁴ Consequently, the Capital Market Law was issued in 2003, and the issuing instrument of this law is the Royal Decree No. M/30 dated 2003 and the Council of Ministers Resolution No. 91. Capital Market Law contains 67 Articles divided into 10 Chapters that address many issues regarding the capital market. The following paragraphs are an attempt to analyse and shed light on the most prominent issues of the law and those which have a direct impact on corporate governance in the business environment of Saudi Arabia.

To start with, one of the main issues of this law is that the CML has ended the ‘duality’ caused by two supervisory institutions and two jurisdictions- the Ministry of Commerce and SAMA by the issuance of the Capital Market Authority, as mentioned above in the previous sections. Starting with **Chapter one**, containing three articles explaining the definitions, and again as can be found in other laws and regulations in Saudi Arabia as mentioned before, this law has defined relatives as the husband, wife and minor children.⁶⁶⁵ The key problem with this explanation is that in the context of GCC countries, and in Saudi Arabia in particular, with extended families with strong relationships, this could be problematic.⁶⁶⁶ Moving to **Chapter Two**, it has 15 Articles covering the issues around the establishment of the Capital Market Authority,

⁶⁶⁴ F. Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 252.

⁶⁶⁵ See chapter five: 5.1.3.3.

⁶⁶⁶ *Capital Market Law* 2003.

the powers and the CMA Council. One of the most significant issues with this law in the context of this theses, is Article 6 of the Capital Market Law which states that, “The Authority shall have the power to carry out its functions under this Law as well as the regulations, rules and instructions issued pursuant thereto” and that including issuing and amending “the Implementing Regulations as may be necessary to enforce the provisions of this Law”.⁶⁶⁷

Chapter 3 of CML is divided into six Articles which deal with the capital market issues, starts with the establishing of the “Saudi Stock Exchange”, which has the legal status of a Joint Stock Company. Proposing the rules, regulations and instructions is one of the Board of Directors of the Exchange’s tasks, as Article 23 states, and that includes matters such as any necessary rules and instructions that the Exchange needs for the sake of investors’ protection by “ensuring fairness, efficiency and transparency in all of the Exchange’s related affairs”.⁶⁶⁸ **The fourth Chapter** of the CML contains five Articles regarding the Securities Depository Center. **The fifth Chapter** deals with brokers’ regulations via seven Articles. Banks have played the role of brokerage in the capital market since 1984. Consequently, due to this regulation, brokerage is no longer limited to banks only, as was the case before 2003, which means the market is open to more brokerage firms.⁶⁶⁹

It is worth noting here that the capital market has witnessed four stages in terms of brokers’ regulations since 1935. The first stage was from 1935 until the early eighties

⁶⁶⁷ Ibid.

⁶⁶⁸ *Capital Market Law 2003*.

⁶⁶⁹ Capital Market Authority, *Investing in Capital Market (CMA)*.

as the market was not official yet, and there were no specialist brokers. During the early eighties, oil prices dramatically increased, resulting in an increase in the state income. However, “Almanakh” market (the Kuwait stock market) collapsed in 1982 which rang a bell to encourage the Saudi government to improve the stock market to take steps in order to avoid any possible crises like what happened in Kuwait, which could be described as the second stage. In 1983, the brokers are limited to the official Saudi banks. The third stage started in 1990 as the SAMA improved the system to create an automated system supervised by SAMA but with the brokers still limited to banks. However, from the perspective of Azzam, there was still what he described as a “loophole that allowed the informal brokers to continue operate in the market”.⁶⁷⁰ Finally, the current fourth stage started after the establishment of the CMA in 2003.⁶⁷¹

Moving on, the **sixth chapter** of Capital Market Law deals with investment funds and collective investment schemes. The issue of disclosure is the subject of nine articles of the CML to form **Chapter Seven**. Next, **Chapter Eight** includes the issue of manipulation and insider trading. In stock markets, insider trading is one of the main unfair practices. Although it was illegal in the Saudi stock market prior to the CML 2003, the condition of enforcement was poor. Moreover, there was a lack of specified penalties for such trading in the existing regulations in the view of Azzam.⁶⁷² So, Article 49 and Article 50 of the CML 2003 has tackled this issue. Moreover, in 2014,

⁶⁷⁰ H T. Azzam, *The Emerging Arab Capital Markets* (Kegan Paul International, 1997) Page: 155.

⁶⁷¹ *Capital Market Law 2003*.

⁶⁷² H T. Azzam, *The Emerging Arab Capital Markets* (Kegan Paul International, 1997) Page: 156.

the jurisdiction of investigation and prosecution of Article 31, 49 and 50 moved from the Capital Market Authority to the Bureau of Investigation and Public Prosecution.⁶⁷³

Chapter nine is about the regulation of proxy solicitations, restricted purchase and restricted offers for shares. Finally, with 12 Articles, **Chapter Ten** clarifies the details of sanctions and penalties for violations.⁶⁷⁴

To sum up, the last two decades have been a remarkable era for the Saudi Capital Market for several reasons. However, the early days of 2004, which witnessed the start of the official effect of the capital market law 2003, could be described as one of the most significant events which the market had waited for a long time for.⁶⁷⁵

Moreover, Article 5 of the CML gave the CMA the right to issue regulations, rules and instructions, and is the solution to the traditional long process and bureaucracy of issuing new legislation. The result of authorising the CMA to issue new rules and regulations is reflected in the 2006 Corporate Governance Regulations.⁶⁷⁶

⁶⁷³ Based on the Royal Order No 4690.

⁶⁷⁴ *Capital Market Law 2003*.

⁶⁷⁵ According to Article 67 of the Capital Market Law 2003, this law shall be effective 180 days after the date of publication.

⁶⁷⁶ F. Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) P: 255 and *Capital Market Law 2003*.

6.3.2 The 2004 listing rules

Based on the Capital Market Law, the listing rules were issued in 2004 by the Board of the Capital Market Authority in 52 Articles divided into nine sections.⁶⁷⁷ In order to allow issuers to place securities on the capital market, the listing rules govern such admission and provide the description of the information that should be disclosed before placing the securities on the official list. Even so, this piece of regulation is not the first issue of listing rules in Saudi Arabia, as the Ministry of Commerce has issued listing rules before. Like any other listing rules, the goals of the listing rules in Saudi Arabia are to provide protection to investors and serve the market's development.⁶⁷⁸ According to Article 2, the objective of the listing rules is "to regulate the public offering registration and admission to listing of securities".⁶⁷⁹

Thus, through a quick review of some decisions by the Capital Market Authority, the observer can notice the importance of the listing rules in the context of corporate governance and the business environment. Article 34 clarifies the compulsory nature of the Listing Rules: "The issuer must comply with these rules and must provide to the Authority without delay all information, explanations, books and records that the Authority may require, which must be clear, accurate and not misleading".⁶⁸⁰ A very recent case that has had a great deal of resonance in Saudi and the GCC business

⁶⁷⁷ *The Listing rules 2004* Pursuant to the CMA Resolution Number 3-11-2004.

⁶⁷⁸ A Baamir, 'Issues of Transparency and Disclosure in the Saudi Stock Market' (2008) 22 Arab Law Quarterly 63.

⁶⁷⁹ *Listing Rules 2004*.

⁶⁸⁰ *Listing Rules 2004*.

environments is the ‘Mobily’ case. The importance of the Mobily case is because of the size of ‘Mobily’ as it is the second largest telecommunications company in Saudi Arabia and has a history of revenues and earnings since its establishment in the Saudi Market in 2004.⁶⁸¹ Following several procedures started to verify whether the company had violated the CML and its implemented regulations, this revealed suspicion about possible violation of section (C) of Article 42 of the Listing Rules and two Articles of the CML 49 and 50. The CMA announced the suspension of trading the shares of ‘Mobily’ for a few days. Moreover, the CMA announced in February 2015, the “assignment of a specialised team to review Etihad Etisalat Co. Mobily's financial statements, conduct site visits, obtain documents and hear concerned parties’ statements”.⁶⁸² The case is still under review at the CMA now and the results could be announced any time this year. Furthermore, there have been many cases of the enforcement of the Listing Rules since their issuance in 2004, whether it is the imposition of a penalty or suspension of trading shares such as ‘Anam’ and ‘Bishah’ in 2007, ‘Almojil’ in 2012, ‘Albaha’ in 2013 and many others.⁶⁸³

Finally, in the context of corporate governance regulations, the Listing Rules have reinforced some of the CGR’s provisions; for example, Article 42 of the Listing Rules, which is about the disclosure of financial information. Another example is

⁶⁸¹ M Rashad, 'Mobily CEO: We Hope to Start Earning again in 12 Months Time' (Reuters 2015) <<http://ara.reuters.com/article/businessNews/idARAKCN0ST0V220151104>> accessed 12/1/2016.

⁶⁸² The CMA’s announcement dated 03/11/2014. See: <http://www.cma.org.sa/en/News/Pages/CMA_N_1676.aspx> Accessed 2/2/2016 .

⁶⁸³ The CMA’s announcement dated 31/12/2014. See: <http://www.cma.org.sa/en/News/Pages/CMA_N_1674.aspx> Accessed 2/2/2016.

Article 43 which deals with the Board of Directors' report and requires them to include any issues that impact upon the company's operations and any other news or factors that are important to investors, which indicates the willingness of the CMA to promote transparency as a principle of corporate governance as well as protecting the market and investors.⁶⁸⁴

6.3.3 Corporate governance regulations

February 2006 left a remarkable mark on the Saudi stock market and the business environment in general. Despite the package of arrangements that had been set up to rescue the market, the index trend continued its steep fall, leading to huge losses. The index dropped from 20600 points to 10046.83 points on 11 May 2006, which means that the Saudi stock market lost more than half of its value in a matter of around 61 business days.⁶⁸⁵ So, in order to regain trust, the arrangements for reform started with packages of reforms. Alshoaibi believes that the absence of corporate governance regulations and the absence of responsibility impacted on the market during the collapse of the Saudi stock market in 2006.⁶⁸⁶ By November 2006, based on the Capital Market Law 2003 issued by Royal Decree No. M/30, the corporate

⁶⁸⁴ F Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 260.

⁶⁸⁵ A Alamri, 'The Fifth Anniversary of the Collapse of the Saudi Stock Market (2006 - 2011) Part (2 of 5)' *Alriyadh* (Riyadh Financial section <<http://www.alriyadh.com/608565>> accessed at 3/1/2015).

⁶⁸⁶ S. Alshuaibi, *The Role of Corporate Governance in Facing Challenges in Saudi Arabia* (Saudi Research & Publishing Company - SRPC, London 2014).

governance regulations were issued by the capital market authority.⁶⁸⁷ Generally speaking, regulators and policymakers reaction will be in the form of introducing corporate conduct new rules as Yeoh stated “policymakers and regulators typically respond with new rules for corporate conduct in the hope that bad corporate conduct would not recur”.⁶⁸⁸ The following paragraphs are an attempt to shed light on the regulations and analyse them.

With 19 Articles, the corporate governance regulations cover many issues that are crucial to improving the level of governance in companies and to protect the shareholders’ rights. The regulations tackle many subjects and are divided into five parts including the rights of shareholders and the general assembly, disclosure and transparency and the Board of Directors’ issues. **The first part** of the regulations deals with preliminary provisions. Despite the fact that the Capital market authority has adopted the legislative policy ‘comply or explain’ method, Article 1 paragraph B states that “These Regulations constitute the guiding principle” which has an exception in the same Article 1 paragraph C of the disclosure: “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”.⁶⁸⁹ However, the capital market authority has chosen a gradual approach to implementing the provisions of the corporate governance regulations,

⁶⁸⁷ *Capital market law 2003* : Article 5, 6 and 66.

⁶⁸⁸ P Yeoh, 'Corporate Governance in the UK: A Time for Reflection' (2015) 36 *Business Law Review* 130.

⁶⁸⁹ *Corporate governance regulations 2006*.

aiming to improve the market by selecting the appropriate times for regulatory Articles to be made mandatory after a procedure of analysing and studying the market.⁶⁹⁰

Article 2 defines some of the regulations' expressions and terms. Remarkably, Article 1 defines the independent member as: "a member of the board of directors who enjoys complete independence" which appears at first glance to be very convenient. However, as mentioned before, in the context of the GCC in general and Saudi Arabia in particular, the cultural framework should be taken into account when explaining what constitutes an infringement of complete independence. Ezzine believes that there is a possible violation of the board's independence "board of directors of Saudi firms are dominated by gray directors who have substantial business relationships with the company, either personally or through their main employers, and also relatives of corporate officers".⁶⁹¹The regulations state that it is infringement if the member of the Board of Directors is a first-degree relative of "any board member" or "any of the senior executives" of the company or of any other company within that company's group. However, this cultural context of the society, with extended families and close relations, should be taken more seriously when defining the first degree relatively. Moreover, according to Almutaz, not only should first degree be taken as an infringement, but the prevention should reach the fourth-degree relative in the context

⁶⁹⁰ CMA, 'About Capital Market Authority' Avalibal at: <<http://www.cma.org.sa>> accessed 13/1/2016.

⁶⁹¹ H Ezzine, *A Cross Saudi Firm Analysis of the Impact of Corporate Governance on the Stock Price Performance During the Recent Financial Crisis* (SABIC Chair for Islamic Financial Market studies, 2012 page: 19).

of Saudi Arabia.⁶⁹² Moreover, making the fourth-degree an infringement is not strange in Saudi regulations, as it can be found in Article 5 of the Certified Public Accountants' Regulations.⁶⁹³

There is no doubt that the ensuring of shareholders' rights is a very important subject in corporate governance and the business environment. Hence, the **second part** of the corporate governance regulations deals with the rights of shareholders and the general assembly in five articles of the CGR. Noticeably, it is one of the CMA approaches to use the new communication technologies in many of its applications. For example, Article 5 paragraph C states that "Modern high tech means shall be used in communicating with shareholders".⁶⁹⁴

Article 3 confirms the shareholders' rights relating to shares such as the right disposition, a share of distributable profits, a share of the company's assets upon liquidation and attending, voting on relevant decisions, deliberations in the general assembly. Furthermore, Article 3 sets out the shareholder's entitlement to supervise the Board of Directors and the right to inquire and have access to information, taking into account the CML provisions and the company's interests. Moving to Article 4, it deals with the facilitation of shareholders' exercise of rights and access to information. To ensure the rights of shareholders in relation to the general assembly, the board of the Capital Market Authority has made Paragraph I and J from Article 5 mandatory. Needless to say, Article 5 is a very important one as it states the

⁶⁹² E Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

⁶⁹³ *The executive regulation of Certified Public Accountants' Regulations* 1994.

⁶⁹⁴ *Corporate governance regulations* 2006.

shareholders' rights to discuss matters, raise questions and to have answers from both the Board of Directors and the external auditor at the General Assembly. However, paragraph (G) states that, "The Board of Directors or the external auditor shall answer the questions raised by shareholders in a manner that does not prejudice the company's interest". Almutaz argues that the exception: "in a manner that does not prejudice the company's interest" could have more than one interpretation, which may be a barrier to disclosure under the pretext of "prejudice the company's interest".⁶⁹⁵ The cumulative voting method has been applied in Article 6 to be used at the general assembly to nominate the members of the board.⁶⁹⁶ The importance of this method is to ensure the proportional representation of shareholders on the Board of Directors.⁶⁹⁷ Article 7 deals with the rights of dividend holders and the rights of shareholders.

Moving to **Part 3**, this clarifies the issues of disclosure and transparency. The importance of this part is the resolution of the board of the Capital Market Authority to make Article 9 mandatory. Article 9 contains seven paragraphs that illustrate the requirements to be included in the report of the Board of Directors such as disclosing the names of any joint stock companies that the member of the Board of Directors acts as a member of directors on its board. Also, it states the details of the Board of

⁶⁹⁵ E. Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

⁶⁹⁶ CMA has defined the Cumulative Voting as: It is a voting method to select the members of the board of directors. Each shareholder can cast a vote in proportion to the number of shares he owns. So he can use this power to vote for one candidate, or divide it on a number of candidates without repetition. This method increases the opportunity for minority shareholders to be represented in the board of directors by focusing the cumulative votes on one candidate.

⁶⁹⁷ A. Alharbi, 'Corporate Governance and the Rights of Shareholders (1-3)' *Alyaum* (Dammam Financial section <<http://www.alyaum.com/article/3083466>> accessed 15/2/2016.

Directors formation and the members' classification, whether executive, non-executive or independent. It also describes the Board's main committees for jurisdictions and duties. Another important point is addressed in paragraph E which includes requiring the company to clarify the details of compensation and remuneration paid to the members of the Board of Directors and the top five executives, including the CEO and the chief finance officer if they are not included already; those who have received the highest compensation and remuneration.⁶⁹⁸

Indeed, **Part 4** deals with the issues of the Board of Directors, and it is the longest part of the corporate governance regulations. Furthermore, Article 10, about the main functions of the Board of Directors, has three mandatory paragraphs including drafting a corporate governance code for the company with no contradictions to the Corporate Governance Regulations.⁶⁹⁹ Likewise, Article 12, Formation of the Board, has three paragraphs that are mandatory, making the majority of the members of the Board of Directors non-executive members and independent members of not less than two or one third of the Board of Directors- whichever is greater.⁷⁰⁰ Moreover, paragraph (B) Article 12 clarifies the duration of the members of the Board of Directors as no more than three years. However, the same paragraph states an exception, which is unless this violates the Articles of Association of the company

⁶⁹⁸ *Corporate governance regulations 2006.*

⁶⁹⁹ Resolution Number (1- 33 -2011) and resolution Number (3- 40 -2012) issued by The Board of the Capital Market Authority.

⁷⁰⁰ See: Resolution Number (1- 36 -2008) and resolution Number (3- 40 -2012) issued by the Capital Market Authority Board.

“members of the Board may be reappointed”.⁷⁰¹ Some people point out that there are some cases where the member of the Board of Directors is still member even after a long period of time without any logical reason.⁷⁰² What is more, the same Article in paragraph (H) sets out the maximum number of joint stock companies that the member of the Board of Directors can be a member of, which is up to five at the same time. Obviously, some argue that being a member of five companies is already too much, taking into account that nowadays companies often face crises; the need for qualified members, and the huge amount of time required from the member for one company to succeed.⁷⁰³

In 2009, Article 14, Audit Committee, was made mandatory, and in 2010 Article 15 on the Nomination and Remuneration Committee was made mandatory as well.⁷⁰⁴ Indeed, the issue of complete independence of non-executives is very important. Despite the fact that concerning the Nomination and Remuneration Committee appointed by the Board of Directors, Article 15 states many roles including ensuring the independence of the independent members, reviewing the Board of Directors’ structure and recommended changes. As Almutaz, has argued this can hinder the committee's performance as "they may at any time be reluctant to bite the hand that

⁷⁰¹ *Corporate governance regulations 2006.*

⁷⁰² E. Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

⁷⁰³ Ibid.

⁷⁰⁴ See: resolution Number (1- 36 -2008) and resolution Number (1-10-2010).

feeds them".⁷⁰⁵ Finally, to some extent, Article 17 on corporate governance has copied the Companies Law 1965 text on remuneration and indemnification of board members. As mentioned previously, the mixing of a percentage of the profits with other forms of remuneration would create an issue from a Sharia perspective due to mixing two contracts- 'Ejarah' and 'Mudarabah'.⁷⁰⁶

To sum up, despite the fact that corporate governance regulations are still the guiding principles, apart from some articles, there is no doubt that issuing corporate governance regulations in Saudi Arabia is a huge step towards a better business environment. However, there are some criticisms of the corporate governance regulations in Saudi Arabia. There is an issue concerning the mandatory nature of the regulations- the Capital Market Authority has utilised a slow gradual way in order to improve the background of the companies and encourage them to adopt the regulations through self-application.⁷⁰⁷ Moreover, Almutaz has claimed that, some weaknesses could have been avoided if the Capital Market Authority had considered the local business environment more, instead of what he describes as a borrowing of some Articles that are suitable for application in other countries.⁷⁰⁸

⁷⁰⁵ See: C Boyd, 'Ethics and Corporate Governance: The Issues Raised by the Cadbury Report in the United Kingdom' (1996) 15 *Journal of Business Ethics* 167. And E. Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

⁷⁰⁶ See page 56 of Chapter 2 for more details.

⁷⁰⁷ *Corporate governance regulations* 2006.

⁷⁰⁸ E. Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

6.3.3.1 Corporate governance enforcement

In terms of investors protection, especially minority shareholders it should be noticed in this context that Saudi Arabia has been ranked by the World Bank as the 17th out of 183 countries worldwide in 2012.⁷⁰⁹ Accordingly, the issue of enforcement is critical in the context of this thesis. First of all, the corporate governance regulations have been issued as a guiding principle and are not mandatory for listed companies on the stock exchange, as mentioned previously. However, the CMA has adopted the 'comply or explain' method of disclosure, which is mandatory. Moreover, the Capital Market Authority has chosen the gradual enforcement of the corporate governance regulations by choosing the best times for Articles to be made mandatory after analysing and studying the market.⁷¹⁰ For example, In 2008 the Board of the Capital Market Authority issued resolution Number 1- 36 - 2008 making Article 9 of the Corporate Governance Regulations regarding the Disclosure in the Board of Directors' Report mandatory on all companies listed on the Exchange effective. Then, in 2009 the board of the CMA issued resolution Number 1-36-2008 making paragraphs (c) and (e) of Article 12 of the Corporate Governance Regulations regarding the Formation of the Board mandatory on all companies listed on the Exchange effective from year 2009. Other example, in 2012 CMA issued resolution Number 3-40- 2012 making paragraphs (i) and (j) of Article 5 of the Corporate Governance Regulations regarding the Shareholders Rights Related to the General

⁷⁰⁹ F. AlKahtani, 'Current Practices of Saudi Shareholder's Rights: A Case for Reform' (2013) 27 Arab Law Quarterly 231.

⁷¹⁰ CMA, 'The Official Website of the Capital Market Authority' (2016) <<http://www.cma.org.sa>> accessed 20/3/2016.

Assembly mandatory on all companies listed on the Exchange effective from 1/1/2013G. Furthermore, in 2006, the regulations had only one mandatory article, whereas nowadays there are several Articles that are mandatory, three of which are partly mandatory.⁷¹¹ However, some believe that the CMA has not provided logical reasons for the slow process of making the corporate governance regulations mandatory, which could be more than just analysing and studying the market in order to choose the correct timing for implementation. Alharbi thinks that implementing all the articles from the corporate governance regulations could lead to financial, administrative and economic burdens on the company's management. For example, Article 12 paragraph D: "it is prohibited to conjoin the position of the Chairman of the Board of Directors with any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager". Therefore, implementing this article would add more burdens administratively and financially, especially to medium and small companies which could not bear the new burdens, such as appointing two different executive positions of CEO and managing director.⁷¹²

6.3.3.2 The inconsistencies between companies law 1965 and corporate governance regulations

It is a fact that there are some inconsistencies between the Companies Law 1965 and the corporate governance regulations due to the long gap between the issuance of both

⁷¹¹ *Corporate governance regulations 2006.*

⁷¹² A. Alharbi, 'The Capital Market Authority and the Boring Process of Implementing Corporate Governance Principles' *Alyaum* (Dammam Financial section <<http://www.alyaum.com/article/2631871>> accessed at: 12/12/2014.

of them. Moreover, Companies Law 1965 is about half century old whereas the corporate governance regulations were issued in 2006. For instance, the Companies Law 1965 in Article 79 states: "the board of directors shall appoint from among its members a chairman and a delegated member. A single member may hold the positions of a chairman and a delegated member."⁷¹³ On the other hand, Article 12D from the corporate governance regulations states that: "it is prohibited to conjoin the position of the Chairman of the Board of Directors with any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager".⁷¹⁴ Another example, is about the notices of the general assembly meetings: Article 88 of the Companies Law 1965 and Article 5C of the corporate governance regulations, have different period of times; the companies law 1965 states that that the notices must be published at least 25 days prior to the meeting, while the corporate governance regulations state at least 20 days.⁷¹⁵ Finally, Article 72 of Companies Law and Article 4B of corporate governance regulations differ, as the Companies Law 1965 prevents the Board of Directors from disclosing the secrets of the company to the shareholders or to a third party outside the meeting of general assembly. On the other hand, the corporate governance regulations mention more cases than 'general assembly meetings' and the information must be made available and provided regularly at the prescribed times.⁷¹⁶

⁷¹³ *Companies Law 1965.*

⁷¹⁴ *Corporate governance regulations 2006.*

⁷¹⁵ *See Companies Law 1965 and corporate governance regulations 2006.*

⁷¹⁶ *Ibid.*

As discussed earlier, these differences between these pieces of legalisation show the overlaps between the market regulators- the Ministry of Commerce and the Capital Market Authority. Furthermore, the corporate governance's inconsistencies are a result of the lack of clarity in distinguishing between the regulatory responsibilities as stated by Amico.⁷¹⁷

6.3.3.3 The main features of the Saudi system of corporate governance

From the previous discussion, the main features of the Saudi system of corporate governance may be summarised according to three features. First of all, the nature of the corporate governance system in Saudi Arabia is not mandatory in general, except for some articles, which means that it only provides guiding principles. It has been stated in the corporate governance regulations that it contains the guiding principles in Article 1 (b), and also states that this is unless any other regulations, rules or resolutions of the Board of the Authority provide for the binding effect of some of the provisions it contains.

Secondly, another feature of the Saudi system of corporate governance is regarding the protection of the rights of the shareholders and facilitating the way for them to exercise their rights. According to corporate governance regulations, the company's Articles of Association must state the procedures and precautions that are necessary for shareholders to exercise all their lawful rights, as stated in Article 3. For example, the right to a share of distributable profits and the right to a share of the company's assets upon liquidation, as well as the right to supervise the Board of Directors'

⁷¹⁷ A. Amico, *Corporate Governance Enforcement in the Middle East and North Africa* (Organisation for Economic Cooperation and Development (OECD), Paris 2014).

activities. In terms of voting rights, another feature is adopting cumulative voting for the election of the Board of Directors. Regarding accountability, there is an important feature of the corporate governance regulations, which is the procedures that are provided to the shareholders to take against the members of the Board of Directors in the case of violating the provisions of the statute of the company.

Thirdly, with regards to the board of directors, directors must promote the success of the company, including setting up strategic plans and laying down rules for internal control, as well as drafting a corporate governance code for the company as long as it does not conflict with the corporate governance regulations. Even though the Board delegates may use some of their powers or set up committees, responsibility for the company ultimately rests with the Board. Good faith, along with due diligence, is the basis of the Board of Directors' duties, which must be carried out in a responsible manner. Regarding the formation of the Board of Directors, the composition requirement is not less than three and not more than eleven, with a majority of non-executive members. The Nomination and Remuneration Committee is responsible for drawing up policies with standards that are related to the performance of the Board members and top executives' indemnities and remunerations. Finally, the Saudi system of corporate governance has clarified the issue around conflicts of interest in detail in Article 18; however, regardless of the importance of this issue, this article is not mandatory yet.⁷¹⁸

On the other hand, it is fair to say that there are some deficiencies in the Saudi system of corporate governance which should be mentioned in this context. To start with, the

⁷¹⁸ *Corporate governance regulations 2006.*

main deficiency could be the fact that the regulations on corporate governance in Saudi Arabia were issued in 2006, which means that they are now out of date to some extent. Secondly, the slow gradual approach that has been taken to make some articles binding is a further deficiency of the Saudi system of corporate governance. There is a need to speed up this process in order to see more positive results from the corporate governance regulations. Thirdly, there is a need to revise some of the issues of corporate governance to be more in tune with the Saudi context. For example, Article 2 part four of the corporate governance regulations regarding “a first-degree relative” as an infringement of the independence of the member of the Board of Directors, defines this as the father, mother, spouse and children only, but should be taken more seriously as a cultural issue in the Saudi context. Fourthly, Article 5 stresses the right of shareholders to discuss matters listed in the agenda of the General Assembly and raise relevant questions to the board members and to the external auditor. However, the same article has explains that the Board of Directors or the external auditor shall answer the questions raised by shareholders in a manner that does not prejudice the company’s interest. A wide exception like that could be taken as excuse that could be an obstacle to disclosure and transparency.

6.3.4 Companies Law 2015 and corporate governance

As mentioned earlier, the Companies Law 2015 can be described as a new era in determining the functions and jurisdictions of the Ministry of Commerce and Industry and the Capital Market Authority. Moreover, there are several issues that Companies Law that has dealt with in the context of corporate governance for the first time. However, the main characteristics of the Companies Law 2015 in terms of corporate governance may be summarised according to three important points: First of all, the

new law has introduced an audit committee to monitor the joint stock company's business.⁷¹⁹ Moreover, a whole chapter has been dedicated to dealing with this essential issue as an important tool of corporate governance. Article 101 states that the formation of this committee must be by a resolution of the General Assembly and contain non-executive members of the board of directors, whether shareholders or others; the number of this committee's members shall not be less than three and no more than five, and the decision must include determining the tasks, functions and the rewards of the committee members. For the meeting of the committee, Article 102 states that the majority of the committee must attend the meeting for it to be valid, and the decisions to be issued must gain the majority vote. However, in the case of a draw of votes, the side where the meeting chairman votes will be taken. Article 103 clarifies the specialisation and power of the committee as monitoring the company's activities. Even more so, the committee has the power to call for a general assembly if the committee is facing obstacles from the board of directors, or if the company has suffered damage or serious crisis. Finally, the Audit Committee must review the company's financial statements, reports and observations provided by the auditor; the committee must provide a report about their opinion and the adequacy of the internal control system in the company and other work within its competence, as detailed in Article 104.⁷²⁰ Around ten years ago, Article 14 of Corporate governance regulations

⁷¹⁹ The Ministry of Commerce and Industry and the Capital Market Authority has signed a memorandum of joint cooperation in February 2016 for cooperation and coordination of policies and procedures in the application of the provisions of the new law in accordance with the rules consistent with transparency and control and corporate governance standards.

⁷²⁰ *Companies Law 2015*.

dealt in more detail with the audit committee, which was made a mandatory Article in 2009.⁷²¹

The second issue is the cumulative voting in the election of the Board of Directors. Therefore, Article 95 states that cumulative voting must be used in the election of the board of directors, so that individuals may not use the right to vote more than once per share.⁷²² It is worth mentioning in this context that the corporate governance regulations mention cumulative voting for the election of the Board of Directors in Article 6 paragraph B. Cumulative Voting is a voting method that is used to select the members of the board of directors. It should be mentioned in this context that cumulative voting is a US idea that is not used in English Law.⁷²³ CMA has explained this method as “Each shareholder can cast a vote in proportion to the number of shares he owns. So he can use this power to vote for one candidate, or divide it on a number of candidates without repetition”.⁷²⁴ The importance this method based on the increasing the opportunity of the minority shareholders to have representation to be in the board of directors.⁷²⁵

⁷²¹ *Corporate governance regulations* 2006.

⁷²² *Companies Law* 2015.

⁷²³ See: Y Wenjia, 'Cumulative Voting: In the Us (Declining), in China (Rising) and the EU (Not-Adopted).' (2015) 12 *European Company and Financial Law Review* 79.

⁷²⁴ CMA, 'The Official Website of the Capital Market Authority' (2015) <<http://www.cma.org.sa>> accessed 1/2/2016.

⁷²⁵ See: F AlKahtani, 'Current Practices of Saudi Shareholder's Rights: A Case for Reform' (2013) 27 *Arab Law Quarterly* 231.

Thirdly, the Companies Law 2015 prohibits combining the post of Chairman of the Board of directors and any other executive position in the company in Article 81 paragraph 1.⁷²⁶ On the other hand, Article 12 paragraph D of the corporate governance regulations mention the prohibition of combining the post of Chairman of the Board of directors and any executive position in the company.⁷²⁷ However, paragraph D of Article 12 is still not mandatory in the corporate governance regulations, which means that from April 2016, the prohibition of combining the post of Chairman of the Board of directors and any other executive position in the company will be in force according to Article 81 paragraph 1 of the Companies Law 2015.

Clearly there has been an impact from the 2015 reforms on the Saudi system of corporate governance. First of all, it is fair to say that Companies Law 2015 has provided a more suitable legal framework for corporate governance that contributes towards more practical, effective, fair and sound corporate governance principles. Secondly, the 2015 reform has reinforced some of the corporate governance issues that are already included in 2006 corporate governance regulations. Thirdly, the new version of Companies Law has solved the issue of a clash between Companies Law 1965 and Capital Market Law 2003 by determining the authorities of the Ministry of Commerce and Industry and the Capital Market Authority. Fourthly, it has encouraged institutional work in order to achieve sustainability and growth for companies by facilitating the requirements for establishing a joint stock company by

⁷²⁶ *Corporate governance regulations 2006.*

⁷²⁷ *Companies Law 2015.*

reducing the minimum capital to 500,000 Saudi Riyal instead of 2000.000, thereby reducing the minimum number of partners to two instead of five, and introducing the one person company. Fifthly, increasing the fair treatment for all partners, and promoting the rights of parties involved with the companies, and providing them with the necessary protection through the prohibition of combining the post of chairman of the board and any executive position of the company, and making cumulative voting in the election of the Board of Directors compulsory. Sixthly, increasing the penalties in the 2015 reform will improve transparency and disclosure; the 2015 law has increased penalties for this to 5,000,000 Saudi Riyal, and prison sentences can reach up to five years, whereas penalties used to not exceed 20,000 Saudi Riyal and no more than one year in prison for the 1965 version. Finally, Companies Law 2015 may be described as being in harmony with corporate governance regulations 2006. Consequently, this means it is fair to say that the issuance of the Companies Law 2015 has solved many issues around the inconsistencies between Companies Law and corporate governance regulations.

6.4 Conclusion

The fact that there was more than one regulatory authority for the capital market, means the situation may be described as having a dual regulatory structure in the Saudi market- the biggest among the GCC countries. The dual structure situation was one of the strongest factors that caused the stock market to underperform before the

launch of the CMA in 2003.⁷²⁸ There were three bodies that shared the responsibility of supervising stock market activities, making it an environment where it is possible for conflict to occur between jurisdictions, even though two committees have been set up at a high level to prevent any possible conflict, which are the Ministerial and the Supervisory Committee.⁷²⁹ Moreover, the capital market environment has suffered due to the absence of detailed regulations to govern the market, including the regulations on full disclosure of information, preventing conflicts of interest, and more transparency and fairness.⁷³⁰

However, a new era for the corporate governance legal and regulatory frameworks started with the introduction of the Capital Market Law 2003, which reshaped the layout of the Saudi stock exchange. Furthermore, the establishment of the Capital Market Authority was a very significant event in 2003 and has changed the roles of the institutional frameworks of corporate governance as well. Thus, the Ministry of Commerce and Industry, who had power over the stock market through the 1965 Companies Law, is no longer the key player, especially after the introduction of the Capital Market Authority and CML; except concerning the role of the incorporation

⁷²⁸ F. Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 276.

⁷²⁹ The 1983 ministerial committee included: 1-the ministry of commerce and industry 2-the ministry of finance and 3- Monetary Agency SAMA.

⁷³⁰ A Alharthi, 'Accelerating the Establishment of the Saudi Capital Market Authority Is Urgent Necessity' *Alsharq Alawsat* (London Financial section <<http://archive.aawsat.com/details.asp?issueno=8435&article=141347#.VQiktCnVv0d>> accessed 5/2/2015.

of listed companies.⁷³¹ On the other hand, SAMA was the government agency responsible for regulating and monitoring market activities until 2003. In fact, establishing the CMA and the issuance of CML by Royal Decree (M/30) in 2003 could be described as forming the backbone of the restructuring of the capital market environment and its legal frameworks. However, that does not mean there were no governmental efforts to reform the capital market before 2003. The reform started earlier during the eighties by producing new regulations to govern the capital market due to the fact that the capital market was expanding and witnessing remarkable changes since its unofficial establishment during the fifties. However, the importance of the CMA in the context of this thesis is due to the crucial role that is played by the CMA in corporate governance because of its legal powers as a government instrument that intends to protect investors; enhance the efficiency, and ensure the transparency of the market, as well as achieving justice. Therefore, it is fair to say that the establishment of the CMA has ended the old period of possible duality in order to supervise and regulate the market between the Ministry of Commerce and SAMA.

Accordingly, as the government authority, the CMA is responsible for the corporate governance of the companies listed on the capital market, and has the responsibility of issuing corporate governance regulations. Therefore, the CMA introduced corporate governance regulations in 2006. Clearly, the CMA had done good work and put in place arrangements prior to and after the issuance of the corporate governance regulations, including reviewing corporate governance international principles such as

⁷³¹ Ministry of Commerce, 'Minstrel Resolution No 4825 Dated 2008' (2008) <<http://mci.gov.sa/LawsRegulations/SystemsAndRegulations/CompaniesSystem/Pages/16-20.aspx>> accessed 1/5/2015.

the OECD principles, and looking at international and regional experiences, local companies' best practice of governance, as well as carrying out consultations with the public. The result was the 2006 corporate governance regulations. However, there are obstacles and challenges that could lead to a negative impact on the business environment. Remarkably, only a few articles from the regulations are mandatory, which raises questions about the effectiveness of the regulations.⁷³²

The Capital Market Law's issuance has ended the 'duality' caused by two supervisory institutions and two jurisdictions, as mentioned above, and has changed the face of the capital market forever. However, having said that, this does not mean there are no problems with this law. From an initial glance, the issue of legal transplantation and adaptation should be taken into account, as Article one of this law has defined relatives as the husband, wife and minor children,⁷³³ but the Saudi and GCC context from a cultural perspective may be contrary to this definition of relatives. Moreover, while this may work in other societies where families are not extended, unlike the tribal families in Saudi Arabia, which are characterised by strong bonds. Thus, limiting the restriction on relatives to the first degree only may be problematic in this context and should be extended wider than first degree relatives to cover more relatives, such as cousins and nephews. Almu'taz believes that many cases of infringement come from this definition of relatives.⁷³⁴

⁷³² *Corporate Governance Regulation 2006.*

⁷³³ *Capital Market Law 2003.*

⁷³⁴ E Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

In 2014, the jurisdiction of investigation and prosecution of Article 31, 49 and 50 moved from the Capital Market Authority to the Bureau of Investigation and Public Prosecution.⁷³⁵ This resulted in ‘Mobily’ being the first case to be referred to the Bureau of Investigation and Public Prosecution on suspicion of violating Article (49) of the Capital Market Law.⁷³⁶ Moving on to the corporate governance regulations, the capital market authority has chosen a gradual approach to implementing the provisions of the corporate governance regulations, aiming to improve the market by selecting the appropriate times for regulatory articles to be made mandatory after a procedure of analysing and studying market.⁷³⁷ The issues of legal transplantation and adaptation arise again in the corporate governance regulations when dealing with complete independence of members of the board of directors. Article two considers being “a first-degree relative” as an infringement of independence. Moreover, the same article defines first-degree relatives as the father, mother, spouse and children only. This should be taken more seriously when defining the first degree relatives, and should be extended to fourth-degree relatives, as can be found in Article 5 of the

⁷³⁵ Based on the Royal Order No 4690.

⁷³⁶ CMA announcement: based on CMA responsibility to protect citizens and investors from unfair and unsound practices involving fraud, deceit, cheating or manipulation, and as part of its efforts to achieve fairness, efficiency and transparency in securities transactions, and based on Article (17) of the Capital Market Law, the CMA would like to inform the investors and participants in the Capital Market that a Board resolution was issued and included: 1) referral of a number of suspects of violating Article (49) of the Capital Market Law to the Bureau of Investigation and Public Prosecution to investigate and prosecute as it falls under their jurisdiction, for the suspicion of conducting businesses during their term at the executive management, when such violations have occurred, that created a false or misleading impression as to the value of the company security’.

⁷³⁷ CMA, 'About Capital Market Authority' (2015) <<http://www.cma.com.sa/>> (accessed 13/1/2016).

Certified Public Accountants' Regulations.⁷³⁸ To sum up, the corporate governance regulations can be described as a huge step towards a better business environment, despite the fact that some weaknesses could have been avoided if the Capital Market Authority had considered the local business environment more, instead of what has been described as the borrowing of some articles that are more suitable for application in other countries.⁷³⁹

Finally, in terms of institutional frameworks of corporate governance, there is a need to examine the main similarities and differences between the Capital Market Authority in Saudi Arabia 'CMA' on the one hand, and the Financial Conduct Authority 'FCA' and Financial Reporting Council 'FRC' in the United Kingdom on the other hand. Obviously, CMA and FRC share the mission of regulating corporate governance, which is the main similarity between them. The FRC sets out the code for corporate governance and has the power of imposing sanctions in the case of poor quality audits, whereas the FCA is responsible for the functions of the UK Listing Authority and the prudential supervision of firms that are not regulated by the PRA. On the other hand, the Capital Market Authority is responsible for issuing corporate governance regulations in Saudi, and it has the power to impose sanctions on listed companies in cases of violating the Capital Market Law CML or the mandatory articles from the corporate governance regulations. The Capital Market Authority is linked directly to the Prime Minister 'the King'; the CMA is a government organisation that has full financial, legal and administrative independence. On the

⁷³⁸ *The executive regulation of Certified Public Accountants' Regulations* 1994. See: E Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura university.

⁷³⁹ E. Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

other hand, the FRC is an independent regulator and it is funded entirely by the firms that it regulates. Therefore, it can be seen that the CMA is clearly a government organization and linked directly to the Prime Minister, whereas the case in the UK, FCA and FRC are not, which can show the main variance in institutional frameworks.

Chapter 7. Conclusion

7.1 Introduction

The aftershocks of the worldwide economic crises of recent times have affected many parts of the world, and that undoubtedly includes the GCC countries. Nowadays, corporate governance plays a crucial role in many aspects of life as a consequence of the corporations that are now governing our lives.⁷⁴⁰ The fact that the world today is characterised by rapid changes, accompanied by the rapid growth in the world economy makes reviewing and evaluating the current legal and regulatory framework a matter of priority. Moreover, the consequences could be very severe, as the collapse of companies could lead to a serious impact on the economy, security, and society as a whole. Vice versa, ensuring an effective framework of corporate governance will lead to improving both the business environment and companies' efficiency.⁷⁴¹ Hence, it is fair to say that the need for corporate governance is globally well acknowledged nowadays and it is not anymore a debatable subject.⁷⁴²

Poor corporate governance frameworks and mechanisms, such as the lack of investor protection, poor information disclosure, as well as the shortcomings in the legal and regulatory framework and inappropriate judicial enforcement, are widely regarded as

⁷⁴⁰ B Joel, *The Corporation: The Pathological Pursuit of Profit and Power* (Constable & Robinson, 2012) Page: 9.

⁷⁴¹ A Khader, *Corporate Governance* (1 edn Dar Alfikr Aljamiey, 2012) Page 1-3.

⁷⁴² S Ahmad and R Omar, 'Basic Corporate Governance Models: A Systematic Review' (2016) 58 *International Journal of Law and Management* 73.

factors that have contributed to the crisis all over the world.⁷⁴³ From this viewpoint, Saudi Arabia as a developing country, definitely is not an exception, and the crisis would have happened even if the financial environment was prepared for it. Moreover, Saudi Arabia could be described as being in the early stages of corporate governance, as the regulations have been issued in the last decade in 2006.⁷⁴⁴ Whereas, in the UK, for example, the Committee on the Financial Aspects of Corporate Governance issued the Financial Aspects of Corporate Governance Cadbury report in 1992.⁷⁴⁵ Moreover, the situation concerning accountability in Saudi Arabia is considered to be poor, along with having weak shareholder protection and poor legal framework.⁷⁴⁶

The other motivation is the fact that there is a government intention in Saudi Arabia towards the privatisation of many public companies and institutions, which makes the issue of corporate governance and reforming its framework very important. Moreover, there is an ongoing review regarding the IPO Saudi Aramco which is the biggest oil company in Saudi Arabia and which has been described as the world's

⁷⁴³ H Ezzine, *A Cross Saudi Firm Analysis of the Impact of Corporate Governance on the Stock Price Performance During the Recent Financial Crisis* (SABIC Chair for Islamic Financial Market studies, 2012) page: 5.

⁷⁴⁴ *Corporate governance regulations 2006*.

⁷⁴⁵ *Financial Aspects of Corporate Governance 1992*.

⁷⁴⁶ H Ezzine, *A Cross Saudi Firm Analysis of the Impact of Corporate Governance on the Stock Price Performance During the Recent Financial Crisis* (SABIC Chair for Islamic Financial Market studies, 2012) page: 6.

most valuable company.⁷⁴⁷ Therefore, the examination and reformation of the current rules and regulations framework mean that this type of legal research is of paramount importance.

This research has discussed in detail the main features of Sharia in the light of the current Saudi system. Sharia provides a good basis for evaluating the current Saudi system for several reasons. It has been clarified that there is an influence from Sharia over many aspects of the Saudi legal system, and that forms a key part of the evaluation of the current Saudi system as its influence can be found in the fundamental legislative texts. There are many examples, such as “must not prejudice against the requirements of Sharia” or must be “in accordance with Sharia” in the various royal decrees and laws issued, including Company law. This research has discovered that Companies Law has been adjusted in the new 2015 version- to some extent- to be more in tune with Sharia principles. It became clear through the survey of Sharia in the context of this thesis, as the supreme law of Saudi Arabia, that there is a level of harmonisation between new concepts like corporate governance and other laws and regulations, and Sharia law. Moreover, examining the regulations and laws to check for compatibility with Sharia principles is crucial in order to avoid a possible clash with such a new concept as corporate governance. It is fair to say that Sharia in the context of this thesis is a fundamental foundation and a central pillar of the Saudi

⁷⁴⁷ The Economist, 'A Thatcherite Revolution: Saudi Arabia Is Considering an IPO of Aramco, Probably the World's Most Valuable Company' (The Economist Group 2016) <<http://www.economist.com/news/middle-east-and-africa/21685529-biggest-oil-all-saudi-arabia-considering-ipo-aramco-probably>> accessed 1/2/2016.

system and, therefore, the survey of Sharia law offers an important basis for evaluating the current Saudi system.

On the other hand, the survey of the UK system of corporate governance in the context of this thesis has provided a good basis for evaluating the Saudi system as well. The reason for that is because aspects of the UK framework of corporate governance, for example the Cadbury report and the Combined Code of Corporate Governance, are to a large extent seen as an international benchmark for good corporate governance practices. This research has shown that there is an influence from the UK legal system, including with regard to corporate governance, in various countries, including Saudi Arabia. The Westernisation of some aspects of Company Law in Saudi Arabia shows the importance of the survey of the UK system, as shown in this thesis. London is commonly described a hub for many aspects of business on a global level, accompanied by the aim of boosting the Islamic finance sector in London and making it the foremost Western centre for Islamic finance. In addition, as discussed earlier, some GCC cities such as Dubai, Abu Dhabi and Doha have allowed a new jurisdiction and legal islands for alternative dispute resolution centres that facilitate the use of English common law, hence attracting experienced judges from Commonwealth. This has created strong connections between the UK legal system and the GCC countries, including Saudi Arabia. This research has found that there is an influence from the UK system over Saudi Arabia and the rest of the GCC

countries, and some researchers think that the economic freedoms within the GCC are due to British influence.⁷⁴⁸

This thesis has provided a new critical evaluation from a different point of view on the current rules and regulatory framework of corporate governance in Saudi Arabia. After this thesis has considered the current rules and regulatory framework of corporate governance, it has become possible to answer the main research question by claiming that although, to some extent, the above examined rules and regulations provide a good system, there is a crucial need for further reforms in order to be more in tune with the local legal and social environment of Saudi Arabia. This research has shown that corporate governance regulations in Saudi Arabia are compatible to some extent with international standards. Therefore, it is fair to say that with more consideration to the local society and legal background, the current rules and regulatory framework of corporate governance are able to large extent to offer an effective matrix of frameworks that promote an attractive business environment.

One of the main contributions of this thesis is that, to my knowledge, this research is the first attempt to examine the new Companies Law 2015, which will be enforced just after the submission of the thesis, and the current rules and regulatory frameworks of corporate governance in Saudi Arabia with regard to the new law as well. Therefore, this research has provided an analysis of the Company Law 2015 in the context of corporate governance and the legal and regulatory framework. The next

⁷⁴⁸ F Facchini, 'Economic Freedom in Muslim Countries: An Explanation Using the Theory of Institutional Path Dependency' (2013) 36 *European Journal of Law and Economics* 139.

section will present a detailed summary of the findings and the contribution of this research to the current literature.

7.2 Summary

An effective legal framework of corporate governance will remain the main safeguard for good corporate governance. Ensuring an effective legal framework in the context of corporate governance will ensure the commitment of all parties involved and the interpolation of rights, and ensure the efficiency of markets.⁷⁴⁹ Moreover, as stated by the OECD, the effectiveness of the legal and regulatory framework for corporate governance “must be developed with a view to the economic reality in which it is to be implemented”.⁷⁵⁰

The importance of promoting the corporate governance system in the context of Arab countries can be seen clearly through encouraging domestic investment in the capital market by reducing the risk. However, as Abdulsabour has observed, this cannot be done without recognising the importance of corporate governance through a clear understanding of the board of directors’ duties, the separation between the job of the CEO and the job of the Chairman of the Board of Directors, and developing strategic plans for decision making and evaluation.⁷⁵¹ The significance of corporate governance can be seen through the successful outcomes that have been achieved in the

⁷⁴⁹ A Khader, *Corporate Governance* (1 edn Dar Alfikr Aljamiy, 2012) Page: 9.

⁷⁵⁰ *OECD principles of corporate governance* 2015.

⁷⁵¹ A Masri, *The Legal Regulation of Corporate Governance: Comparative Study* (Alqanun wa Aleqtisad, 2012)Page:12.

commercial sector, taking into account that corporate governance is a new concept nowadays.⁷⁵²

International organisations and supranational authorities such as the World Bank and the Organisation for Economic Co-operation and Development play a crucial role in providing contributions and improvements such as benchmarks, recommendations, stability, support of economic growth, and fighting poverty that benefit developed and developing countries. For example, one of the OECD's missions is to improve living standards and economic success by promoting policies.⁷⁵³

On the other hand, corporate governance theories can be described as being in a state of never-ending evolution, as can be seen throughout the history of corporate governance.⁷⁵⁴ And so, in order to have effective corporate governance, a combination of various theories is suggested, rather than a single corporate governance theory approach.⁷⁵⁵

Generally speaking, the history, culture, politics and traditions of a country are the reasons for the variety of corporate governance approaches, just like legal systems vary from one country to another. To some extent, path dependency theory could aid

⁷⁵² A Khader, *Corporate Governance* (1 edn Dar Alfikr Aljamiy, 2012) Page: 8.

⁷⁵³ OECD official website. 'About the Organisation for Economic Co-operation and Development (OECD)' <http://www.oecd.org/pages/0,3417,en_36734052_36734103_1_1_1_1_1,00.html> accessed 5/6/2012.

⁷⁵⁴ A Haslinda and B Valentine, 'Fundamental and Ethics Theories of Corporate Governance' (2009) 7 Middle Eastern Finance and Economics 88.

⁷⁵⁵ Ibid.

an explanation in this context.⁷⁵⁶ Although religion may be the principal influence in the GCC countries, and especially Saudi Arabia, there are other important factors that could explain the Westernisation of some aspects of the Companies Law. Facchini has described this as a double institutional dependence path, and he believes that the economic freedom of the GCC has more of a British influence.⁷⁵⁷ Even so, it is widely accepted that there is the need for an effective and consistent corporate governance system across borders. The demand for this is motivated by two important factors: Firstly, the fact that investment and business are of a growing international nature nowadays; secondly, the corporate scandals' regulatory responses. Therefore, comparability and harmonisation of standards could be an important solution to reducing the possibility of confusion and complications. However, a unified corporate governance system might not be suitable for all countries across the world and will not work as a magic solution that can be applied to all countries across the world, taking into account legal and cultural differences. Yet this fact is not an obstacle to the “opportunities for commonly accepted practices to encourage more efficient global capital markets”.⁷⁵⁸

Accordingly, the importance of taking the UK as an example is very clear in this context, with its evolving judiciary and over ten centuries of legal revolution, that has

⁷⁵⁶ O Hathaway, 'Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System' (2001) 86 Iowa Law Review 601.

⁷⁵⁷ F Facchini, 'Economic Freedom in Muslim Countries: An Explanation Using the Theory of Institutional Path Dependency' (2013) 36 European Journal of Law and Economics 139.

⁷⁵⁸ K Wearing, *Effective Corporate Governance Framework: encouraging Enterprise and Market Confidence* (Beyond the Myth of Anglo-American Corporate Governance, Institute of Chartered Accountants in England & Wales, 2006).

resulted in what is widely described as “one of the best and most independent in the world”.⁷⁵⁹ Moreover, the reason for the UK market attracting capital could be attributed to the "confidence in a sound governance framework and associated practices, combined with flexibility and the ability to innovate".⁷⁶⁰ On the other hand, the outstanding UK approach has been described as highly developed and stringent, and it has attracted the attention of researchers in many parts of the world, such as Cheffins. Not only in comparison with the UK's European neighbours' markets, but also compared to many parts of the world, the UK approach could be described as highly developed and stringent, and “The work which has been done in the United Kingdom has spurred reviews of corporate governance in markets around the world and has provided a yardstick against which investment frameworks in other countries are measured”.⁷⁶¹

Some researchers think that the UK approach to corporate governance is narrow and focuses more on the company's internal structure with the main goal of assisting the shareholders and their profit maximisation: “One limitation of corporate governance in the UK is the arguably narrow perspective that has been adopted”.⁷⁶²

⁷⁵⁹ Courts and Tribunal Judiciary, 'History of the Judiciary' (Courts and Tribunal Judiciary 2015) <<https://www.judiciary.gov.uk/about-the-judiciary/history-of-the-judiciary/>> accessed 3/9/2015.

⁷⁶⁰ Financial Reporting Council, 'Developments in Corporate Governance and Stewardship 2014' (The Financial Reporting Council Limited, London 2015).

⁷⁶¹ B R. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan Via Toronto' (1999) 10 *Duke Journal of Comparative and International Law* 5.

⁷⁶² J Birds and others (eds), *Boyle & Birds' Company Law* (9th edn Jordans, Bristol 2014) Page: 371.

This thesis has shown how the framework of corporate governance in the UK is shaped by different levels of regulations, such as common law and statutory rules, alongside internal measures and structures. It is fair to say that the rich developmental process of the corporate governance code in the UK has added to its effectiveness and value, starting with the well-known Cadbury Committee to passing revisions to the code, and the importance of this is clear in the context of this thesis. Obviously, the non-stop efforts made with regard to corporate governance, with series of committees, reports and reviews, are very important examples, which could reflect the impact on many aspects of life, including the business environment.

The increasing trend towards business systems governed by Sharia principles, such as Islamic banking, nowadays may be explained by the business ethics and morals that are paid great attention to in Sharia and identified by its principles such as responsibility, accountability and transparency.⁷⁶³ One of the significant findings of this study is that corporate governance as a concept is not essentially strange to Sharia, despite the fact that the main sources of Sharia are more than 1400 years old. It has been found that the principles of corporate governance are included separately in the sources of Sharia, and the call for principles of corporate governance is not alien to Sharia.⁷⁶⁴ This is shown when discussing some important aspects of Sharia in relation to corporate governance.⁷⁶⁵ It has been made clear that there is room to

⁷⁶³ L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' [2010] *Journal of Business Law* 126.

⁷⁶⁴ A M Abu-Tapanjeh, 'Corporate governance from the Islamic perspective: A comparative analysis with OECD principles' (2009) 20 *Critical Perspectives on Accounting* 556.

⁷⁶⁵ 'Islamic finance in the spotlight' (2009) *Banker, Middle East*. Available at <http://search.proquest.com.ezproxy.lancs.ac.uk/docview/232390090?accountid=11979>.

produce or even adapt new rules and regulations although certain rules and principles of Sharia that already exist, as long as they do not breach the Sharia. Moreover, providing for this does not violate Sharia- Sharia supports procedures that protect the rights of all parties, which is one of the most important aims of corporate governance.

In fact, there are many theories of business that are based on religious and ethical principles, such as Quaker theory. However, the nature of corporate governance from an Islamic point of view is wider and shaped by two aspects. One of them is that all of life's aspects are covered by the sovereignty of Sharia, and the Islamic principles of finance and economic issues.⁷⁶⁶ Moreover, it has been found that Sharia has a more comprehensive view due to the ethical values involved. Although the Sharia view of corporate governance is more comprehensive, the closest modern model of corporate governance to Sharia is the stakeholder model.⁷⁶⁷

The Saudi Companies Laws of 1965 and 2015 include several types of companies which differ in name from the Sharikah types mentioned in classical Sharia. However, regarding the argument that Saudi Arabia's Company Law does not contain the Islamic law names of sharikah, may be responded to with two answers: First of all, all of these companies that are included in Companies law do not breach Islamic law's sharikah types, and all of them can be adapted; also, the origin of each can be found in one of the Islamic law's sharikah types.⁷⁶⁸ Moreover, decision number 130 (4/14) of

⁷⁶⁶ M Lewis, 'Islamic Corporate Governance' (2005) 9 Review of Islamic Economics 5.

⁷⁶⁷ RA Kasri, 'Corporate Governance: Conventional vs. Islamic Perspective' (2009) SSRN 11.

⁷⁶⁸ *Saudi Company Law 1965* states in article two "Without prejudice to such companies known in Islamic jurisprudence." And *Saudi Company Law 2015* states "The rules do not apply to the types of

the International Islamic Fiqh Academy has agreed to recognize the types of companies such as that mentioned in companies law.⁷⁶⁹

As for Sharia, another finding from this study is that Sharia may impose constraints upon corporate governance in ways not found in the Western point of view. This is due to the fact that 'riba', 'gharar' and 'maysir' are prohibited transactions in Sharia. However, it is true to some extent that there are several prohibited transactions in Sharia that can be found in some transactions in Saudi Arabia at the same time, 'riba' for instance. That is a significant issue which will lead to a clash with Article 7 and 8 of the basic law of governance that is described as the Saudi Arabian 'constitution'.⁷⁷⁰

The results of this research indicate the importance of Sharia groups or Sharia supervisory boards remaining independent. This study has also shown that the 'Sharia groups' which can be found in some companies and banks within the GCC countries (including Saudi Arabia) do not clash with the standards of corporate governance if the management of the organisation remains independent.⁷⁷¹

sharikah that known at Islamic jurisprudence, unless it take the form of the companies listed in paragraph (1) of this Article” .

⁷⁶⁹ International Islamic Fiqh Academy: decision number 130 (4/14). Available at: <http://www.fiqhacademy.org.sa/qarat/14-4.htm>.

⁷⁷⁰ Article 7 of *The Basic Law Of Governance 1992* stated that “Government in the Kingdom of Saudi Arabia derives its authority from the Book of God and the Sunna of the Prophet (PBUH), which are the ultimate sources of reference for this Law and the other laws of the State” and Article 8 stated that “Governance in the Kingdom of Saudi Arabia is based on justice, shura (consultation) and equality according to Islamic Sharia”.

⁷⁷¹ M Casper, *Sharia Boards and Sharia Compliance in the Context of European Corporate Governance* (Rochester 2012).

There is a link between company profits and managerial reward, which may be apparent in the conduct of some managers in terms of financial priorities and interpersonal priorities.⁷⁷² The fact is that, practically, there is no guarantee that everyone will display ethical behaviour in any cultural context, including the Islamic business environment, indicates the significance of the relationship between the Board of Directors and the shareholders from a Sharia perspective. Thus, the issues of rewards for boards of directors from a Sharia perspective depends on the type of rewards, which are divided into four cases, and a reward of a percentage of earnings should not be mixed with other reward types in Sharia.⁷⁷³ However, the Saudi Arabian Company Law 1965 and the corporate governance regulations allow the mixing of these cases, which places this issue under criticism.⁷⁷⁴

This thesis has found that treating the contract between the director and shareholders as a ‘wakalah’ contract is important in order to distinguish the acceptable cases of reward and delegation from a Sharia perspective.

The fact is that modern companies have more complicated issues compared with sharikah back in the 14th century in classical Sharia. One implication of this thesis is the possibility that Sharia jurisprudence is able to absorb these types of companies.

The thesis has also shown that there are huge efforts being made by the government to attract foreign investors, which can be seen through SAGIA ‘Saudi Arabian General

⁷⁷² SA Baron, SJ Hoffman and JG Merrill, *When work equals life : the next stage of workplace violence* (Pathfinder Pub. of California, Oxnard, CA 2000) Page: 62.

⁷⁷³ See section 5.6.1.1 for more details.

⁷⁷⁴ *Companies Law* 1965.

Investment Authority'. According to SAGIA, Saudi Arabia is the largest economy in the MENA region. In terms of "fiscal freedom", Saudi Arabia is ranked 5th and the 3rd in terms of the most rewarding tax system in the world. However, the situation of the business environment could impact upon these attempts.⁷⁷⁵ One of the last attempts from the government to attract foreign investors was that the capital market has been opened to qualified foreign investors in 2015. This study has described critically the structure of the main Saudi institutions, including those that have legislative powers. Clearly, reviewing the main characteristics of the Saudi legal system and the main authorities of the state reveals that there are overlaps between them. This could cause an environment of uncertainty and legal confusion that will have a direct impact on corporate governance regulations, and then the business environment of Saudi Arabia.

This research has identified the significance of the involvement of the Ulama in legislative circles discussions, as this participation will solve the problem of the rejection of new legal solutions, as the reason for some obstacles to legislative bills and regulations are due to 'traditional forces', which includes the Ulama, can "to some extent be attributed to ex ante stances taken before such laws and proposals were examined".⁷⁷⁶ Undoubtedly, the 'Ulama' Sharia scholars play a crucial role in terms of being the interpreters of the Sharia sources that Saudi Arabia has as supreme

⁷⁷⁵ 'Saudi Arabian General Investment Authority Official Website' (2014) <<http://www.sagia.gov.sa>> accessed 1\9\2014.

⁷⁷⁶ F. Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Sabir Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) Page: 236.

law, and legitimising the government's actions. Moreover, to a large extent, the Ulama have played an important role in the successful improvement of the Saudi legal system.

Reforming the legal framework of corporate governance is very important for the economy to prosper, and it is a key issue which has a direct impact on the business environment. It is true that the path of reforming the legal system has witnessed remarkable and huge steps, through the 2007 Royal decrees, towards developing and improving the judicial system. However, eight years have passed since 2007, and the question that still needs to be asked is: with the slow reforming progress, will the observer see the results soon? Yet there are some problems associated with certain factors that together have created what can be called 'legal confusion' for foreign investors and for Saudis as well. This study has shown that a dualistic legal system, for example, is one of the factors that can cause chaos. Therefore, it may be true to describe the 'legislative powers' as 'scattered' between the King, the Consultative Council, the Council of Ministers and the Supreme Judicial Council.

This study has shown that the establishment of the Capital Market Authority in 2003 ended the dual regulatory structure in the Saudi capital market. It is clear that the reason was the fact that there were three bodies that share the responsibility of supervising stock market activities for the capital market. It is a huge step towards reforming the legal and regulatory framework, which is one of the solutions to the stock market underperforming before the launch of the CMA in 2003.⁷⁷⁷It can be seen

⁷⁷⁷ F. Almajid, *Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (Chair For Islamic Financial Studies at Imam Muhammed Bin Saud Islamic University, 2012) P: 276.

that the business environment has improved due to this reform and it has solved, to large extent, the possibility of conflict occurring between jurisdictions.⁷⁷⁸

On the other hand, it can be seen from this research that a new era for corporate governance legal and regulatory frameworks started with the introduction of Capital Market Law 2003, which reshaped the layout of the Saudi stock exchange, ending the suffering caused to the capital market environment from the absence of detailed regulations to govern the market, including regulations on full disclosure of information, preventing conflicts of interest, and more transparency and fairness.⁷⁷⁹

Furthermore, the establishment of the Capital Market Authority was a very significant event in 2003 and has changed the roles of the institutional frameworks of corporate governance as well.⁷⁸⁰

⁷⁷⁸ Prior to the establishment of CMA and the issuance of CML there were two committees have been set up in 1983 at a high level to prevent any possible conflict, which are the Ministerial and the Supervisory Committee included: 1-the ministry of commerce and industry 2-the ministry of finance and 3- Monetary Agency SAMA who was the government agency responsible for regulating and monitoring market activities until 2003.

⁷⁷⁹ A Alharthi, 'Accelerating the Establishment of the Saudi Capital Market Authority Is Urgent Necessity' *Alsharq Alawsat* (London Financial section <<http://archive.aawsat.com/details.asp?issueno=8435&article=141347#.VQiktCnVv0d>> accessed 5/2/2015.

⁷⁸⁰ The Ministry of Commerce and Industry, who had power over the stock market through the 1965 company law, is no longer the key player, especially after the introduction of the Capital Market Authority and CML; except concerning the role of the incorporation of listed companies. See: Ministry of Commerce, 'Minstrel Resolution No 4825 Dated 2008' (2008) <<http://mci.gov.sa/LawsRegulations/SystemsAndRegulations/CompaniesSystem/Pages/16-20.aspx>> accessed 1/5/2015.

Due to the fact that the capital market was expanding and witnessing remarkable changes since its unofficial establishment during the fifties, the governmental efforts to reform the capital market started earlier during the eighties by producing new regulations to govern the capital market. However, establishing the CMA and the issuance of CML by Royal Decree (M/30) in 2003 can be described as forming the backbone of the restructuring of the capital market environment and its legal frameworks. It is fair to say that the establishment of the CMA has ended the old period of possible duality in order to supervise and regulate the market between the Ministry of Commerce and SAMA. Therefore, the importance of analysing the CMA in the context of this thesis is due to the crucial role that is played by the CMA in corporate governance because of its legal powers as a government instrument that intends to protect investors; enhance efficiency, and ensure the transparency of the market, as well as achieving justice.

Accordingly, as the government authority, the CMA is responsible for the corporate governance of the companies listed on the capital market, and the CML 2003 has been given the responsibility of issuing corporate governance regulations to the CMA. This research has shown the efforts that have been made in order to put in place arrangements prior to and after the issuance of the corporate governance regulations, including reviewing and studying corporate governance international principles such as the OECD principles, and looking at international and regional experiences, and local companies' best practice of governance, as well as carrying out consultations with the public. The result was the 2006 corporate governance regulations, which have changed the face of the capital market forever. However, there are obstacles and challenges that could lead to a negative impact on the business environment. Remarkably, only a few articles from the regulations are mandatory, which raises

questions about the effectiveness of the regulations.⁷⁸¹ Moreover, having said that, the issuance of CML 2003 has ended the ‘duality’ caused by two supervisory institutions and two jurisdictions, and, as mentioned above, this does not mean there are no problems or obstacles. From an initial glance, the issue of legal transplantation and adaption should be taken into account, as Article 1 of this law has defined relatives as the husband, wife and minor children,⁷⁸² yet in the Saudi and GCC context from a cultural perspective may be contrary to this definition of relatives. Although this may work in other societies where families are not extended, the situation of tribal families in Saudi Arabia, which are characterised by strong bonds, could lead to some infringements due to this definition of relatives.⁷⁸³ Thus, limiting the restriction on relatives to the first degree only may be problematic in this context and should be extended wider than first degree relatives to cover more relatives, such as cousins and nephews.

It can be seen very clearly that reforming the rules and regulations framework has been accelerated through some cases, which highlights the intention of improvement, such as moving the jurisdiction of investigation and prosecution of Article 31, 49 and 50 from the Capital Market Authority to the Bureau of Investigation and Public Prosecution.⁷⁸⁴ This resulted in ‘Mobily’ being the first case to be referred to the

⁷⁸¹ *Corporate Governance Regulation 2006.*

⁷⁸² *Capital Market Law 2003 .*

⁷⁸³ E Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University .

⁷⁸⁴ Based on the Royal Order No 4690.

Bureau of Investigation and Public Prosecution on suspicion of violating Article (49) of the Capital Market Law.⁷⁸⁵

Moreover, the gradual approach being taken by the Capital Market Authority in implementing the provisions of the corporate governance regulations has aimed to improve the market by selecting the appropriate times for regulatory articles to be made mandatory after a procedure of analysing and studying the market.⁷⁸⁶ One of the significant findings of this study concerns the issue of legal transplantation and adaptation, which arise again in the corporate governance regulations such as in the CML 2003. This arises when dealing with complete independence of the members of the board of directors, as Article 2 considers being “a first-degree relative” as an infringement of independence. Moreover, the same article defines first-degree relatives as the father, mother, spouse and children only. Again, this should be taken more seriously when defining first degree relatives, and should be extended to fourth-

⁷⁸⁵ CMA announcement: based on CMA responsibility to protect citizens and investors from unfair and unsound practices involving fraud, deceit, cheating or manipulation, and as part of its efforts to achieve fairness, efficiency and transparency in securities transactions, and based on Article (17) of the Capital Market Law, the CMA would like to inform the investors and participants in the Capital Market that a Board resolution was issued and included: 1) referral of a number of suspects of violating Article (49) of the Capital Market Law to the Bureau of Investigation and Public Prosecution to investigate and prosecute as it falls under their jurisdiction, for the suspicion of conducting businesses during their term at the executive management, when such violations have occurred, that created a false or misleading impression as to the value of the company security’.

⁷⁸⁶ CMA, 'About Capital Market Authority' (accessed 13/1/2015).

degree relatives, as can be found in Article 5 of the Certified Public Accountants' Regulations.⁷⁸⁷

To sum up, the corporate governance regulations can be described as a huge step towards a better business environment, despite the fact that some weaknesses could have been avoided if the Capital Market Authority had considered the local business environment more, instead of what has been described as the borrowing of some articles that are more suitable for application in other countries.⁷⁸⁸

It can be clearly seen that the Saudi Companies Law has a shorter history than the UK Companies Act, even with the newly introduced Saudi Arabian Companies Law 2015.⁷⁸⁹ The differences between the two laws goes back to their roots, as the Saudi Companies Law 1965 has been described as being adopted from French law through Egypt.⁷⁹⁰ Even though the new Saudi Companies Law 2015 has many significant differences compared to the 1965 Companies Law, the 1965 Law could be described as the basis of the 2015 Companies Law. Generally speaking, the changes have solved many issues, including some of the conflict with Sharia principles, as well as modifying the types of companies. The new law states that the top amount to be paid as remuneration must be no more than 500000 SAR (about £90000). Moreover,

⁷⁸⁷ *The executive regulation of Certified Public Accountants' Regulations* 1994. See: E Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura university.

⁷⁸⁸ E. Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

⁷⁸⁹ *Companies Law* 2015. For the Saudi Arabian legal system, see chapter 4 and 5.

⁷⁹⁰ T Korayyem, 'The Islamic Nature of the Saudi Regulations for Companies' (2000) 15(1) Arab Law Quarterly 63.

Companies Law 2015 has increased the severity of sanctions. This research has found that the Companies Law 2015 has solved the issue of a clash between Companies Law 1965 and Capital Market Law 2003 by determining the authorities of the Ministry of Commerce and Industry and the Capital Market Authority. So, it is fair to say that the Companies Law 2015 may be described as being in harmony with corporate governance regulations 2006 and has solved many issues around inconsistencies between the Companies Law and corporate governance regulations.

Generally speaking, it can be seen very clearly from this thesis that there are several differences between Saudi Arabia and the UK from a variety of aspects. For example, in terms of legislative framework, despite the fact that the number of judges has risen dramatically during the last two decades in Saudi Arabia, the Saudi Arabian justice system is way behind the United Kingdom in regard with judges' numbers.⁷⁹¹ Unlike the UK, corporate governance could be described as a new concept in Saudi Arabia. Moreover, the Saudi Arabian authorities did not recognise corporate governance until 2006 when the first regulations were introduced by the Capital Market Authority.⁷⁹² On the other hand, the situation is very different in the UK, which recognised the importance of corporate governance two decades earlier in 1992, since the Cadbury

⁷⁹¹ Ministry of Civil Service, 'Monthly Statistical Statement' (Ministry of Civil Service, Riyadh 2015). See also: A Alhudaithi, 'Legislative Developments in Saudi Arabia During the Twenty Years' *Asharq Al Awsat* (London) <<http://archive.aawsat.com/leader.asp?article=65433&issueno=8381#.VIJYNmThAsl>> 2001.

⁷⁹² See: *Capital market law 2006* and *Corporate governance regulations 2006*. For more details see: chapter 4 section 4.2.3.

Committee.⁷⁹³ In terms of the code, Saudi Arabian corporate governance regulations have adopted the UK's 'comply or explain' method. However, the Saudi corporate governance regulations provide guiding principles and these are not mandatory except for certain articles, due to the gradual enforcement approach chosen by the CMA. This gradual approach involves selecting the appropriate times for regulatory articles to be made mandatory.⁷⁹⁴ From the previous sections, it can be seen very clearly that the United Kingdom has its own distinctive corporate governance code, which has been developed over the years through the work of the committees that started from with the Cadbury Committee's recommendations. On the other hand, the Saudi Arabian corporate governance regulations have been adopted and modified- to some extent- from other jurisdictions, which possibly will result in some weaknesses during their application. Undoubtedly, the Capital Market Authority should have considered the local business environment more, because some issues that are suitable for application in other countries are not necessarily suitable for others.⁷⁹⁵

The fact that Saudi Arabia is a developing country raises a number of questions around whether the legal, regulatory, judicial, institutional and governance standards need to be reformed. Corporate governance, which is to some extent considered as a new topic -especially in Saudi Arabia-, is evolving and improving and requires more

⁷⁹³ P Yeoh, 'Corporate Governance in the UK: A Time for Reflection' (2015) 36 Business Law Review 130.

⁷⁹⁴ CMA, 'The Official Website of the Capital Market Authority' (2015) <<http://www.cma.org.sa>> accessed 1/2/2015.

⁷⁹⁵ E Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' (Umm Al-Qura University <<http://uqu.edu.sa/page/ar/18978>> accessed 8/11/2015.

efforts. Although some factors such as politics, culture, institutional structure and path dependency could be obstacles to the transplanting of new concepts such as corporate governance, the process of improving corporate governance is still marching forward, with help and support provided by governmental initiatives, supranational organisations such as the OECD and World Bank; local institutions such as Hawkamah, as well as local initiatives.⁷⁹⁶

This research is an attempt to provide a reference source and to bridge the gap in the academic discourse as well as for legislators, lawyers, consultants and local and foreign legal professionals. This research also provides a reference source to the local and foreign companies that have the intention to invest in Saudi Arabia.

7.3 Recommendations

This thesis has shown the flexibility of Sharia to adapt to modern concepts, which has a direct impact on such a conservative legal system like in Saudi Arabia. Definitely, that will impact upon the business environments in other countries like Saudi Arabia and will make it more attractive for both domestic capital and foreign and international investors. However, the lack of codification of Sharia could be considered as an obstacle to improving the frameworks of corporate governance. There is a fear of using the codification as a tool to shift to change from Sharia to adopting a completely new civil law instead of Sharia, which has happened in Turkey, Egypt and other Islamic countries over recent decades. However, the UK example has shown that common law and case law are not obstacles. Accordingly, this thesis

⁷⁹⁶ A Ahmed, 'An Examination of the Principles of Corporate Governance from an Islamic Perspective: Evidence from Pakistan' (2011) 25 Arab Law Quarterly 27.

suggests that engaging scholars of Sharia more in the discussion of new legal drafts will be more useful to avoid the possible conflict between Sharia as a supreme law and the new laws. That will add more strength to the new laws and will introduce more ideas that could improve the legal and regulatory framework of corporate governance.

It can be seen very clearly from the previous chapters that corporate governance regulations in Saudi Arabia are compatible to some extent with international standards, such as OECD and the UK regulations. Moreover, Saudi corporate governance regulations have adopted the UK's well-known comply or explain approach in some articles, as appears in the regulation's text.⁷⁹⁷ However, some weaknesses could have been avoided if the Capital Market Authority had considered the local business environment more, instead of what is sometimes described as a borrowing of some Articles that are suitable for application in other countries.⁷⁹⁸ Therefore, activating a research institution, the use of think tanks and more academic research in Saudi universities could make the adapted rules and regulations, such as the corporate governance, more harmonious with the local business environment.

Although the steps towards reforming the legal and regulatory frameworks of Saudi Arabia are marching towards the correct path, there is a need for more effort from all parties involved, including governmental institutions and judicial bodies, to speed up

⁷⁹⁷ Paragraph c of Article 1 of the *Corporate governance regulations* 2006 has stated that: "As an exception of paragraph (b) of this article, 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".

⁷⁹⁸ E. Almutaz, 'Corporate Governance in the Kingdom of Saudi Arabia' Umm Al-Qura University.

the reforms. The cloud of uncertainty, confusion and slowness in clearing this up, could be described as complicity in the legal system. This could be addressed through support provided by local experts who are doing a good job of drafting new laws and regulations, such as the recent Companies Law. On the other hand, the successful examples around the world such as the UK could also provide guidance in terms of improving current practices. Finally, supranational organisations, such as the OECD and the World Bank, could provide more support as they have a long history of experience dealing with a variety of developed and developing countries.

On the other hand, the UK experience of reviewing corporate governance through a series of committees such as Cadbury is a phenomenal approach that Saudi Arabia could learn many lessons from. Consequently, setting up committees in Saudi Arabia specialising in the issue of corporate governance and the whole legal and regulatory framework would provide similar worthy recommendations.

7.4 Areas of further research

The new Companies Law that was issued at the end of 2015 could be described as step forward towards the reforming of the legal and regulatory frameworks of corporate governance. Therefore, I believe that the new law will need more research to explore the new features and to check its compatibility with other laws and regulations, such as the corporate governance regulations.

Saudi Arabia has a huge influence on other Muslim countries, and could be employed to provide an example of an effective legal and regulatory framework that is compatible with the principles of Sharia on the one hand, and suitable for application in the modern world. On the other hand, Sharia groups in Saudi Banks could form the

base of a committee that provides new compatible products and adapts borrowed concepts.

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