The Enhancement of Accountability and Transparency in Corporate Governance Framework in Saudi Arabia

A Thesis Submitted to the University of Sussex for the Degree of Doctor of Philosophy in Law

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Declaration

No part of this thesis has been submitted in support of an application for another degree or qualification or any other university or other institute of knowledge.

Signed

Ibrahim Ayed Almajri

Acknowledgments

Firstly, I would like to thank Allah for His blessings in making my educational journey to progress well. I also thank my father who supported and encouraged me to continue my higher education. He was always proud of my educational progress until he passed away a few years ago. I would also like to thank my mother for her continuing support and guidance over the years until the present time. I thank my wife Norah for supporting me emotionally, and kindly giving me endless care despite her involvement in her current PhD study. I particularly thank my brothers and sisters for their support and encouragement which empowered me to travel abroad to seek developed education and wisdom. I also thank my little boy Bassam who has given me great joy.

From the beginning of my studying for my master's degree in the United States, I developed greater interest in the subject of corporate law. However, after reading, and being involved in numerous discussions in this legal field, several questions came to my mind regarding issues specifically associated with corporate governance provisions. Therefore, in order to find solutions to the shortcomings associated with this legal field, I decided to choose the topic of Saudi corporate governance accountability as a title for my current thesis. I was very fortunate to have the supervision and guidance of Dr Femi Amao and Dr Qingxiu Bu whom without their guidance I would not have been able to complete this thesis. I particularly appreciate their kindness and their willingness to make tremendous efforts to discuss and comment on my drafts. No words can express my appreciation for their unlimited support throughout my PhD study. I also thank my government who have provided me with the scholarship.

Abstract

This thesis evaluates the Saudi Arabia's corporate governance accountability in listed companies by examining core issues such as shareholders' accountability, transparency and the directors' accountabilities and duties. In addition, the study assesses the legal bodies responsible for enacting Saudi corporate governance regulations and supervising their implementation. Furthermore, the thesis attempts to determine whether the responsibilities and duties of the board members are clearly defined and whether board is sufficiently obligated to disclose relevant information. This thesis applies a comparative methodology using library-based information such as regulations, codes, cases, books, journals and articles in order to accomplish its aims. Measures were taken to compare the new developing corporate governance approach of Saudi Arabia to the models of the United Kingdom and the United States.

Some barriers exist that have slowed the improvement of Saudi corporate governance practice. Saudi government-owned firms are influenced by political choices. The dominance of government ownership may not enhance corporations' accountabilities. Family firms also have a significant influence on the Saudi corporate governance. In addition, Saudi Arabian shareholders in the equity market tend to be passive, and rarely coordinate with each other. Moreover, the Saudi approach is still experiencing some ambiguity and omission of needed corporate governance framework to identify board duties. The framework standard of transparency and the level of disclosure are very low and inadequate.

A key aim of this research is to assist regulators in their efforts to promote corporate regulatory framework and identify additional alternative optimal measures to enhance the accountability of Saudi corporate governance. Besides, the literature on corporate governance in Saudi Arabia is minimal and inadequately researched. Thus, this research project aims to bridge the gap in the field of the corporate governanceregulations with the intention of extending the current literature and to find solutions to the above issues with the objective to increase the enhancement of fairness, accountability and transparency in Saudi corporations.

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Chapter One

Introduction and Literature Review

1.1 Introduction

In the past few decades, various countries around the world have experienced corporate scandals, incompetence, malpractice and fraud due to the absence of sufficient regulations, which have resulted in major financial collapses and heavy financial losses. However, in response to that failure and in pursuit of change, tighter measures and comprehensive reforms have been introduced across the globe. In strategic terms, it is essential for all countries to progress in their markets in order to guarantee transparency, accountability, and fairness.

However, while considerable improvement has been observed in developed countries, in recent years the situation in the Kingdom of Saudi Arabia has been different because some barriers exist that have slowed the improvement of corporate governance practice in this country. In addition to these obstacles, Saudi Arabia affected by a weak legal infrastructure as well as ineffective oversight, coupled with an absence of an adequate and enforceable corporate governance framework.[1] Indeed, the accountability of CG in KSA is at an embryonic stage and is failing to demonstrate sufficient accountability.[2] Furthermore, many provisions in the Saudi Corporate Governance Regulations are still ambiguous and need more clarity.

The majority of the Saudi listed companies belong to the founding families;[3] therefore, the owners of these firms usually appoint some family members to the board of directors, or they appoint friends who may not be qualified to serve on the board. This problematic issue is compounded by the scarcity of a board being independent, and the lack of separation of the roles of the chairman of the board, as well as the company's CEO.[4] In addition, the Corporate Governance Regulation is silent about independent nomination and compensation committees. Moreover, the director's responsibilities are not well designated.

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[1] A Abdallah and A Ismail, 'Corporate Governance Practices, Ownership Structure, and Corporate Performance in the GCC Countries' (2017) 46 Journal of International Financial Markets Institutions andMoney 98, 107-111

[2] A Al-Nodel and K Hussainey, 'Corporate Governance and Financing Decisions by Saudi Companies'(2010) 6 Journal of Modern Accounting and Auditing, 11, 13

[3] K Al Saeed, 'the Association between Firm-Specific Characteristics and Disclosure: The Case of Saudi Arabia' (2006) 21 (5) Managerial Auditing Journal, 476, 477

[4] ibid 477

The standard of transparency and the level of disclosure are very low and inadequate. An illustration of this weakness is the fact that there is no requirement for the board of directors to disclose related self-transaction. Thus, a feasible recommendation should be suggested to resolve this issue. An additional concern is that commercial courts and the Committee for the Resolution of Securities Disputes that deal with corporate governance litigation are poorly run, and these bodies take a longer time to reach resolutions in comparison to the international standard. In addition, political interference and the dominance of government ownership may not enhance corporations; in fact, both frequently have a negative influence on a firm's operations.[5] Reinforcing the above factors would strengthen corporate governance practice within Saudi Arabia, and it could ensure the enhancement of fairness, accountability and transparency in Saudi corporations.

1.2 The Research Objective and Questions of this Thesis

The KSA is deemed to have an enormous influence throughout the Middle East, and indeed globally, as it one of the greatest oil producers in the world, and thus has a tremendous impact on oil prices and products across the world.[6] Moreover, in the Arab world, Saudi Arabia has the largest market,[7] and its capital market will be further developed through the promotion of effective governance.[8] However, despite thishuge market and the improvements in the corporate governance framework that have been achieved, to some extent many challenges remain. These shortcomings not only reveal mismanagement, but they also point to the necessity of considering comprehensive reform and implement an instrument to correct the current corporate governance practice; however, more research is needed to assist regulators in their efforts to promote a regulatory framework and identify additional alternative solutionsto enhance a accountable corporation climate in Saudi Arabia.

[5] Y Alazzani, 'Does government ownership affect corporate governance and corporate disclosure?' (2016) 31 Managerial Auditing Journal 871, 872
[6] T Niblock, *Saudi Arabia: Power, Legitimacy and Survival* (Routledge 2006) 57
[7] M Alotaibi, 'The Economic Impact of Corporate Governance in Saudi Arabia Economy' (2016) 7 Journal of Economics and Finance 39, 47
[8] Al-Nodel and Hussainey (n2) 11, 13

Scholars in a variety of fields have studied corporate governance from many different angles and have published many papers. However, unlike many developed markets, the literature on corporate governance in Saudi Arabia is minimal and inadequately researched. All the issues mentioned above have increased the motivation to conduct a research project to bridge the gap in this area with the intention of extending the current literature. Indeed, the gaps identified in the literature have inspired the researcher to address corporate governance from the perspective of accountability to establish the factors that may influence the way in which Saudi companies ensure they are accountable

The overall objective of this thesis is to assess the scope of Saudi Arabia's corporate governance practice in listed companies on the Saudi Stock Exchange in order to examine the accountability of that practice by investigating core issues such as shareholders' accountability, disclosure, transparency and the directors' obligations and duties. The study will assess the adequacy of corporate governance practice in Saudi Arabia and identify its weaknesses and its strengths to determine whether reforms are needed, and whether vital comparative solutions are justified and can be adapted and well fitted to this country. The rationale behind the objective of this research is to enhance the accountability of corporate governance in Saudi Arabia and create alternative optimal measures to accommodate the shortcomings of the current corporate governance practice.

In order to fulfil the specified aims and to address the main research question, this study will seek to respond to the following sub-questions:

-Do the rules and principles governing shareholders performance in listed companies guarantee sufficient accountability in Saudi corporate governance practice?

-Are the responsibilities and duties of the board of directors clearly defined, and ensure accountability within Saudi corporate governance performance?

-Are the disclosure and transparency requirements currently in place in Saudi listed corporations adequate to enhance accountability in Saudi corporate governance practice?

-Do the Saudi external institutions that are responsible for enacting corporate regulations enhance accountability within Saudi corporate governance framework?

1.3 The Thesis Methodology

This thesis will apply a comparative methodology in order to accomplish its aims. A comparative approach plays a fundamental role in assisting developing countries to benefit from the successes and rich experience of developed countries. Therefore, special concentration on and analyses of the accountability of shareholders, the responsibility of the board, the roles of transparency will be used when making comparisons with suitable corporate counterparts. This will be for the purpose of gaining a clear picture of their systemic functionality and gaining a deeper understanding of the legal infrastructure and dynamics governing these corporate governance mechanisms. It is also useful to pay attention to the cultural, legal and political dimensions and background when comparing laws.

Furthermore, this thesis is primarily conducted using library-based information, since the library collection is considered to be the richest source of information, particularly when comparing and discussing concepts or theoretical approaches. Therefore, an analytical study will be conducted to explore fundamental sources; for example, regulations, codes and cases in addition to secondary ones; for instance, books, journals and articles. Care will also be taken to obtain reliable and well-regardedsources written by respected scholars who have added valuable studies to the literature on corporate governance.

Using the comparative method, an effort will be applied to compare the new developing corporate governance approach of Saudi Arabia to the models of the United Kingdom and the United States. Measures were taken when choosing these specific jurisdictions so the comparisons of corporate governance practices in those countries would be suitable to this thesis. The chosen countries have the most successful models and have proven their appropriateness and lead through their valuable contribution in promoting corporate governance legislation both locally and internationally.

The method of comparative law can offer an abundantly richer choice of model solutions than a legal study focused on a single country.[9] However, we should not underestimate the difficulties involved in this comparison. Before accepting any foreign legal solutions, we need to ask whether the rules approved are satisfactory in their country of origin and whether they will be workable in the country in which we propose to implement them. Comparative law analysers are obligated to prove their neutrality when comparing legal systems and must distance themselves from psychological mentalities such as the dislike of novelty or a feeling of bias when comparing their national law with that of another country.

An additional important method in comparative law is the consideration of legal language, which is fundamentally essential to understanding the legal information in any foreign law. Legal language is different from ordinary language because legal terminology is a technical language for people who acquire special expertise in law and are capable of an in-depth understanding of specific legal meanings. The explanation behind this differentiation is that each language serves a particular aim. Legal language not only implies ordinary expression but also cultures, values and multifaceted intellectual work, and the translation of legal material is crucially important and a core question in comparative law analysis.[10]

A harmonization of law is another benefit of comparative study. Unlike convergence, harmonization seeks to eliminate key differences and create minimum standards. Comparative analytical approaches can evaluate the possibilities of coordination between systems. Indeed, permitting harmonization rather than divergence is a useful strategy with which to meet the needs of international trade, and to ease the involvement of international investors.[11] Specifically, comparative law is fundamentally useful in the Saudi Arabian corporate sector since it is needed to restructure the Saudi commercial systems and help enhancing the corporate legislative reform.

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[9] K Zweigert and H Kötz, *An Introduction to Comparative Law*, (3rd edn, Oxford University Press,1998) 15
[10] ibid
[11] P Cruz, *Comparative Law in Changing World*, (4th edn, Routledge-Cavendish 2018) 20

Nevertheless, it is wise to accept that a "one-size-fits-all" approach is not always appropriate. Corporate governance programmes may achieve success in some jurisdictions while being unsuitable for others. Thus, context matters in corporate governance.

1.3.1 Justification for Choosing US and UK Corporate Governance for a Comparison

The American and British models were chosen because of their comparative success and their worldwide influence. In comparison to other developed countries, the US and the UK share the advantage of having the strongest corporate systems accompanied by the largest performance and returns. The US has the most successful model, because its system is the most developed and has the largest liquid capital markets in the world. In 2014, publicly listed US companies had a market value of $22 trillion, representing about 35 percent of the value of equity in the entire world.[12] In addition, The Anglo-Saxon one-tier board structure model has been shown to be appropriate. An important empirical study directed by Massen and Bosch, after conducting a survey of 50 of the largest Dutch corporations characterised by two-tier board structures, found support for and a tendency towards transformation into an Anglo-Saxon single-tier board paradigm.[13]

Among the superior aspects of the USA and UK systems is fairness to the minority shareholder. An empirical study conducted by La Porta, Silers, Shleifer and Vishny showed that common-law countries have the highest standards of investor protection due to the development of a dispersed ownership style where no individual shareholder, or a group of them, owns most of the shares. In contrast, civil law provides the lowest rate of minority shareholder protection as a result of the prevalence of a concentration of ownership.[14]

Moreover, an increasing number of institutional investors have appeared in the US and the UK. These shareholders have become influential and they own a huge share of the

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[12] D Larcker and B Tayan, *Corporate Governance Matters* (Pearson FT Press 2015) 29
[13] F Allen and D Gale, 'A Comparative Theory of Corporate Governance' (2002) 3 Wharton Financial Institutions <https://ssrn.com/abstract=442841> Accessed 21 February 2018
[14] R La Porta, F Lopez-De-Silanes and A Shleifer, 'Corporate Ownership around the World' (2001) 54 The Journal of Finance 1, 35

stock market, even though they are not in control.[15] The US has the most developed system of shareholder activism through institutional ownership and widely dispersed share ownership, whereas the UK market is considered to be institutionary and more dominated than the US corporations, possessing about two-thirds of all public British stocks, while US institutions only hold around half of US public stocks.[16]

The enforcement mechanism of the US is the most favourable. Personal action is allowable when managers breach their fiduciary duty and do not act in the best interest of shareholders. The US legal systems for enforcement have evolved to overcome the collective action problem which discourages investors from suing.[17] In addition, comparative legal scholars rate the US courts most highly due to their high standards with respect to judicial activism. An empirical test of judicial discretion conducted by Cooler and Ginsburg analysed many factors contributing to effective judicial engagement, and these authors' results located the US at the top.[18] Indeed, not just the suitability of one corporate governance model but also the effectiveness of enforcement structures should be analysed. Otherwise, any implementation of corporate governance codes may lead to failure.

Another strong point of the US corporate governance approach is that its corporate governance principles are naturally more prescriptive. That is, it operates on rules rather than on principles and operates on mandatory requirements rather than on voluntary codes. The Sarbanes-Oxley Act of 2002 is a clear example of the prescriptive requirements of the US corporate legal system,[19] unlike the UK approach, which relies on self-regulation and voluntary provisions. However, The UK Comply or Explain Approach has provided the firm with the flexibility to choose which provision to comply or not comply with. However, this voluntary approach has not always operatedwell in other jurisdictions, especially in civil law countries.[20]

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[15] R Pinto, 'Globalization and the Study of Comparative Corporate Governance' (2005) 23 Wiscons International Law Journal, 1, 19
[16] B Black and J John, 'Hail Britannia: Institutional Investor Behaviour Under Limited Regulation' (2001) 92 Michigan Law Review 1997, 2007
[17] J Coffee and C John, 'Privatization and Corporate Governance: The Lessons from Securities Market Failure' (1999) 25 Journal of Corporation Law 1, 5
[18] R Cooter and T Ginsburg, 'Comparing Judicial Discretion: An Empirical Test of Economic Models' (1996) 16 International Review of Law and Economics, 295
[19] The Sarbanes-Oxley Act of 2002
[20] M Goergen, *International Corporate Governance* (Pearson 2012) 147

This has prompted the decision to use these two different systems as bases for comparison in order to recommend adopting their commercial strengths and avoiding their corporate weaknesses. It should be taken into consideration the fact that no corporate system adheres to a pure ideal or is completely perfect; each system has some defects, as we saw during the financial market collapse and during the revelation of many corporate scandals through the years.

In Saudi Arabia, it is apparent that the paradigm and corporate governance theory employed bear a closer resemblance to the Anglo-Saxon model and its basic theory. Corporate governance rules and general legislation in Saudi Arabia use the unitary board of directors and give no option to accept the two-tier paradigm.[21] Moreover, similarly, companies in Saudi Arabia have no obligation to entitles employees to have any representative format or to be involved in any strategic management decisions.

1.4 The Thesis Structure

To achieve the objective of this thesis, and to answer its research questions fully, this thesis is organised and separated into seven chapters. The first of these will provide a basic introductory explanation of Saudi Arabia’s corporate governance structure and an overview of the Islamic corporate perspective. Several issues will be presented in this chapter, as well as an outline of the comparative methodology used in this study. Next, the second chapter will explore various definitions of corporate governance in order to consider the most suitable approach for the Saudi context. This chapter will also discuss the theoretical framework related to corporate governance accountability.

In Chapter Three, the focus will be on the ownership structure that is prevalent in Saudi Arabia in order to examine the shareholders’ accountability and the shareholder protection mechanism and will investigate whether minority shareholders areprotected against abusive action. This chapter will also explore the factors that can prevent managerial misconduct against shareholders. The concept of an institutional shareholder will be introduced as a rationale to investigate its effectiveness, emphasising the activism of ownership as an effective strategy to enhance companies’ accountability.

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[21] H Elasrag, ‘Unemployment and Job Creation in the GCC Countries’ (2014) SSRN Electronic Journal <http://mpra.ub.uni-muenchen.de/54600> Accessed 11 February 2019

The discussion in Chapter Four will focus on the board of directors. This chapter's purpose is to establish whether or not the responsibilities and duties of the board members are clearly defined, and whether the board's rules ensure fairness and accountability for all shareholders. This chapter will address the necessity of appointing a nominating committee in order to ensure the selection of qualified board members. This chapter will also closely examine the suggestion of having independent members on the board. Furthermore, this chapter will critically evaluate the Sharia board of directors established in the financial sector, with the aim of evaluating its practicality to improve accountability.

Chapter Five aims to assess the current disclosure and transparency process used in Saudi corporations. It will also evaluate disclosure and transparency requirements in order to measure their adequacy to ensure accountability. Particular emphasis will be given to discussing the measurement problem and the high cost of transparency along with the requirement for choosing qualified external auditors. In this respect, evaluation of the preparation of a corporate annual report will be tested, since the accuracy of this report is regarded as being a major factor in conducting efficient business practices. The rationale is to determine potential ways to improve disclosure legislation and enhance the corporate performance.

The objective of Chapter Six is to reveal the problems surrounding the enforcement of current legislation that affects publicly held companies. This chapter is linked to the previous chapters in order to ensure the enforcement of the previously suggested recommendations. Therefore, this chapter will concentrate on external institutions, specifically the legal bodies responsible for enacting corporate regulation and for supervising the implementation of the corporate governance code. To evaluate the regulatory authority in guaranteeing corporate accountability, the Capital Market Authority, the Saudi Organisation for Certified Public Accountants, and the Saudi Stocks Exchange will be examined in order to highlight the potential drawbacks inherent in their corporate-related roles. An attempt will be made to review specifically the specialised court (the Committee for the Resolution of Securities Disputes).

Finally, Chapter Seven will present the conclusion as a summary of the previously discussed chapters. It will highlight the proposed study's contributions to the current literature, and it will provide recommendations for further reforms. This chapter will end with a brief discussion about the possible applicability of the suggested recommendations; it will also make suggestions for a roadmap in which this subject can be extended for further research.

1.5 Literature on Internal and External Corporate Governance Mechanisms

The objective of corporate governance mechanisms is to handle the complications which emanate from separating control and ownership.[22] The literature on corporate governance implies that both external and internal mechanisms have a crucial function in enhancing the performance and value of a company.[23] Internal control mechanisms are inclusive of: company compensation, ownership structure and directors as well as fiscal policies (dividends and debts).[24] However, external control mechanisms are inclusive of: the legal system, the corporate control market, as well as the product and factor market.[25] It is advocated that those mechanisms have the capacity to supply checks and protection to a company's operations as well as to provide discipline to the shareholders and the management.

1.5.1 Literature Review on Board of Directors accountability

According to Solomon, it is the responsibility of directors to deliver a structure that provides accountability to their owners.[26] Such a board has responsibility for decision-making on behalf of the shareholders, since it would be impracticable for the shareholders to meet on a frequent basis, particularly where the number of shareholders is large.[27] In corporate governance, directors occupy a significant role to ensure accountability of the organisation to its shareholders, authorities and other stakeholders.[28] Therefore, The majority of international CG regulations and codes

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[22] A Shleifer and R Vishny, 'A Survey of Corporate Governance' (1997) 52(2) Journal of Finance, 737, 749
[23] B Black and S Bhagat, 'The Non-Correlation Between Board Independence and Long-Term FirmPerformance' (2001) 27 Journal of Corporation Law 231, 261
[24] A Agrawal and C Knoeber, 'Firm Performance and Mechanisms to Control Agency Problems Between Managers and Shareholders' (1994) 31 Journal of Financial and Qualitative Analysis 377, 381
[25] A Smith and R Bushman, 'Financial Accounting Information and Corporate Governance' (2001) 32Journal of Accounting and Economics 1
[26] J Solomon, *Corporate Governance and Accountability* (3rd edn, John Wiley & Sons Ltd 2010) 123
[27] C Mallin, *Corporate Governance* (2nd edn, Oxford University Press 2007) 75
[28] B Jaggi, 'Corporate Governance: Structure and Consequences' (2013) https://doi.org/10.1007/978-1-4614-5360-4_52 Accessed 10 February 2018

accept that the composition of the board directly influences a firm's values and activities.

The principal function of the directors, with regard to the company's value, is to undertake their administrative tasks and oversee the performance of the management.[29] Furthermore, Boards are authorised to appoint various subcommittees, also have the power to assign different activities to them, which should be regularly reported to the board.[30] Harrison highlights the significance of these subcommittees in facilitating board accountability and in maintaining independent supervisions of the actions of the board.[31]

Monks and Minow advocate that the principal functions of the directors are the responsibilities of loyalty and care. They claim that in order to fulfil the duty of care, directors ought to be conscientious when making decisions; for example, prior to reaching a decision, directors ought to be aware of and consider every acceptable option. In order to fulfil the responsibility of loyalty, directors ought to show total loyalty to the shareholders of the organisation.[32] For instance, anyone who is member of boards of two firms ought to resign from one of them because such dual membership could be a conflict of interest. Dine contends that boards ought to act in good faith and with truthfulness concerning the organisation's interests, as well as those of its stakeholders.[33] The members of directors ought to be highly qualified as well as being totally familiar with their responsibilities to the firm.[34] It cannot be determined if this is occurring in Saudi Arabia. It is uncertain as to whether such companies take serious consideration of the experience and qualification of potential new board members; therefore, this research investigated this Particular concept.

Board members who are independent non-executive directors are regarded as being significant in the accountability method. They have a function in defending the minority shareholders' interests from those of major shareholders and management.[35] Aguilera maintains the existence of a powerful opinion that the presence of INEDs on the board

[29] Mallin (n27) 79

[30] C Weir and D Laing, 'The Performance-Governance Relationship: The Effects of Cadbury Complianceon UK Quoted Companies' (2000) 4 Journal of Management and Governance 265, 266-267

[31] R Harrison, 'The Strategic Use of Corporate Board Committees' (1987) 30 California ManagementReview 109, 111

[32] A Robert and G Monks and N Minow, *Corporate Governance* (5th edn, John Wiley and Sons, Ltd 2011) 66

[33] J Dine, *The Governance of Corporate Groups* (Cambridge University Press 2000) 8

[34] B Cheffins, *Company Law: Theory, Structure, and Operation* (Clarendon Press 1997) 109

[35] M Page and L Spira, 'Ethical Codes, Independence and the Conservation of Ambiguity' (2005) 14Business Ethics: A European Review 301, 303

results in improved governance, this is because when a sufficient number of independent directors are appointed to the board, this reduces the power and control of the principal shareholders, thereby improving accountability.[36] Moreover, Beasley and Dechow et al. find that fraud can be reduced when a greater percentage of board members are INEDs.[37]

Therefore, It is suggested by the majority of the principal GC codes that most board members ought to be independent; for instance, the UK CG Code required that a minimum of 50 percent of the board (not including the chairman) ought to be independent executive directors.[38] However, in MENA nations, the majority of boards are not sufficiently independent to undertake their function of supervising efficiently.[39] Nonetheless, In order to increase accountability and to avert conflict between management and supervisory procedures, Article 16 of the SCGR suggests that most directors ought to be non-executive, and also that one-third should be independent.[40] However, no decisive evidence exists that listed firms in Saudi Arabia conform to this stipulation. However, no conclusive proof exists that Saudi-listed company boards guarantee the effective independent of directors, thus, being another important element matter that this study will examine.

The board of directors are thus indicative of efficacious corporate governance between a company and its owners. It is therefore important to clarify the role they play in Saudi Arabia and their effect concerning the protection of those who are minority shareholders. If a firm is to be successful, it is essential that it has an efficient and effective board,[41] and also that the responsibilities and functions of the directors are unambiguously defined.[42]

1.5.2 Literature Review on Ownership Accountability

According to Shleifer and Vishny, the focus of ownership structure occupies a significant function in forming corporate governance.[43] Ownership structures vary between

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[36] R Aguilera, 'Corporate Governance and Director Accountability: An Institutional ComparativePerspective' (2005) 16 British Journal of Management S39, S47

[37] M Beasley, 'An Empirical Analysis of the Relation Between the Board of Director Composition and Financial Statement fraud' (1996) 71 Accounting Review 443, 445

[38] UK Corporate Governance Code 2018, Article 10

[39] P Andres, V Azofra and F Lopez, 'Corporate Boards in OECD Countries: Size, Composition, Functioning and Effectiveness' (2005) 13 Corporate Governance: An International Review 197, 201

[40] Corporate Governance Regulation in the Kingdom of Saudi Arabia 2017, Article 16

[41] Solomon (n26) 141

[42] C Mallin, *Corporate Governance* (4th edn, Oxford University Press 2013) 78

[43] Shleifer and R Vishny (n22) 749

different nations; ownership have been dissolved in Anglo-Saxon nations like the US and the UK. Contrastingly, corporate ownership remains under government control, or that of a small number of families in the majority of other countries.[44] In studying the ownership structure of many large listed firms in 27 nations, La Porta etal. found five types of this structure: (i) controlled by a family; (ii) controlled by the state; (iii) broadly controlled by financial organisations such as banks, insurance companies and pension funds (iv) broadly controlled by corporations; and (v) various groupings.[45]

Shelfier and Vishny indicate that the concentrated ownership has effective impact on supervision of managers' decisions and actions. Nevertheless, such ownership could result in majority shareholders controlling management, as their one desire is to consider their own interests to the detriment of the minority shareholders.[46] According to Solomon, highly-concentrated ownership could have an adverse impact; the ability to obtain privileged information, possibly resulting in an increase in information imbalance between the minority shareholders and themselves.[47]

Nevertheless, Sourial claims that, in the MENA nations, ownership structures are concentrated by government or family ownership, therefore, the entitlements of shareholders need to be protected and guaranteed if a good level of corporate governance is to be obtained.[48] specifically, it may be necessary for the legal system to include stipulations to defend minority shareholders' entitlements from beingneglected by large shareholders and managers.[49]

1.5.3 Literature Review on Disclosure and Transparency

Fox argues, transparency guarantees accountability.[50] It is impossible to apply the notion of accountability without paying regard to the need for transparency. Gray et al contend that providing financial information to shareholders constitutes crucial requirements to establish accountability.[51] This implies that transparency is an essential component in the demonstration of accountability. Therefore, to minimise information asymmetries, agents must inform principals of their behaviour and actions, both current

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[44] Mallin (42) 77
[45] La Porta (n14) 5
[46] Shleifer and R Vishny (n22) 753
[47] Solomon (n26) 142
[48] M Sourial, 'Corporate Governance in the Middle East and North Africa: An Overview' (2004) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=508883> Accessed 22 March 2019
[49] Mallin (n42) 79
[50] J Fox, 'The Uncertain Relationship between Transparency and Accountability' (2007) 17 Working Paper Series, 3
[51] R Gray, D Owen and C Adams, *Accounting and Accountability Changes and Challenges in CorporateSocial and Environmental Reporting* (Prentice Hall Europe, 1996) 8

and planned.[52] In the Cadbury Report, it is advocated that boards ought to include details of their conformity to the corporate governance code provisions in their annual report, and also to give reasons if they do not comply.[53] Additionally, the OECD principles indicate that transparency and disclosure could facilitate the prevention of corruption, for the entire economy as well as for a firm.[54]

The Saudi corporate legislation considers the need for accounting disclosure. This stipulates that joint-stock company managers should produce a balance sheet, income statement and report on the organization's activities for every financial year.[55] Furthermore, Article 5 of SCGR specifies the board's responsibility for guaranteeing that all information which investors need is disclosed.[56] In addition, the SCGR requires that Saudi-listed firms should disclose what has been applied and what has not, regarding CG regulations.[57] However, no specific practical proof exists of the level of transparency and disclosure that predominates in Saudi-listed firms. Therefore, the research examined this matter. Chapter six will supply further detail of this mechanism and evaluate its influence on Saudi corporate accountability.

1.5.4 Literature Review on Corporate Accountability

Monks and Minow contend that corporations must implement an effective method of ensuring accountability to fulfil their duties and responsibilities,[58] and to ensure they are perceived as legitimate. According to Keasey and Wright, good governance is strengthened by accountability.[59] Mallin argue that corporate governance development has led to greater accountability, as well as helping to allow stability to companies generally.[60] Chakrawal contends that it is interesting to be aware that the concept of corporate governance and accountability go hand in hand.[61]

The expression 'accountability', from the CG aspect, is a basic notion for enhancing the system of governance and for an assurance of an acceptable standard of equity.

[52] Alotaibi (n7) 45
[53] A Cadbury, *The Financial Aspects of Corporate Governance: A Report of the Committee on CorporateGovernance* (1992) 18
[54] B Turner, *OECD Principles of CorporateGovernance* (OECD Publications Service 2004) 11
[55] Corporate Governance Regulation in the Kingdom of Saudi Arabia 2017, Article 5
[56] ibid
[57] ibid
[58] R Monks and N Minow, *Corporate Governance* (4th edn, John Wiley and Sons, Ltd 2008) 10
[59] K Keasey and M Wright, 'Issues in Corporate Accountability and Governance: An Editorial' (1993) 23 Accounting and Business Research 291
[60] Mallin (42) 80
[61] A Chakrawal, 'Corporate Governance and Accountability' (2006) 2 Asia Pacific Business Review 88, 91

According to Mahdy, the idea of accountability shows a concept of justice and equity.[62] Furthermore, accountability is a way of reducing the possibility of fraud to a minimum.[63] Moreover, Avoidance of unethical application of responsibility and inappropriate gains from a company's resources, as well as eliminating mismanagement are significant objectives of accountability.[64] Thus, In order to guarantee total compliance with corporate governance laws by companies, managerial bodies must undertake responsibility for efficient introduction of accountability procedures and methods.

The accountability notions guarantee that every person and group in a company hold responsibility for their own actions.[65] This type of accountability relationship is described in the Cadbury Report that as the firm's owners, being the shareholders, elect the directors to administer the business on their behalf and considering them to be accountable for the progress of the company.[66] Moreover, Benston contends that companies ought to be accountable to the general public as well as to stakeholders and shareholders.[67] Agents' accountability to the principal and to the other stakeholders is the original concern of CG. Firms are accountable not to shareholders alone, but also to other groups, such as, creditors, debtors and employees, as well as others who have direct transactional or contractual links with the company.

Smyth asserts that the necessary core of a relationship of accountability is not genuine without a control method on the basis of sanction or reward.[68] According to Tricker, accountability can exist only if the accountee has the ability to impose it.[69] Bovens recognises three features of accountability: (i) the requirement to provide an account, (ii) The entitlement of the accountee to question the accountor; and (iii) the entitlement of the accountee to impose unconditional sanctions.[70]

[62] D Mahdy, 'Corporate Governance and the Financial Crisis: What Have We Missed?' (2019) 19 Journal of Accounting and Finance 42, 50
[63] E Ferlie, L Lynne and C Pollitt, *Public Accountability in the Oxford Handbook of Public Management* (Oxford University Press 2005) 21
[64] Solomon (n26) 129
[65] Aguilera (n36) S46
[66] Cadbury Committee (n53) 20
[67] G Benston, 'An Analysis of the Role of Accounting Standards for Enhancing Corporate Governance andSocial Responsibility' (1982) 1(1) Journal of Accounting and Public Policy 5, 8
[68] S Smyth, 'Contesting Public Accountability: A Dialogical Exploration of Accountability and SocialHousing' (2012) 23(3) Critical Perspectives on Accounting 230, 232
[69] R Tricker, 'Corporate Responsibility, Institutional Governance and the Roles of Accounting Standards' in M Bromwich and A Hopwood (ed), *Accounting standards setting: an international perspective* (Pitman Books 1983) 45
[70] M Bovens, 'Public Accountability in the Oxford Handbook of Public Management' in E Ferlie, L Lynne and C Pollitt (ed) *The Oxford Handbook of Public Manageme* (Oxford University Press 2005) 122

1.5.5 Literature Review on Islamic Corporate Governance Framework

Sharia is a comprehensive legal framework in Saudi Arabia. The fundamental law of governance (the constitution) states that Saudi Arabia is totally a sovereign Arab Islamic state, whose religion must be Islam, with its constitution being the Book of God, and of His messenger, the Sunnah.[71] Sharia provides fiscal and economic discipline together with moral commercial principles and having a considerable effect on corporate practice.

Therefore, a convergence of any corporate governance principles and modern norms must be subject to the examination of the Islamic perspective. Sharia law states that all law must be brought into compliance with Islam as written down in the Quran and Sunnah of the Prophet Muhamad.[72] Therefore, any activity conducted by a firm must not be prohibited in Islam. Saudi Arabia observes Islamic law (Sharia) while at the same time adopting a modern western legal system where it does not conflict with Islamic principles. Consequently, it is absolutely necessary to regard the effects of Islam when analysing corporate governance in Saudi Arabia. For this purpose and in order to advance Sharia-compliant companies, firms which obey Islamic requirements can attract investors and customers to prefer them.

To some extent, the Islamic perspective of corporate governance is similar to the stakeholder approach. It identifies who can qualify to be a stakeholder and what rights and obligations firms and stakeholders have and should be held to.[73] Islamic business principles are not codified into a specific civil code; rather, they are spread throughout the holy book of Islam. Thus, the Sharia court system is considered to be the foundation of the Saudi jurisdiction, and its judges must be Islamic jurists who have obtained a certificate from a Sharia college and who take into consideration that all courts, whether commercial or otherwise, must conduct themselves in compliance with Sharia.[74]

In pursuit of enhancing Islamic principles in the financial sector and ensuring the application of Islamic ethical standards, Islamic fiscal organisations are required to create Shariah Committee consisting of Muslim jurists as advisors to the financial institutions.[75] The Shariah Committee is made up of three or five Islamic scholars who

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[71] Basic Law of Governance 1992, Article 1
[72] N Brown, 'Charting the Islamic Way' (2016) Oxford Scholarship Press <10.1093/acprof:oso/9780190619428.003.0006> Accessed 20 May 2018
[73] K Rahmatina, 'Corporate Governance: Conventional vs. Islamic Perspective' (2009) SSRN <http://ssrn.com/abstract=1685222> Accessed 21 June 2018
[74] A Al-Ghadyan, 'The Judiciary in Saudi Arabia' (1998) 13 Arab Law Quarterly 235, 243
[75] The Shariah Governance Framework for Local Banks Operating in Saudi Arabia 2020, Article 7

have expertise in finance and business. They get together on behalf of all investors, depositors and shareholders to check if particular services, products or transactions or services are in compliance with Islamic commands.[76]

1.6 Overview of Saudi Regulatory Landscape in the Corporate Sector

Saudi Arabia has established a foundation and has made considerable progress in setting up corporate market mechanisms. In pursuit of enforcing capital market law, the Capital Market Authority (CMA) was instituted, accompanied by the issuance of an inclusive code (called the Corporate Governance Regulation in the Kingdom of Saudi Arabia). This market, for publicly held corporations listed on the Saudi capital market according to 'a Comply or Explain standard', requires that in cases which ignore the implementation of the code, these listed corporations must report the reason to the CMA.

Another important body with enormous influence on corporate governance is the Ministry of Commerce and Industry, which carries responsibility for regulating rules. As part of the economic reform, the Saudi Ministry of Commerce and Industry enacted the Capital Market Law of 2003 (amended in 2016) to provide an inclusive framework for the capital market. In addition, in March 2007, the Saudi stock exchange (Tadawal) was instituted. The fundamental mission of Tadawal is to act as a securities exchange and depository. Its legal status and all its responsibilities are clearly defined in the Capital Market Law (CML).[77]

In addition, Saudi Arabia published the new Law of Companies in December 2015, replacing the 1965 law. The objective of the new law is to satisfy the sector's current requirements and to generate an encouraging atmosphere to enable companies improve good practices in corporate governance. Furthermore, it addresses the flaws of the 1965 Saudi Company Law and its various amendments. Numerous limitations and obstacles to the growth of the corporation's sector are eliminated by this new law.

As a matter of reform, and due to the fact that judges in the traditional Saudi Judicial Authority lack basic expertise and understanding of corporate governance principles, a Committee for the Resolution of Securities was also established. The fundamental objective of this specialised court is to resolve disputes emerging between listed

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[76] ibid

[77] The Saudi Stock Exchange (Tadawul), 'Capital Market Overview' (2015) <https://www.tadawul.com.sa/wps/portal/tadawul/knowledge-center/about/Capital-Market-Overview> Accessed 11 March 2018

companies.[78] To provide an opportunity and authorisation to appeal, the Appeal Committee for the Resolution of Securities Conflicts was then created. The Appeal Committee's decision is considered to be the final verdict in a corporate dispute.

Due to these legal structures and reforms, the Saudi Arabian stock market is currently the largest of its kind in the Middle East. The stock exchange had a capitalization of SAR 9,504.35 billion Riyal at the end of the 1st half 2021.[79] However, although there are observable successes, some irregularities still need to be addressed. This is what makes this comparative thesis so essential, so that strengths can be highlighted, and weaknesses pointed out, while vital recommendations can be suggested, and adjustments emphasised when needed.

1.7 Conclusions

Since the objective of this thesis is to investigates practices of corporate governance in the extent to which this regulations and practice discharging accountability, this chapter provides a summary of the study framework, describing the principal components of all seven chapters. In addition, it has presented a brief background about the Saudi Arabian corporate governance framework and has evaluated the influence of the Sharia legal framework on the Saudi corporate regulations. This chapter has found that the literature has been heavily focused on several internal and external corporate governance mechanisms influencing CG practices such as ownership structure, the quality of the board, and the enforcement of related regulations. The separation between control and ownership is the central concept that corporate governance depends on.

A brief explanation is given of comparative methods which serve this thesis from many different approaches. The justification for this comparison is to offer an abundantly richer choice of model solutions[80] In this research, the American and British models were chosen based on their comparative success and worldwide influence. In comparison to other developed countries, the US and the UK share the advantage of having the strongest corporate systems accompanied by the largest performance, returns and highest standards of shareholders protection. In the next chapter, the theoretical structure employed in this study which concentrates on accountability is discussed.

[78] The Resolution of Securities Disputes Proceedings Regulations 2011, Article 36
[79] The Saudi Stock Exchange Performance Report – First Half 2016
[80] Zweigert and Kotz (n9) 19

Chapter Two

Corporate Governance Theoretical Framework

2.1 Introduction

The theoretical structure adopted in this thesis is constructed on the integration of the notions and theories which have been addressed in the literature in order to expound the corporate governance framework in companies. This theoretical framework comprises agency theory, stakeholder theory, stewardship theory, the Nexus of Contracts Theory and the Resource Dependence Theory. These theories lead to the recognition that corporate governance encompasses economic, legal and social themes. Based on agency theory, the separation between managers and capital owners results in the agency problem. Companies with effective corporate governance mechanisms may have the capability to reduce agency costs, whereas stakeholder theory indicates that companies cannot operate in isolation from the various stockholders, who have crucial roles to play. Moreover, stewardship theory presumes that it would be probable to attain an improved financial performance by trusting the directors as well as giving them greater powers. Additionally, resource dependence theory assumes that internal corporate governance mechanisms; for instance, the directors (as valuable resources), may have an improved impact on company performance. Whereas, the Nexus of Contracts theory presumes that corporation is a range of private contractual links that provide companies the freedom to avoid unnecessary interference from the state. Therefore, the aforementioned theories have comparable benefits and serve to highlight a different type of issue in corporate governance. Consequently, the aim of the current chapter is to supply a discussion of the integrated theoretical frameworks to evaluate their applicability to this current thesis.

2.2 Corporate Governance Definitions

There are differences among scholars, whether legalists, economists or social scientists, when discussing the meaning of corporate governance. They rely on different viewpoints and provide theoretical justifications for their definitions.Therefore, there are no fixed universal definitions for the concept of corporate governance. However, some influential perspectives have been instrumental in the formation and the development of the corporate governance concept. Most notably, the definition of corporate governance may be considered from the perspective of twomain notions, one of which is broad, and the other narrow.

The narrow definition is limited to the subjects of management control, shareholder protection, and additional matters related to agency theory for the purpose of managing problems originating from the separation of ownership and control.[81] Advocates of this narrow definition of corporate governance focus only on the association between shareholders and management, and the means of balancing their interests. Anglo-American corporate governance systems; for instance, those in the United Kingdom and the United States are heavily dependent on this narrow interpretation.[82] Critics of this definition have argued that it focuses primarily on the shareholders' interests, and aims to further their welfare at the expense of other stakeholders who may also have a legitimate stake in the company. In corporate governance, external stakeholders and social factors are additional features that dictate the success of a corporation but were left out of this definition.

In contrast, the broad definition of corporate governance relies on the notions of stakeholder theory and focuses on the relationship between the company and a broad scope of stakeholders; for example, creditors, employees, consumers, investors and the community generally. The OECD Principles of Corporate Governance defines this concept in a broader sense by stating that corporate governance concerns a series of relationships between a firm's board, its management and its shareholders as well as other stakeholders.[83] Corporate governance, in this sense, stipulates the entitlements and duties of various participants. This definition goes beyond the maximisation of shareholder interests as the main focus, to the pursuit of the interests of various stakeholders who are affected one way or another by management decisions.

Some criticize this definition and considers the external mechanism of corporate governance too broadly as it encompasses numerous instances of far-reaching participations within the corporate sector. In contrast, the proponent argued that, this

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[81] McConnell and H Servaes, 'Additional Evidence on Equity Ownership and Corporate Value' (1990) 27(2) Journal of Financial Economics 595, 597

[82] ibid

[83] Organisation for Economic Co-operation and Development, *OECD Principles of Corporate Governance* (OECD Publications Service 2004)

definition was clearly developed to balance the interests of all corporate participants, as such; it addresses the concerns of both internal and external stakeholders.[84] Therefore, this definition become the preferred perspective in most countries around the world. The aforementioned definition resembles the one presented by Sir Adrian Cadbury that corporate governance involves maintaining the balance between social and economic objectives, and also between communal and individual targets. The intention is to unify the concerns, not only of corporations and individuals, but also of society generally, as closely as possible.[85]

Even though the expression 'corporate governance' is frequently applied in the corporate sector throughout the world, In the Saudi context, the term 'corporate governance' is a comparatively novel phenomenon in the kingdom's legal system., a lack of clarity remains regarding the definition and concepts of corporate governance. This is because 'corporate governance' translated into Arabic as 'hawkama', the meaning of which is ambiguous as Arabic literature on corporate governance is generally lacking.[86]

Thus, since the complete definition of corporate governance is not mentioned in the Saudi Corporate Governance Regulations, a clarification of the meaning of this notion is necessary. Thus, For the purpose of setting the focus, the definition given by the OECD as well as the Cadbury Report made in the UK in 1992 will serve as the definitions chosen for this thesis. The reason for this is that the OECD Principles of Corporate Governance are a universally accepted principle and are regarded as being a sound and comprehensive model of corporate governance. Indeed, the corporate governance definition should include particular mention of numerous elements; such as, regulatory and legal domains as well as societal and business ethics ought to bepart of the definition because they influence a company's standing and its potential success into the future.[87]

[84] H Hansmann and R Kraakman, *Toward a Single Model of Corporate Law* (Oxford University Press2002) 21
[85] Cadbury Committee (n53) 30
[86] T Abdel and others, *Corporate Governance: Concepts, Principles, Experiences*, (Arabic edn, University House 2005) 30
[87] OECD (n83)

In this context, many philosophical views have had an impact on the development of corporate governance. The main theories which have affected its norms arereasonably diverse. In the following section, an analytic discussion of such theories is given for the purpose of widening the comprehension of their concepts in addition to exploring their applicability. Specifically, five of the most popular and influential theories which have shaped corporate structures, as well as their main concepts, will be discussed further in the thesis chapters when relevant.

2.3 Agency Theory in Corporate Governance Accountability

In consideration of all the theories, the agency theory has the most powerful effect on the progress of corporate governance thinking.[88] The principle that management must be accountable to their owners is predicated on the notion of agency theory. The agency theoretical perspective is grounded on the context of the separation of ownership and control. Berle and Means began the debate over the separation between ownership and control and mentioned the agency problem which would arise from this relationship.[89] Agency theory recognises the interaction association in which one party (the shareholder) assigns responsibility to another (the manager). Although the separation of the control and agency relationship is essential, a particular agency problem could slow or even damage the firm's performance.

The agency problem occurs when the manager (the agent) advances his self-interest over the shareholders' (the principals) interest and causes conflict in the relationship. The agency problem could be a direct one, for example in reducing the wealth of shareholders, or it could be indirect, such as, incurring huge costs in order to monitor the management. Therefore, the higher the complexity in monitoring the manager, the higher the cost.[90] In addition, the agency problem could occur between shareholders when the controlling shareholder uses significant power to abuse the minority shareholders, who just own a small percentage of shares.

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[88] T Clarke, *Theories of Corporate Governance* (Routledge 2004) 49
[89] A Berle, *The Modern Corporation and Private Property* (Routledge 1991) 5
[90] H Hansmann, J Armour and R Kraakman, 'Agency Problems, Legal Strategies and Enforcement'(2009) 21 Oxford Legal Studies Research Paper 4

Insufficient information is another agency problematic issue; when directors have access to different information, the shareholders is weak, because the agent will have information that the shareholders cannot possess. A manager may also hold different opinions from the ownership with respect to corporate risk. Directors might expose corporate funds to riskier projects or a hostile takeover, simply because the money they are risking is not their own.

The Saudi SCGRs attempt to alleviate difference between managers (agents) and owners (principals), in conformity with the agency theory. This is in order to enhance the responsibility, accountability and transparency of the board. Nevertheless, it is apparent that these techniques have more theoretical success than practical success. The reason for this is that ownership is concentrated among wealthy and dominant Saudi families as well as the state. Listed firms in Saudi Arabia are categorised by dominating ownership, and various types of block-holder ownership; such as banking, corporation and insurance companies; and also, a small foreign ownership.[91]

It is significant that this massive concentration, which is typical of the situation in Saudi Arabia, may have an adverse impact on minority shareholders' entitlements.[92] Consequently, this generates a conflict of interest between the controlling and the minority shareholders. According to La Porta et al., it is in growing capital markets that the agency issue is most prevalent. They claim that little protection is given to minority investors in such markets.[93] Similarly, in markets such as those of Saudi Arabia, where capital market is emerging, the agency issue appears not exclusively between shareholders and managers, as in the UK and the USA, but as well as between controlling owners (usually rich families or state institutions) and minority investors.[94] Consequently, the potential impact of anticipated difficulties in Saudi companies performance and accountability means that the agency theory is important in the Saudi legal environment.

[91] N Baydoun and others, 'Corporate Governance in Five Arabian Gulf Countries' (2013) 28(1) Managerial Auditing Journal 7, 10
[92] ibid
[93] La Porta et al (n14) 1
[94] S Claessens, D Simeon and H Lang, 'The Separation of Ownership and Control in East Asian Corporations' (2000) 58 SSRN <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=206448> Accessed 18 February 2019

A principal objective of the Saudi Corporate Governance Regulations is to improve the transparency, quality, responsibility and accountability of the board, thereby alleviating the conflict between managers and shareholders.[95] However, as in the majority of emerging markets, it is common practice for directors to be appointed by large shareholders, not necessarily because of their abilities or experience, but rather as a result of their political or social contacts.[96] Consequently, these directors may undertake their responsibilities inefficiently or protect the self-interest of large shareholders. Therefore, such practices could have an adverse effect on financial performance and corporate disclosure; thereby accentuating the importance for an agency theoretical structure in Saudi Arabia.[97]

The objective of agency theory is to moderate the cost resulting from an agency relationship by imposing internal procedures to keep the agent's behaviour under control. Internal mechanisms are generally preferred, because they are less expensive than external ones. But if internal controls fail, external mechanisms are an appealing tactic to control the self-serving impulses of managers. In addition. Agency theory has produced some beneficial insights for enhancing corporate governance. However, it has also been critiqued on various grounds.

Agency theory has been criticized for its narrowness and for its neglect of the political, structural and procedural dimensions that affect the development of corporate governance. This theory has a deficiency in that they fail to accept other agents; for example, regulatory agencies and the public at large. The effort to cover all corporate interests requires a more analytical approach than what agency theory has offered. Indeed, for the purpose of achieving a profound comprehension of corporate governance, a consideration of additional theoretical standpoints is needed.[98] Another potential difficulty in the agency theory is that It can be an expensive exercise to supervise agents. Jensen and Meckling apply particular emphasis on how contractual

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[95] A Alshehri and J Solomon, 'The Evolution of Corporate Governance in Saudi Arabia' (2012) British Accounting and finance Association 20

[96] R Haniffa and M Hudaib, 'Locating Audit Expectations Gap Within a Cultural Context: The Case ofSaudi Arabia' (2007) 16(2) Journal of International Accounting, Auditing and Taxation 179, 199

[97] W Albassam and others, 'Corporate Boards and Ownership Structure as Antecedents of Corporate Governance Disclosure in Saudi Arabian Publicly Listed corporations' (2015) Business and Society 335, 341

[98] T Clarke, *International Corporate Governance A Comparative Approach* (Routledge 2007) 24

preparations between a company's top managers and its owners influence agency expenses.[99]

In finding solutions to the abovementioned imperfections, the law should address these defects and provide fair remedies. Responses to the agency predicament require accountability and transparency, independent executive directors and the need to establish minority protections, as well as an emphasis on active shareholder engagement. In addition, it is essential to establish supervising mechanisms in order to alleviate conflicts of interest between owners and agents.[100] Agency problems could be minimised, and both market value and firm performance could be improved by introducing effective control over the actions of management.

It is hard to solve the agency problem without advancing transparency. It has often been said that the high costs of disclosure and delays in reporting are major concerns which a company must face and address to resolve the agency problem. Some information to which managers have access is unavailable to shareholders. Therefore, shareholders should agree to take agency costs in order to supervise the behaviour of managers, thereby guaranteeing that they do not apply this exclusive information for their own self-interest. Shareholders' activism in the decision-making process is considered important solution which can mitigate the agency problem. Shareholders, whether individuals or institutions, should have an active role and should increase their influence and their interference for the purpose of enhancing the quality of corporate governance.

Judicial intervention is also an essential mechanism in resolving any agency relationship and unjustified costs. The judiciary can clarify the role of the court in order to assure investors of the strength of the judicial system.[101] Judges must also be required to have special expertise and specific knowledge of how to scrutinise sophisticated corporate matters; otherwise, they will bring down inappropriate judgements. Thus, since the agency theoretical standpoint is based on the context of the separation of ownership and control, this theory has clear applicable benefits to this thesis as to serve to highlight the agency issues results in a conflict of interests between shareholders and directors in Saudi companies.

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[99] R Johnson and D Greening, 'The Effects of Corporate Governance and Institutional Ownership Typeson Corporate Social Performance' (1999) 42 Academy of Management Journal 564

[100] F Darus, A Mohamed and R Jusoh, 'Corporate governance and corporate failure in the context of agency theory' (2011) <http://myjms.mohe.gov.my/index.php/tifej/article/view/1582> Accessed 11 February 2018

[101] Cheffins (n34) 113

2.4 Stakeholder Theory in Corporate Governance Accountability

In juxtaposition to agency theory is the stakeholder theory. In this theory, the company is accountable to a broader range of constituents instead of primarily concentrating on the shareholder. The objective of stakeholder theory is to encourage all stakeholders to engage in the decision making, to exert legitimate influence on company strategy and to have their rights and obligations balanced and met. The satisfaction of the stakeholders contributes to the success of the company and overcomes any barriers which may emerge when conflict occurs.

Freeman defined the stakeholder as a group of persons who can influence or be influenced by the attainment of the aim of the company.[102] Freeman also redefined stakeholders as the groups that are essential if the firm is to survive.[103] Other scholars define the concept in another way. Clarkson divided stockholders into two groups: Primacy stakeholders are those whose contribution is critical to the firm and failing to obtain their participation will result in the failure of the firm. The other group consists of secondary stakeholders, whose roles do not directly affect the corporation and who are not important for the firm's survival.[104]

Hill and Jones suggest that anyone who contributes to the firm will have a legitimate expectation of return in exchange for what he supplies. These authors state that shareholders pay for capital, and in exchange, they want to see their investments and interests maximised. Creditors expect their loans to be paid. Managers and other employees expect their commitment and effort to result in better treatment. Customers expect value, and local communities provide infrastructure and expect, in exchange, that the firm will enhance their quality of life. The public who pay taxes expect a beneficial contribution from the firm.[105]

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[102] E Freeman, *Strategic Management: A Stakeholder Approach* (Pitman 1984) 14
[103] E Freeman, *A Stakeholder Theory of Modern Corporations, Ethical Theory and Business*, (Prectice Hall, 7th edn, 2004) 22
[104] B Clarkson, 'A Stakeholder Framework for Analysing and Evaluating Corporate Social Performance'(1995) 20 The Academy of Management Review 92, 103
[105] C Hill and T Jones 'Stakeholder-Agency Theory' (1992) 29 Journal of Management Studies 139, 133

The challenge of turning value into process remains a key barrier to sustainable business practice. This theory fails to suggest how stakeholder satisfaction might be accomplished. Therefore, it provides no specific, defined measurable objectives, and consequently, it leaves managers unaccountable for their actions. Some opponents criticize this theory for making any design duty unmanageable. Sternberg argued that the stakeholder theory is fundamentally uncontrollable. She claimed that the expectations of different stakeholders were incompatible and could produce possible conflicts.[106]

Furthermore, managers may have an opportunity of taking advantage of this complex situation not to be responsible for their actions when managing numerous immeasurable interests at various stakeholder group levels.[107] Moreover, in certain situations, some stakeholder groups may be favoured at others' expense.[108] Nevertheless, it is challenging to include the numerous groups who have variety of an interests or stake in a company in the current rapidly changing business climate.[109]

Besides, this theory presupposes the need for firms to be accountable to every stakeholder, rather than to their own shareholders, thereby contravening the principal-agent relationship. However, Turnbull rebuts such criticisms by claiming that excessive empirical evidence fails to support the opinion of there being, according to stakeholder theory, a conflict either with the agent-principal association or the firm's aim.[110] Moreover, stakeholder relationships cannot weaken the notion of shareholder and agency interests, but rather defend them.

Despite this debate surrounding the stakeholder aspect, this theory was eventually enacted in law in some countries. Germany, for example, mandates worker representation on supervisory boards. In the US, a firm's board of directors is not only accountable to its owners but also must act in the best interests of all stakeholders.[111] Certain aspects of the stakeholder theory portray Saudi corporate governance practice; Article 2 of the SCGRs stipulates social responsibility and also the protection of

[106] E Sternberg, *Just Business: Ethics in Action*, (2nd edn, Oxford University Press 2000) 23
[107] Mallin (n42) 82
[108] E Freeman and J McVea, 'A Stakeholder Approach to Strategic Management' (2008) The BlackwellHandbook of Strategic Management 210
[109] M Wang and K Hussainey, 'Voluntary forward-looking statements driven by corporate governance and their value relevance' (2013) 32, (3) Journal of Accounting and Public Policy 26, 28
[110] S Turnbull, 'Stockholder Governance: A Cybernetic and Property Rights Analysis' (1997) 5(1) Corporate Governance: An International Review
[111] B Kogut and P Cornelius, *Corporate Governance and Capital Flows in a Global Economy* (OxfordUniversity Press 2003) 8

stakeholders' entitlements.[112] It is implied that companies which function in Saudi Arabia ought to seek the interests of other stakeholders; for instance, local communities, governments and employees. Few companies have been complying with this principle, for instance, the Saudi Arabian Oil Company (Saudi Armaco), which is owned entirely by the Saudi government and thought to be the largest firm in the country and has a multinational profile; This company's website states that it has attempted to perform activities that increase value for the Saudi people. Such value includes the construction of railways, roads, hospitals and schools, as well as providing wildlife sanctuaries.[113] This portrays aspects of corporate social responsibility as suggested by stakeholder theory.

Nevertheless, in Saudi Arabia, the theoretical usage of the stakeholder theory is more successful in theory than in practical situation. This is due to the fact that conformity with SCGR requirements is optional rather than mandatory ('comply or explain' principle). Consequently, an assessment of websites and annual reports produced by the board indicate that most of Saudi listed companies remain unwilling to accept CSR.[114] An additional explanation of how certain listed companies have an ineffective or low engagement of corporate social responsibility is possibly due to the fact that SCGRs fail to explain this valuable criterion properly, as well as lack of knowledge on the part of company boards. Thus, this corporate governance notion remain partly undeveloped and recognised in Saudi Arabia. Therefore, the applicability of the stakeholder theory to the discussion of this thesis is apparent and has clear merit. Saudi companies need to engage with various stockholders who have crucial responsibility to undertake and to exert legitimate influence on company strategy and to have their rights and obligations balanced and met.

2.4.1 The Corporate Social Responsibility Approach

Corporate Social Responsibility (CSR) is associated with stakeholder theory. CSR holds that there are essential moral features of a business, such as preventing damage to the environment, paying attention to employees' needs, furthering ethics in business and helping local communities. In a prominent report, the Green Paper described CSR as a perspective that deals with social and environmental concerns and pushes for mutually

[112] Corporate Governance Regulation in the Kingdom of Saudi Arabia 2017, Article 2
[113] <http://www.saudiaramco.com/en/home/news-media/publications/corporate- reports/Citizenship 2014.html> Accessed 8 February 2019
[114] Staff of International Monetary Fund, 'Labor Market Reforms to Boost Employment and Productivityin the GCC' (2013) International Monetary Fund

beneficial interaction with various stakeholders in a voluntary manner.[115]

Within companies, CSR principles should be laid out in a written self-regulatory code or be explicitly explained in the corporate constitution, allowing all players in the company to know their ethical roles and act accordingly. International organizations, trade unions and non-governmental institutions have also attempted to establish ideal ethical codes for their employees to follow on a voluntary basis, and as a step toward inspiring corporations to adopt detailed CSR guidelines of their own.

A considerable number of businesses in countries throughout the developed world are recruiting CSR consultants and training their staff in CSR-related issues, teaching them to take ethical principles into consideration in a coherent manner.[116] On the other hand, there has been scant adoption of CSR in Saudi Arabia. Very few Saudi corporations have adopted CSR, and even fewer have applied it. It has been observed that companies in less developed countries such as Saudi Arabia repeatedly carry out unethical commercial activities that violate principles of CSR and do not meet human rights standards.

Indeed, since obedience to the SCGR and CSR is optional rather than mandatory in the Saudi situation, efficient application of the stakeholder theory could experience some difficulties. This implies that government-owned or family-owned firms in Saudi Arabia could ignore the interests of stakeholders in order to pursue their own shareholders' interests. Although one objective of CSR is to protect the environment, it is unfortunate that in Saudi Arabia, this is performed only partially. Unfortunately, the numerous petrochemical industries in the country generate considerable harm, despite the fact that they are owned by well-respected firms, who indeed know of the damage that they are causing. For example, approximately 352 petrochemical industry manufacturers are located in Jubail City, which are owned by several listed companies, a considerable level of pollution is induced by these manufacturers which endangers residents' health.[117]

2.5 Stewardship Theory in Corporate Governance Accountability

The stewardship theory presumes that managers, as stewards, are encouraged toserve in the shareholders' best interests and that they want to cooperate with each other to

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[115] Commission of the European Communities, *Promoting a European Framework for Corporate Social Responsibilities* (Brussels 2001) 6

[116] A Dignam and M Galanis, 'Corporate Governance and the Importance of Macroeconomic Context'(2008) 28(2) Oxford Journal of Legal Studies 201, 203

[117] Y Alzahrani, 'The corporate governance in Saudi listed companies' (2013) (1)4 International Journal of Humanities and Management Sciences 84, 87

advance their performance. Behind this motivation is the objective of having an impressive reputation, with their interests and wealth increasing accordingly. Donaldson and Davis state that executive managers have a willingness to do a good jobas stewards of the company and that no problem or self-interested behaviour exists amongst executives. Executive performance depends on the involvement and the structure of the organisation and will increase when the managers' expectations of having a clear role and sufficient authority are met.[118] Davis, Schoorman and Donaldson have also argued that stewardship theory encourages managers to behave collectively with other players in the company and promote strong relationships with them. They can be encouraged and motivated to work harder through the use of intrinsic rewards such as opportunities for promotion as well as chances to celebrate their accomplishments. Linking their identification to the company's successes and failures will also provide them with the advantage of a reputation for handling the business successfully.[119] A healthy and personal relationship with the employees is necessary for stewards; it builds trust and advances commitment. Supporting employees by enhancing their motivation leads to stewardship behaviour which adds value to the organisation.[120]

Proponents claim CEO duality in stewardship theory could be an effective method of corporate governance in having decisive results for a firm's financial effectiveness. This is due to the unification and coordination of the authority chain, thereby resulting in quicker decision-making.[121] In contrast, opponents argued that, if such functions are combined, in conformity with the stewardship theory, this will result in managers having greater control over the company's information. Consequently, this will increase the difficult matter of information asymmetry, and simultaneously reduce the transparency in the company environment.[122] Furthermore, the relationship of trust between executives and owners, in accordance with the stewardship theory, could persuade executives to gain advantage from the company's information and resources in their own self-interest.[123]

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[118] J Davis and L Donaldson, 'Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns' (1991) 16 Australian Journal of Management 49, 52

[119] F Schoorman, J Davis and L Donaldson, 'Toward a Stewardship Theory of Management' (1997) 22 The Academy of Management Review 20, 24

[120] K Volker, 'Stewardship Behaviour and Creativity' (2011) 22 Management Review 274, 276

[121] G Vintila and S Gherghina, 'An Empirical Investigation of the Relationship Between Corporate Governance Mechanisms, CEO Characteristics and Listed Companies Performance' (2012) 5(10)International Business Research 175

[122] M Mizuno and I Tabner, 'Corporate Governance in Japan and the UK: Codes, Theory and Practice'(2009) 14 Pacific Economic Review 622, 625

[123] Beasley (n37) 450

Again, as with the previous theory, the narrowness of its theoretical focus limits the explanatory significance of this theory. Also, critics of stewardship theory claim that current corporations cannot accept the old notion and believe that directors are self-motivated and will take care of their fiduciary duty. The global financial crises and the collapse of major corporations have revealed the valuable lesson that trust in directors without any oversight or engagement of the shareholders will potentially lead to mismanagement or opportunistic behaviour.

It is apparent that, from a critical viewpoint, corporate governance practice in Saudi Arabia differs markedly from the presuppositions of stewardship theory. For example, according to articles 20 of SCGR, it is indeed essential to appoint independent non-executive board members who ought to have total independence.[124] Likewise, Article 24 highlights that the functions of the firm's CEO and its chairman ought to be separate.[125] The aforementioned provisions certainly conflict with the stewardship theory presuppositions. Consequently, the stewardship theory usage has no considerable relevance with the internal directors. However, this theory would be only appropriate and applicable when discussing the benefit of appointing independent directors since Stewardship theory accepts the fact that improving the financial performance could result from trusting the independent directors and giving them greater powers.

2.6 The Nexus of Contracts Theory in Corporate Governance Accountability

According to the Nexus of Contracts theory, a corporation is an assortment of private contractual ties that afford companies the freedom to avoid intervention from the state.[126] The selection of charter terms is called contracts because such decisions cannot be modified without the vote of company shareholders. This concept defines the state's role as the entity that enables a corporation's authority, but the state should not have ultimate control over a company. Ballantine was the first to express this opinion when he wrote that corporation law's principal objective is not to regulate, but rather to be enabling acts allowing investors to conduct and administer their business, be it large or small, with the advantage of the corporate mechanism. Such plans are prepared in order to facilitate the effective management of business as well as to make

[124] Corporate Governance Regulation in the Kingdom of Saudi Arabia 2017, Article 20
[125] ibid, Article 24
[126] J Dine and M Koutsias, *Company Law*, Eighth Edition (Palgrave Macmillan 2014) 20

adjustments with regard to the necessity of change.[127]

The logical result of this theoretical and contractual approach is to distance social responsibility and obligations from corporations and to establish prevention of regulatory intervention. Corporations can express their rights to obtain political and legal positions which are autonomous from the state, to achieve the free market principle.[128] The concept of the state regulating corporations as a corrective response to market failure is arguable; corporate insiders are efficiently capable of balancing their roles much better than the state because they have insider information of the company dynamic and can form contracts at lower costs. Flexibility and the freedom to choose among different market governance mechanisms is the optimal circumstance for any firm. Freedom of contracts enables all parties to form a relationship in amanner that mitigates agency problems inherent in the corporate sector. Although there are those who advocate for the appropriateness of privately negotiated contracts, there are also those who oppose the nexus of contracts theory.

Criticisms arise due to the fact that contracts are formulated by individuals inside a corporation who favour economic rather than legal approaches. Therefore, according to this criticism, private contracts are unfriendly to regulations.[129] Moreover, in Saudi context, shareholders are unable to adjust default regulations according to their self-interest, when operating in a weakened ownership activism. However, it is not only shareholders who have no bargaining power, but other stakeholders have no means of participating in the collective decision-making model. Therefore, the self-interest of the shareholders or of other stakeholders is not necessarily served by the default rule paradigm. However, The Nexus of Contract Approach continues to be the principal 'legal academy' theory that is relevant to corporate governance and it is rationale to evaluate their applicability to this current thesis. It would serve to illuminate a different type of problem associated with the government corporate regulations role. However, this theory is not always applicable and valid in all corporate governance conditions.

2.7 Resource Dependence Theory in Corporate Governance Accountability

The Resource Dependence Theory also indicates the reason why it is possible for company performance to be influenced by internal corporate governance mechanisms.

[127] J Ballentine, *Equity, Efficiency, and the US Corporation Income Tax* (American Institute for PublicPolicy Research 1980) 42
[128] Dine (n33) 10
[129] ibid 14

According to this theory, boards of directors and other corporate mechanisms are essential, not exclusively for monitoring, but also to act as a crucial link between a firm and every necessary resource that it requires if it is to function effectively. The resource dependency theory enables a board whose links with the external environment to facilitate and enhance access to useful resources, thereby enhancing corporate governance practices.[130] Consequently, it is particularly significant to appoint board members who represent diverse independent organisations.[131]

According to resource dependence theory, it is possible for directors to be a significant resource for the company in several ways. They provide the company with such necessary resources as independence, knowledge and experience. Directors connect institutions with major stockholders like consumers, competitors, suppliers and creditors as well as to the external environment, thereby giving them improved access to resources. Thus, the resource dependence theory focuses on the external links and functions of every director who arrived from various independent institutions, and who are meant to occupy an essential role in obtaining necessary resources for a company. Nonetheless, the resource dependence theory was criticised by academics. They criticise the resource dependency theory for failing to concentrate on the internaland decision-making procedures.[132]

From the Saudi context, appointing board members, as well as the composition of the board appear to contrast the resource dependency theory presuppositions. The fact that rich Saudi families, as well as the nation's government appoint board members in the Saudi securities market.[133] Such appointments pay no regard to the legal requirements as presented in in this theory. Consequently, the resource theory is applicable to the discussion of this current thesis because it assumes that internal corporate governance mechanisms, such as obtaining skilful and experienced boardsof directors would have a productive impact on company performance by associating itwith critical external resources.

2.8 Conclusion

In this section, a theoretical setting for this study have been given. Understanding the

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[130] G Davis and J Cobb, *Resource dependence theory: Past and future.' Stanford's organization theoryrenaissance, 1970-2000'* (Emerald Group 2010) 6

[131] H Abdullah and B Valentine, 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4Middle Eastern Finance and Economics 88, 92

[132] ibid

[133] Alzahrani (n117) 86

above-mentioned theories and definitions leads to the recognition that corporate governance encompasses economic, legal and social themes. Therefore, a broader definition must be adopted in order to clarify this term, limit this study and set the focus. The OECD definition of corporate governance and the definition presented in the 1992 UK Cadbury Report were decided upon as the main definitions for this thesis. The OECD principles and the Cadbury Report are especially effective, and many nationshave selected the OECD principles as a global standard for efficient corporate governance. This selection was the result of the nonexistence of a thorough definition of corporate governance in the Saudi corporate Regulations.

Given this, the main theory which has contributed significantly to the development of corporate governance is agency theory, according to which the separation of control and ownership results in a conflict of interests between shareholders and directors, consequently resulting in agency expense for companies. Furthermore, companieshave become aware of the necessity of adopting the stakeholder theory and have become convinced that companies cannot operate in isolation from the various stockholders who have crucial roles to play. Furthermore, stewardship theory presupposes that it would be possible to attain improved financial performance by trusting the directors as well as giving them greater powers. Lastly, resource theory assumes that internal corporate governance mechanisms, for example boards of directors, may have a productive impact on company performance by associating it with critical resources.

However, each theoretical approach has its rationale and limitations, but each servesto illuminate a different type of problem in governance. No theory of corporate governance is always applicable and valid in all situations. Consequently, there is no perfect corporate governance theory. Another element which has an impact on a specific nation’s theoretical viewpoint of corporate governance is the variations between nations regarding cultural values, social, and political circumstances as well as economic contexts. Therefore, the ideal means of constructing an efficient governance practice is a meticulous consideration of the different theories. The aforementioned theories, which may all be applied in this paper, have comparable benefits applicable to the discussion of this current thesis. Therefore, in order to enhance company’s accountability as well as comprehending the links between different groups in a corporation, it is necessary to discuss these main theories farther in this thesis when relevant.

Chapter Three

The Impact of Saudi Company Ownership on Accountability

3.1 Introduction

The previous chapters discussed the thesis issues, research objectives, structure and importance of the topic, and included a critical assessment of current literature and theoretical review on corporate governance. In keeping with the objectives of this thesis, this chapter evaluates the ownership structure in Saudi firms. Ownership framework, which together with corporate directors may influence the performance and strategic investments of the company.[134] Thus, In the process of reforming the corporate governance structure and the accountability of the company, the association between its performance and ownership structure is of particular significance.[135]

The corporate sector in Saudi Arabia is highly concentrated, as ownership is dominated by large investors, namely the state, families, and other large institutions that possess large blocks of shares. Thus, this chapter addresses the issues associated with all types of ownership structures in the context of Saudi corporations. In addition, this chapter reviews and evaluates different definitions of family firms from various perspectives, discusses the problems associated with the agency costs that stem from family-concentrated ownership, and describes the advantages of adapting succession planning, which may help reform corporate governance in Saudi family firms. In addition, Saudi state companies suffer from weak performance because the state does not implement effective regulatory policies for its firms. Thus, analysis is conducted in order to develop suitable instruments for governments and regulators to improve the regulatory framework for Saudi state-owned companies. Furthermore, the preceding chapter investigated the legal structure used for addressing foreign involvement in listed companies in the kingdom in order to develop proper reform that eliminates any restrictions to the presence of foreign investors in the Saudi corporate sector, thus improving the investment climate for them.

[134] La Porta (n14) 4
[135] M Jensen and W Meckling, 'Theory of the firm: Managerial behavior, agency costs, and ownershipstructure' (1976) 3 Journal of Financial Economics 469, 479

Ownership structure is categorised into two principal kinds according to how common shares are disseminated in connection with shareholders' voting entitlements.[136] The first of these ownership structures is where dispersed corporate ownership is common; whereas the second is where the ownership of companies is dominated.[137] If common shares having voting entitlements are disseminated among several small shareholders, each of whom owns a small number of company shares, ownership is dispersed. In contrast, if significant proportions of shares with voting entitlements are disseminated among groups of shareholders, ownership is dominated. Both concentrated and disseminated ownerships could generate agency difficulties in the case of unsuitable dissemination of control and ownership and weak supervision.

Ownership that is disseminated restricts the incentive of shareholders and their ability to participate in monitoring procedures, since such procedures are time consuming and expensive.[138] It is not unexpected if disseminated shareholders do not participate in monitoring, since high costs could exceed their residual entitlements of a company's profits. Dispersed ownership emphasises agency expenses as a result of shareholders' weakened motivations to supervise their investment due to the intrinsic collective action restrictions and the free rider issue.[139] In this situation, the information gap between managers and shareholders is widened by separating control and ownership in disseminated companies. This can result in severe conflict of interests between managers (agents) and shareholders (principals).

Nevertheless, in nations where concentrated ownership predominates, the number of shares which assertive shareholders own enhances their motivation to increase their activism. There is a greater possibility that assertive shareholders with sizeable control will participate in the activities and make important decisions regarding the company's policies. Nevertheless, the conflict of interest between controlling and minority shareholders is the principal difficulty.[140] The controlling shareholders' opportunistic behaviour may include failure to pay dividends, freezing out transactions and seeking non-profit maximisation aims of major investors.[141] Due to the aforementioned

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[136] R Aggarwal I Erel, M Ferreira and P Matos, 'Does governance travel around the world? Evidence from institutional investors' (2010) 100 (1) Journal of Financial Economics 154, 155

[137] ibid

[138] D Diamond, 'Financial Intermediation and Delegated Monitoring' (1984) 51 (3) Review of EconomicStudies 393, 410

[139] McConnell and Servaes (n81) 597

[140] M Ferreira and P Matos, 'The Colors of Investors' Money: The Role of Institutional Investors around the World' (2008) 88 (3) Journal of Financial Economics 1, 28

[141] ibid

ownership framework, nations in which the disseminated ownership structure is dominant need a different corporate governance approach from that needed by nations where the concentrated ownership structure dominates. Therefore, since the ownership framework could influence the effectiveness of other governance mechanisms in the capital market in Saudi Arabia, the objective of this chapter is to measure the effect of ownership concentration on Saudi corporate efficiency. It will explore the positive effects of having a dominant state and families monitoring a corporation, and weigh the potential negative effects resulting from ownership concentration in order to recommend a reform.

3.2 The Impact of the Separation of Ownership and Control on Saudi Companies' Accountability

The separation of control and ownership is a term that refers to a publicly held corporation in which the shareholders have little or no direct control over the management.[142] Since the case of Salomon v Salomon, the concept of such separation became the main character of the corporation when Salomon transferred his business to Salomon Ltd and incorporated his shares with his family. Later, when the company failed and went into liquidation, Salomon was entitled to obtain security against debt and was free from any liability; the liquidator pursued to overlook the separate personality of Salomon Ltd., and to make Salomon personally liable for the company's debt. Therefore, the issue was whether, regardless of the legal separate personality of a company, a shareholder or controller could be held liable for its debt, so as to expose an individual shareholder to personal liability. The House of Lords, however, ruled that the firm was properly incorporated and regarded as an independent personal identity with its liabilities, and also stipulated that Salomon was not liable for the loss as the corporation is independent from his involvement in the management. This case is

[142] E Fama and M Jensen, 'Separation of Ownership and Control' (1998) 26 The Journal of Law and Economics 1

considered illustrative of the concept of the separation between control and ownership.[143] In other words, this case indicates that a company has a separate legal personality, being independent from its shareholders' identity. Hence, any obligations or liabilities of a company are distinct from those of its owners.

Listed corporations have too many shareholders, making it impossible to have the shareholders manage the firm directly. Therefore, separating the ownership from management becomes essential and allows for the continuity and stability of management without a direct effect resulting from changes of ownership, which would enable the firm to be run by professionals who possess diverse skills. Thus, the whole notion behind this concept has always been that it offers shareholders an opportunity to invest in a company without any engagement in the day-to-day management.[144] However, this does not exclude owners from influential activism.Shareholders occupy a vital position in the company and have a wide range of powers to act collectively when disciplining and monitoring the company.[145]

Jensen and Mecckling argued that the separation of control from ownership creates the agency problem, motivating managers (the agents) to maximize their interests at the expense of shareholders (the principals), and does not give managers the incentive to run the business in the same manner as owners would, thus making the management operate inefficiently.[146] It has been stated that managers' and shareholders' interests are not always identical; consequently, the agency difficulty can exacerbate issues. The effect of managerial malpractice on the firm's value can be threatening, because managers could exploit corporate opportunities, obtain extravagant remuneration, and get involved in self-dealing transactions.[147]In addition, agency costs may result from the expenditure of monitoring the management and from the residual loss resulting from the divergence of interests between owners and managers.

143 Salomon v A Salomon & Co Ltd (1897)
144 D French and S Mayson and C Ryan, *Mayson, French and Ryan on company law* (Oxford UniversityPress 2013) 94
145 R Nolan, 'Indirect Investors: A Greater Say in the Company?' (2003) 3 Journal of Corporate Law Studies 73
146 Jensen and Meckling (n135) 479
147 ibid

There are not satisfactory laws in Saudi Arabia that specify the process via which directors should be nominated. Resultantly, the controlling shareholders wield significant power in terms of the nomination and appointment of directors who uphold their interests. Additionally, Saudi Companies are not obliged to distribute notices showing who the shareholders have nominated, and nor is it compelled to furnish biographic information of the nominees. The structure of the director nomination process means that the rights of minority shareholders are contradicted. In practice, nomination rights are purely afforded to controllers. In fact, the only contribution that minority shareholders can essentially make is to decide whether they approve or disapprove of the candidates that the controlling shareholders have nominated.

Certainly, it is probable that the rights of shareholders in terms of appointing and removing board members will be questioned, particularly in the context of Saudi listed corporations that have an ownership framework that is concentrated. This is because the Saudi Arabian Government and prosperous families are significantly influential with respect to appointing and removing the board members of numerous listed corporations in the country. For this situation to be improved, reforms should be implemented to dictates how directors are appointed. Amendments should be made to the regulations governing the distribution of nomination notices to guarantee the protection of minority shareholders' nomination rights. It is also recommended that the process by which board members are appointed and removed is detailed in the articles of association of the corporation. These recommendations will be discussed in depth in the next chapter.

3.3 The Impact of Ownership Concentration on Saudi Firm Accountability

Concentration ownership indicates the amount of equity belonging to large-block shareholders who hold at least 5% of stock ownership in a listed company.[148] According to this definition, Saudi Arabian ownership is heavily concentrated, as Saudi listed companies are dominated by government, families, banks, and other institutions. The impact of having concentrated ownership is debated in the literature. Some scholars perceive it as an undesirable form of ownership because of the potential of increasing the risk of minority expropriation. On the other hand, there are some scholars who are in favour of ownership concentration and regard it as animportant internal mechanism

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[148] G Gutierrez and T Philippon, 'Ownership, Concentration, and Investment' (2018) 108 American Economic Association 432, 434

to enhance the performance of management. A high level of concentrated ownership by large holders is the result of a stronger monitor over management decisions due to the high incentive from these investors to safeguard their interests.[149] Large owners who possess significant shares could use their powerful influence and their voting power to influence the process of election to the board of directors or the replacement of a CEO and other senior managers. In fact, both arguments regarding the positive and the negative impact of concentrated ownership on company performance are justified in the literature, and both have merits depending on the concentration level, the kind of investors.

Nations that have the best quality of investor protection, such as those with origins in the common-law tradition, tend to have less concentration. This is opposite to the civil-law tradition, where ownership concentration is extremely high due to the wealth protection that concentrated shareholders enjoy.[150] La Porta et al. (1999) used data from large firms in the 27 richest countries in order to classify the ultimate controlling owners of those corporations. They found that more than one-third of large firms in these developed nations; for example, the United Kingdom and the United States, were widely distributed. The rest, especially in emerging countries, fell under the concentrated ownership category.[151]

In contrast to the US and the UK ownership structure which is classified as dispersed ownership., Saudi Arabia is characterized by concentrated ownership; this resembles the dominant structure globally, especially in the continents of Europe and Asia.[152] In Saudi Arabia the percentage of concentrated ownership, whether by families, state or other groups, exceeds 70% of all the shares in the Saudi capital market.[153] The high concentration proportion in the kingdom is caused by various elements: there is less liquidity in the hands of Saudi citizens to invest on a large scale in the capital market; the state has a tendency towards investing in its economy; there is an increase in the number of large institutional investors, including banks and hedge funds; an inherited family ownership tradition, all of which lead to concentrated ownership.[154]

[149] Vintilă and Gherghina (n121) 177
[150] La Porta and others (n14) 4
[151] ibid
[152] J Doh and S Stumpf, *Handbook on Responsible Leadership and Governance in Global Business* (Edward Elgar Publishing 2005) 65
[153] W Alajlan, 'Ownership Patterns and the Saudi Market' (2004) 9 Advances in Financial Economics 161, 177
[154] Alazzani (n5) 872

3.4 Controlling Shareholders Fiduciary Duties as Measure to Enhance Firm Accountability

It is not sufficient to hold only executives and shareholders accountable for violations of fiduciary responsibilities while ignoring the role that controlling shareholders play. The imposition of fiduciary responsibilities on controlling shareholders is aimed at ensuring equity; principles of proper purpose; controlling shareholders do not abuse their powers and good faith.[155]

An analogous case is that of Clemens v. Clemens Bros. Ltd.[156] In this case, the plaintiff and her aunt, Miss Clemens, owned the company. In terms of the percentage of shares owned, 55 percent were owned by Miss Clemens and the remaining 45 percent by the plaintiff. Miss Clemens made the decision to raise capital via the issuance of newshares to company directors who held no shares. It is unsurprising that the proposed increase in capital was approved at a general meeting by Miss Clemens. The plaintiff opposed this action as its effect would be to reduce the plaintiff ownership to 25% with the aim to deprive her from her position to have 45% of the votes. While the court ruled that the resolution served the company's best interests, it adjudicated that the resolution's objective was to ensure that the plaintiff was denied a degree of control within the firm, which resulted in his dismissal. Consequently, in this situation, Miss Clemens was denied the opportunity to impose her majority vote as she pleased.

The aforementioned case demonstrates that there is no overriding principle that governs how the power of majority shareholders should be limited. It is generally accepted that each case that falls into this category is different. Hence, when reviewing majority shareholding voting, the court conducts assessments based on specific facts.[157] However, the primary concern of the court when constraining the power of majority shareholders is not elusive. In the abovementioned case, the courts preferred to evaluate whether the voting power of shareholders was being utilised for a "proper corporate purpose". Therefore, the presence of "proper corporate purpose doctrine" in controlling the shareholders' voting powers within the United Kingdom is clear.

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[155] J Coffee and C John, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 The Yale Law Journal 1, 9

[156] Clemens V. Clemens Bros Ltd (1976), 2 All ER 268

[157] R Flannigan, 'Fiduciary Duties of Shareholders and Directors' (2004) Journal of Business Law 277, 278

In the United States, particularly with respect to the Delaware case law, a series of loyalty assignments have been developed for controlling shareholders. US law acknowledges the fiduciary responsibilities of majority shareholders. The approach that courts adopt in adjudicating fiduciary cases is analogous to that taken in the aforementioned corporate opportunity case. In the case of Weinberger v. UOP INC,[158] an "entire fairness standard" was developed by the Delaware judiciary in cases pertaining to the fiduciary responsibility of controlling shareholders. Whereby a parent company purchased the minority ownership of a subsidiary. The court decided that the price was fair, there was a proper purpose for the operation, and the parent firm had no fiduciary duty to minority ownership. Two tests are included in the standard: fair price and fair dealing. For a controlling shareholder to demonstrate thata given transaction was completely equitable to both the company and its minority shareholders, it should satisfy the court that the transaction was performed at a "fair price" and that it was achieved via "fair dealing".[159] Nonetheless, the judgement as to whether fair dealing and a fair price have occurred is primarily reliant on the facts presented and the discretion of the judge in the given case.[160] The responsibility to prove that the transaction is fair is only transferred to the majority shareholder if proof can be provided that the decision made by the majority represents objectivity.[161]

In the context of Saudi Arabia, controlling shareholders in public listed companies have fiduciary responsibilities. Such shareholders are required to show good faith to the company and minority shareholders.[162] Nevertheless, company law in Saudi Arabia does not contain a "proper purpose test" in its legislation similar to that which exists in UK law. The only law that addresses this matter stipulates that a block-holder must not"use his controlling position to injure other shareholders' interests".[163] However, the excessive demands placed on block-holders by this doctrine make it difficult to obey. It is extremely challenging to achieve complete homogeneity in terms of the interests of different shareholder groups, particularly in public-held firms that have a state shareholder, institutional investors as well as portfolio shareholders. It is natural that these types of shareholders may vote to promote their best interests instead of those

[158] Weinberger v. UOP, Inc., 457 A.2d 701 *(*Del. 1983

[159] I Anabtawi and L Stout, 'Fiduciary Duties for Activist Shareholders' (2008) 60 Stanford Law Review 9

[160] Z Cohen, 'Fiduciary Duty of Controlling Shareholders: A Comparative View' (1991) 12 Universityof Pennsylvania Journal of International Business Law 379, 382

[161] ibid

[162] Saudi Company Law 2015, Article 110

[163] ibid

of other shareholder groups. Consequently, this doctrine should be narrowed down into a form that has increased precision and accuracy. This can be accomplished through the establishment of a general principle according to which majority shareholders, whose voting power allows them to control decisions made at general meetings, should utilise their votes for a “proper purpose". According to this precept, even when the controlling power of the majority harms a minority shareholder, this will not be considered a violation of their duties if their controlling power is employed for a "proper corporate purpose".

3.5 The Impact of Family Ownership on Saudi Firm Accountability

The Saudi Arabian economy relies heavily on family firms, since these firms possess the majority shares of most companies operating in the Saudi Kingdom.[164] As this type of ownership plays a critical role in the Saudi national economy, the future of family firms will heavily impact the economy as whole. Currently, 95% of corporations in the Kingdom, both listed and unlisted, are owned by families, excluding oil production, which contributes 50% of the country’s GDP.[165] These rich families own approximately 75% of the stock market in the Saudi Kingdom.[166] The concentration of shareholders in a handful of those families has enabled them to increase their wealth, as well as control over their companies. Indeed, the number of corporations owned by families in Saudi Arabia is higher than that of developed countries. Saudi firms have nearly double the family ownership of US and UK corporations.[167] Therefore, more focus should be allocated to Saudi family enterprises in order to improve the families’ behaviour if the country wants the performance of corporate family firms to prosper.

In order to evaluate family ownership in the Saudi kingdom, we should specify a definition and set a clear boundary between family and nonfamily ownership. Because families may not have similarities in their preferences for organizational characteristics, the determination of this concept is varied; therefore, no general consensus exits for the definition of a family company; however, the literature has revolved around the theme of the relationship between the management and the ownership. The definition

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[164] M Ramady and M Sohail, ‘Assessing the role of family business in promoting economic growth: perspectives from Saudi Arabia’ (2010) 10 International Journal of Entrepreneurship and Small Business

[165] A Abdallah and A Ismail, 'Corporate Governance Practices, Ownership Structure, and Corporate Performance in the GCC Countries' (2017) 46 Journal of International Financial Markets Institutions andMoney 98, 99

[166] MENA Family Businesses, *MENA Family Businesses: The Real Power Brokers?* (Masah Capital Management Limited, 2011) 47

[167] The Draft of a Corporate Governance Guide for Saudi Arabian Family Companies 2018, Article 1

presented by the Saudi Arabian Ministry of Commerce and Industry (MOC) in the Draft of a Corporate Governance Guide for Saudi Arabian Family Companies states that a family company is a company that owns all or the majority of the firm's shares and is controlled by a single family or a range of family members bound by special ties.[168] This definition is sufficient to clarify the boundaries of the domain of family business, because the Saudi draft of corporate governance of family firms meets the three criteria described in the literature, which include themanagement, the ownership, and the succession of a generation of families. This definition of family firms is acceptable and satisfactory to set the focus when discussing the issues of Saudi family firms.

There are several potential areas of difficulty inherited in family businesses. Roles and responsibilities are not clearly defined due to the lack of long-term planning and absence of organizational charts, which results from the family's resistance to structuring their firms in a formal way. Another disadvantage of having a family business structure is that there is no separation between family relationships and business relationships; family members cannot keep their family issues out of business issues; rather, they view business and family life as one and manage the firm accordingly. In addition, due to the concentration of family ownership and family employees, the lack of outside opinions and the absence of diversity at the management level is apparent.[169] Other scholars have criticized family enterprises for giving family members some benefits and compensations that are not given to other non-family members. In addition, some agency theorists argue that agency costs in family-owned business appear because managers act merely for the dominant familyat the cost of the interests of other shareholders, thereby promoting a nepotistic culture which leads to minority ownership expropriation. Moreover, others explain that when family business leadership moves to the second generation and beyond, performance in the company is likely to be affected negatively.

On the other hand, other scholars advocate that active owners such as family shareholders act as an effective mechanism to mitigate agency difficulties caused by the overlapping role of owners and managers at the control level in enterprises.[170] It has been argued that families who own businesses have longer strategic investment

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[168] Ibid

[169] P Westhead and C Howorth, 'Ownership and Management Issues Associated with Family FirmPerformance and Company Objectives' (2006) 19 Family Business Review 598, 606

[170] E Chell and M Karataş-Özkan, *Handbook of Research on Small Business and Entrepreneurship* (EdwardElgar Publishing 2014) 33

horizons that can alleviate managerial conflict and opportunism and can introduce connections that provide dynamic capabilities.[171] Family companies have distinct features that can produce important competitive advantages. Family members are committed and driven by a deeper bond, which gives family businesses an advantage by fostering loyalty and devotion to the firm among its employees.[172] lastly, concentration of family ownership is advantageous, because monitoring expenses are lower in family companies than in non-family ones. This is due to the fact that there is no need for families to consume time and resources while monitoring the behaviour of agents in the same family. In addition, trust, wealth, honesty and detailed knowledge eliminate any level of diversification between family members, limiting unnecessary agency costs as a result.

As a consequence of this mix result of the advantages and shortcomings of family ownership of firms, one may claim that the positive correlation between family ownership and control is varied, depending on the level of the concentration and the rate of capitalization. If family ownership in a company is heavily concentrated, expropriation can potentially occur due to majority control.[173] On the other hand, if family ownership in a company is less concentrated, expropriation may not be probable.

Possession of considerable shares, as well as involvement in the management, is common in Saudi Arabia family firms. In listed Saudi family firms, as well as closed family businesses, most leadership positions are held by family members who are largely incompetent and lack professional management. They have low levels of expertise in specialized areas, and usually these members cannot be fired; as a result, their negative performance reflects the lack of professional management. Family members may lack skills such as dealing with complicated financing or marketing, particularly when the family business grows and becomes complex.[174] Families workingin the business usually are not strictly supervised or monitored due to their close relationships, accompanied by cultural customs which say that monitoring family members in charge of the business is shameful or inappropriate. In Indeed, favouritism among relatives in Saudi-held family businesses is common, and family managers entitle themselves to privileges that can

[171] S Newbert, *Small Business in a Global Economy: Creating and Managing Successful Organizations* (Praeger 2015) 74
[172] A Cadbury, *Family Firms and their Governance Creating Tomorrow's Company from Today's* (EgonZehnder International 2002) 2-7
[173] M Soliman, 'Ownership Concentration and Firm Financial Performance - Evidence from Saudi Arabia'(2013) Arab Academy for Science –Technology, SSRN <https://ssrn.com/abstract=2257832> Accessed 12 February 2020
[174] W Jr, 'Integrating Professional Management into a Family Owned Business' (1989) 11 Family BusinessReview 221, 224

generate agency costs.[175]

In addition, many Saudi family companies experience breakdown caused by family conflict. Anees Ahmed (CEO of SEDCO) stated that many family firms that possessed particularly effective business paradigms and good organization, but were ruined as a result of conflict at ownership level.[176] This dilemma has recently concerned lawmakers in the Saudi Kingdom, due to the percentage of bankrupted companies resulting from family conflict. SR 15 billion in family firms are frozen in Saudi Arabia due to disputes among family members after the deaths of their founders.[177] Not surprisingly, when a family firm becomes a battleground, it can hinder communication among the members running the business and limit the decision-making as a result.

Proper succession plans are absent from most family-owned businesses in Saudi Arabia. According to a family business review in the MENA region including Saudi Arabia and other Arab countries, seven out of ten family-owned corporations fail to make the succession to the second generation, and only one in ten make the transition to the third generation.[178] Reluctance to let go is a cause of failure to appoint asuccessor. Leaders of family companies are emotionally attached to the business and unwilling to lose social status; thus, they have a tendency to occupy a leadership position even after retirement. Even though, their presence may hinder active business development.

In Saudi family corporations, changing leadership can potentially trigger several issues that family firms must tackle. For instance, most family firms in Saudi Arabia are in favour of passing on the business to the eldest son through traditional succession, regardless of his qualifications. This conservative tradition forces eligible members away from engagement in the succession process. Miller stated that one of the main reasons for succession failure is a personal tradition, as preference is usually given to elder sons to take over the business regardless of their proficiency.[179] Consequently, managing sibling relationships and solving the inherited tradition of appointing the eldest son to leadership positions in firms are essential for family firms to settle. As a result of this,

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[175] W Schulze, M Lubatkin and R Dino, ‘Toward a theory of agency and altruism in family firms’ (2003) 18 Journal of Business Venturing 473, 475

[176] Family Business in Saudi Arabia: Role Model for Corporate Governance, (2015) <http://www.marcopolis.net/family-business-in-saudi-arabia-role-model-for-corporate-governance.htm> Accessed 27 May 2020

[177] Saudi Arabia Billions Frozen in Family Disputes (2012) ARAB NEWS, <http://www.arab news.com/billions-frozen-family-disputes> Accessed 28 May 2020

[178] MENA Family Businesses (n166) 48

[179] D Miller, L Steier and L Breton, ‘Lost in Time: Intergenerational succession, change, and failure infamily business’ (2003) 18 Journal of Business Veturing 413, 414

agency difficulties in family-owned companies become more difficult to solve, since connections between agents (family CEOs) and principals (family owners) will probably be according to informal linkages, sentiments and emotions rather than formal principles and regulations. Furthermore, irrational strategic decisions, generational envy and rivalry among siblings could cause the company to incur greater costs.[180]

The challenge usually increases when the Saudi corporations goes to the third generation, due to the weakness of family ties. In the third generation, many families appear under other family names; therefore, one company may be divided into different family names. In this stage, family property in the company is shared by a considerable and growing number of family members who have several different interests. This leads to a conflict of interest and also to a negative relationship between company performance and family ownership.[181] This could make the new families minority owners in the business and either make them uninterested in being involved in the management or increase their tendency to sell their shares. This explains why Saudi family firms vanish and deteriorate faster at this stage.

Saudi family enterprises in general have fewer internal formal governance structures and conflict management processes in place than those of global family companies.[182] For this reason, establishing a written framework for internal governance, which often assumes the form of a family charter, is an important stage in implementing governance inside the firm. Forming written guidelines can positively affect family performance. A family charter should clearly outline the family company's structure direction. The interior family governance framework must be formally rewritten with more flexibility, as families with tremendously rigid boundaries find it difficult to persist.[183] For example, allowing individual family members to come in and out by selling their shares is essential, and well-defined exit agreements are crucial for the stability of family enterprises.[184]

Moreover, the importance of having robust family succession planning is more widely recognized. Succession planning is defined as the cautious formal process that facilitates

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[180] J McGuire, S Dow and B Ibrahim, 'All in the family? Social performance and corporate governance inthe family firm' (2012) 65 (11) Journal of Business Research 1644

[181] J Chrisman, J Chua and P Sharma, 'Trends and directions in the development of a strategic management theory of the family firm' (2005) 29 (5) Entrepreneurship Theory and Practice 555, 557

[182] The Pearl Initiative and PwC, 'family matters governance practices in GCC family firms' <http://pearlinitiative.org/mediafiles/articles/doc-181-20160512063511.pdf 8> Accessed 11 March 2020

[183] P Sharma and C Salvato, 'Family firm longevity: A balancing act between continuity and change' (2010)The Endurance of Family Businesses: A Global Overview 35

[184] E Burton, *Business and Entrepreneurship in Saudi Arabia: Opportunities for Partnering and Investingin Emerging Businesses* (2016) John Wiley and Sons 22

the transition of control from one generation to the next.[185] However, there is no one solution that fits all firms. Succession planning depends on the type of firm as well as its needs, values, and characteristics. However, ensuring strong strategies and successful planning is essential; however, it will not work alone. Family firms cannot survive without coalition and coherence between members. Mutual respect between afamily business and any members who are involved in management, along with minimization of rivalry and tension, is necessary for long-term stability.[186]

To tackle the abovementioned family firm issues, introducing optimal guidance to family firms for addressing particular corporate governance matters that emerge from their specific business environment can be beneficial for their accountability and longevity. Therefore, this thesis argues for an initiative that is driven primarily by the private sector, specifically for family firms. A form of self-regulation, as a legal regulatory mechanism, is highly suitable to the family corporate governance guidelinesand is differentiated from the 'one size fits all' method reflected by the more generic corporate governance codes.

In addition, in the family domain, the formation of what is known as a family council is regarded as being critical.[187] This council is primarily responsible for representing the family in the family enterprise. Also, its primary duty involves the organization of the family firm and its governance as well as drawing up details that show the stance of the family regarding the manner in which the family influence will be reflected within the company. The family council should be configured in such a way that it is representative of the entire family. A member of the family that has experience and broad respect, who ideally does not also have a senior role in the business side,[188] is normally recommended to be appointed as the chair of the council.

In addition, when the succession plan is being drafted, the skills, competencies and necessary character attributes that the new leaders need should be assessed so that the existing business can be effectively transferred to the future generation. The primary challenge for guidelines covering family business governance is determining the

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[185] P Sharma, J Chrisman and J Chua, 'Succession Planning as Planned Behaviour: Some Empirical Results' (2003) 16 Family Business Review 3

[186] M Morris and Others, 'Correlates of success in family businesstransitions' (1997) 12 Journal of Business Venturing 385, 390

[187] D Miller, L Breton-Miller and H Lester, 'Family firm governance, strategic conformity, and performance: Institutional vs. strategic perspectives' (2013) 24 Organization Science 189, 203

[188] A Idris, 'Cultural Barriers to Improved Organizational Performance in Saudi Arabia' (2007) 72 Society for the Advancement of Management, 10

relevance and manifestation of the succession procedure. If this procedure is to be planned and implemented effectively, this necessitates a united effort and continual collaboration of all aspects of governance within the family enterprise. It is essential that family enterprises have awareness of the significance of pre-determining the general terms and conditions that govern the transferal of shares.[189] This includes the establishment of additional transaction terms; for example, the family could have the right to obtain available shares to ensure that family ownership is upheld.[190] Moreover, allowing women to have access to the company, either by involving them in management or giving them a say in family meetings, will lead them to remain in the firm instead of feeling isolated and thus consider exiting the business.[191]

Furthermore, as the board is at the heart of the corporate governance process of family enterprise, the board chairman occupies a crucial function, and therefore it is essential that the appointment process is given due consideration. In addition to the requirements of the experience and qualifications, the selected individual should have significant respect among other family members to facilitate the process of communicating with the family and shareholders as well as reaching a level of agreement on issues that affect all aspects of governance in the family enterprise. In terms of the board configuration, allowing independent directors to have seats could be advantageous to the family enterprise and should be considered. They contribute to the family firms by providing balance and mediation to the board, particularly in cases where other members of the board have been recruited from within the family. Additionally, directors from outside the family often can introduce their own professional skills and experience in fields where the current board qualification is lacking.[192]

Another issue that triggers concern among corporate critics is that conflict between members of the family is not managed adequately.[193] Division or conflict in family enterprises can negatively affect the business continuity of such firms. This situation that is unique to family firms is the motivating factor behind the need for family companies

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[189] E George, '5 steps to planning for internal successors in a small business environment' (2013) 26(8) Journal of Financial Planning 4

[190] B Villalonga and R Amit, 'How do family ownership, control and management affect firm value?' (2004) 80 Journal of Financial Economics 385, 390

[191] Miller, Breton-Miller and Lester (n187) 203

[192] M Harvey and R Evans, 'Family business and multiple levels of conflict' (1994) 7 Family Business Review 331, 345

[193] C Cruz and M Nordqvist, 'Entrepreneurial orientation in family firms: A generational perspective' (2011) Small Business Economics 33, 36

to make a combined effort to agree, design and implement mechanisms forresolving conflicts when they occur. Therefore, guidelines covering the governance of family firms should emphasise the necessity to implement such frameworks for resolving conflicts.

In addition, offering a small family company the opportunity to have an alternative investment market (AIM),[194] as in that of the UK Market, which was established in 1995 as an alternative to the London Stock Exchange and was designed for smaller and growing companies, is advantageous to the Saudi family who wants to join the exchange market but chooses not to do because of the rigidity of its corporate governance policies. Thus, AIM allows such firms to join an alternative exchange market that has more flexible regulations than that of the main market exchange.

Going public and selling considerable shares to nonfamily members is also recommended. This can provide substantial cash flow, which could solve the slow growth caused by avoiding risk-taking decisions. It would also force companies to adopt and impose proper governance policies. The resistance from family members to selling to strangers, due to the fact that they want to keep control, would no longer be justified.

3.6 The Impact of Government Ownership on Saudi Firm Accountability

The definition of government ownership is important when evaluating this type of ownership in the Saudi context. The definition of government ownership is as follows: "enterprises where the state has significant control, through majority or significant minority ownership".[195] This definition has been chosen in this section due to its comprehensive coverage of all types of government ownership. In Saudi Arabia, although the government has transferred a considerable amount of its shares to the general public, it still has massive and influential investment in corporate enterprises. This began in 1990, when the Saudi government increased its shares in several firms due to the corresponding need to cope with underdevelopment in the Saudi stock market.[196] The large oil resource led to an enormous increase in the Saudi national GDP, and that growth motivated the government to diversify its investments and involve itself in enterprises.[197]

Currently, the Saudi government and its agencies own a high percentage of shares in the

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[194] R Power, 'Why the Alternative Investment Market remains a compelling market for growth companies' (2016) <https://www.octopusinvestments.com/adviser/adviser-centre/news-and-insights/why-the-alternative-investment-market-remains-a-compelling-market-for-growth-companies> Accessed 11 November 2019
[195] OECD (n83)
[196] Alajlan (n153) 177
[197] Alazzani (n5) 871

Saudi stock market. In addition, the firms whose shares the government owns are the largest in terms of the value traded and percentage of capitalization. Government investments are varied, but concentrate specifically on important sectors such as banking, petrochemicals, cement and real estate.[198] Also among these are oil and gas firms such as SABIC and the Saudi Arabian oil firm, Aramco, which is the largest such firm in the world.[199] Consequently, the government-owned enterprises in Saudi Arabia are considered the main players in the Saudi economy, and contribute heavily to the country's GDP.

An essential objective of reform is to transfer state-owned shares to foreign and private sectors. By transferring its shares to the private sector, the state will limit its function in managing stated-owned listed firms. Public ownership should no longer be dominant; it must be replaced by private ownership. The operation of state-owned corporations will be enhanced by diverse ownership from both the public and private sectors. However, the government is still unwilling to let go of its shares. The privatization process in Saudi Arabia is still slow. The Supreme Economic Council Approved Cabinet Decree 60 in 1997 to set a privatization strategy for Saudi Arabiaand described the steps to be taken to achieve these objectives.[200] This document initiated a set of eight objectives of privatization; however, since its creation, the document remains symbolic and few achievements have been made due to the lack of clear policies and a clear timeline, which are needed to accompany the document's objectives.

In addition, privatization was too large to be absorbed by a few local businesses and unenthusiastic foreign investors; this was accompanied by the lack of financial leverage necessary to get involved in such governmental projects. The ambitious objectives outlined in the privatization objective document failed to offer specific policies for ensuring achievement of these objectives. Such policies include setting a sustainable and gradual timetable for privatization to avoid wide governmental privatization without considering the inadequate availability of leverage and the limited absorptive capacity.

This thesis therefore advocates gradual privatisation of companies with national assets. State-controlled companies must be restricted to core areas in which the private sector is unwilling or unable to invest. It is therefore important that the Saudi government is

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[198] M Eljelly, 'Ownership and Firm Performance: The Experience of Saudi Arabia's Emerging Economy' (2009) 8 International Business and Economics Research Journal 25

[199] Saudi Stock Change, <https://www.tadawul.com.sa/wps/portal/tadawul/home/> Accessed 13 July 2020

[200] Cabinet Decree 60, August 6, 1997

aware of the benefits that can be accrued from permitting privatisation at a level that will increase the accountability of stated-owned listed companies and enhance efficiency. Most notably, reducing the role of the government in the economy will motivate the private sector to participate and help reduce the fiscal deficit.

Thus, in order to avoid setbacks and to overcome any delay in achieving this objective, regulatory provisions must be introduced. These provisions include the necessity for the corporatization of the target sector before privatization in order to restructure the intended governmental agency and to ensure proper contract design as well as an appropriate regulatory framework. Moreover, the government should not privatize essential services completely; rather, the government should have partial ownership of some essential firms to ensure stability, to safeguard the welfare of citizens. The government should sell their majority shares of any firm to be privatized in order to offer autonomy to the management, while at the same time retaining considerable minority shares in order to have a say in board meetings and prevent abusive dealings that would affect the national wealth distribution.

To guarantee wide private investors and to avoid letting important sectors belong exclusively to a small group who may exploit these essential services, the government must sell these privatized companies by listing their shares on the capital market exchange, which has considerable corporate governance and not through partnership, which is not sufficiently monitored by clear governance policies. Moreover, there should be a policy to ensure that firms intended for privatization operate on a commercial basis and to follow market standards in terms of selection of management and the pursuit of profitability.

The intent behind the constant governmental involvement in corporate enterprises is to maintain possession of this important source of income, in order to safeguard essential utilities that are important to national security. Nowadays the Saudi government, through its agencies, is virtually the sole provider of all essential services for its citizens such as education, healthcare, water, electricity and housing. The Saudi government cares about the welfare of its citizens more than about developing its utility companies that are intended to be privatized; as a result, various subsidies and enormous financial incentives such as direct cash grants, interest-free loans, bailouts, and low cost of water, fuel, and electricity have been granted to Saudi state-owned firms so these companies can sell their products below the market level.[201] For instance, the Saudi Kingdom issued subsidies to its electricity company that were worth 150 billion Riyals during the 2013 fiscal year.[202]

For this reason, Saudi government social support would create a heavy burden on the state budget and would weaken the potential for economic growth. In addition, the last years show that the kingdom's oil-based revenue has decreased dramatically and cannot continue to keep up with these expenditures.[203] As consequence, state subsidies have made the firms which are earmarked for privatization accustomed to government aid. Consequently, continued dependence on state support rather than onprofit-seeking behaviour makes these governmental utility firms unattractive to businesses for involvement in privatization. Indeed, there is a heavy burden on the Kingdom's budget to continue meeting these needs; therefore, it must transfer key sectors to private companies to operate in a competitive, efficient and profitable manner while maintaining a fair cost.[204]

A golden shares provision would be useful if adapted and implemented in Saudi Arabia to ensure the stability of public service-providing companies.[205] 'Golden shares' is a term describing special voting rights that are usually given to the state upon the transition of its owned company to a stock company, particularly when only owning minority shares. These rights include veto power to prevent changes to the corporation charter, the right to issue prior approval of any new owners who want to acquire shares beyond a set of limited shares or upon making strategic decisions such as dissolution, and the right to block takeover, especially when the government wants to prevent the sale of essential corporations overseas or to competitors who engage in anticompetitive behaviour.[206]

The term 'golden shares' has been used historically for many years in the UK, especially during the privatization movement of the 1980s, as a strategy to guarantee the movement's stability.[207] Thus, the purpose of the golden right is to ensure a smooth transition from state ownership to private business and to stabilize the process of

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[201] T Kuruvilla and M Fischer and C Kreymborg, 'Preparing for privatization in the Middle East' (2011) privatization in the Middle East 65, 67

[202] N Taher and B Al-Hajjar, *Energy and Environment in Saudi Arabia: Concerns and Opportunities* (2013) Springer Science and Business Media, 14

[203] IMF Country Report 'Saudi Arabia Selected Issues' (2016) International Monetary Fund 32

[204] M Ramady, *The Saudi Arabian Economy Policies, Achievements, and Challenges,* (2nd edn,Springer science +Business media, 2010) 15

[205] M Moran and C Prosser, 'Privatization and regulatory change in Europe' (1994) 71 International Affairs 171, 172

[206] Big Society Capital, 'How golden shares can help lock in mission for social enterprises' (2015) Hogan Lovells

[207] J Bekkum, 'Golden Shares: A New Approach' (2009) 7 European Company Law, 11

privatization in the face of unpredictable circumstances, while allowing companies the freedom to operate day-to-day management as they prefer. However, the golden shares approach has been criticized for limiting the flexibility of the company management and being controlled by state wishes, which are not necessarily for the pursuit of financial benefit but rather for meeting the citizens' social needs.[208] Moreover, opponents claim that the golden shares approach increases the uncertainty and expectation of the possibility that the state will make decisions in an unpredictable manner.[209] Others have described the approach's negativity regarding share prices and deterrent of foreign investors, who get discouraged by the special privileges that are given to the government, which contravene the free market principle.[210]

Despite this critique, the golden share approach remains useful for protecting national security and employment interests;[211] and would be more acceptable if it were narrowed and defined more clearly. Consequently, the provision of golden shares must be limited to a pre-determined period of time such as five or ten years, to give the company sufficient time to be stably privatized. The golden share must then be removed after being sure of the propriety of its operation, in order to allow the company to make its own decisions in the future. Also, the provision of takeover right must be limited and should define who may need government approval before proceeding in the process and determine whether those acquisitions are foreign or local and whether they are competitors. The right to obtain the approval of strategic decisions also must be well-defined to prevent state interruption and hindrance of decision-making.

The combination of having ownership advantage while holding a managerial position is often considered to be the main challenge facing state-owned enterprises in Saudi Arabia. The Saudi government usually appoints state officials or administrators through the Ministry of Finance or the Saudi investment fund, such as the case of SABIC, where most directors were nominated by the sovereign fund agency.[212] This kind of nomination leads to inefficiency, because allocations are motivated by political agenda, nepotism and favouritism rather than the manager's qualifications or experience. It has

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[208] E Lim, 'Concentrated Ownership, State-Owned Enterprises and Corporate Governance' (2021) Oxford Journal of Legal Studies 663, 664

[209] OECD Directorate for Financial and Enterprise Affairs, *Corporate Governance: Relationship of State-Owned Enterprises with Other Shareholders* (OECD Publishing, 2007) 18

[210] OECD, *OECD Reviews of Regulatory Reform Regulatory Impact Analysis: A Tool for Policy Coherence* (OECD Publishing, 2009) 18

[211] OECD, *Privatizing State-Owned Enterprises an Overview of Policies and Practices in OECD countries: An Overview of Policies and Practices in OECD countries* (OECD Publishing 2003) 41

[212] 'Saudi Basic Industries Corporation (SABIC) Corporate Governance Regulations' (2013) 7 SABIC Board Resolution

been stated that trying to hold a state-nominated board of directors accountable without giving them full autonomy is pointless, due to their lack of independence.[213] Political officials in Saudi Arabia remain heavily involved in the day- to-day management of state-owned companies. Though not qualified to do so, these officials frequently interfere in company decisions, thereby making other managers think more politically rather than commercially. Therefore, giving more autonomy to the management of state-owned enterprises would result in fruitful performance that follows market principles. Many regulators in the Kingdom are calling for giving boards of directors more autonomy, freeing them from pressure.

Therefore, to resolve these structural challenges, it is proposed in this thesis that ensuring the levels of state-owned companies independence would assist in resolving the inconsistency between powers and accountabilities. Thus, to ensure that boards remain independent, it is essential that the relationships among the government and corporate boards are suitably reorganised at distinct levels of the new structure. This thesis contends that in such companies where there is a direct connection between the government and the board, the supervision should still be provided by the government. This thesis argues that the performance of listed companies can be improved if the level of government intervention is reduced. Ensuring that such companies retain their independence when participating in the market will assist with promoting market conditions that are strong and equitable. This is due to the fact that only directors who have independence, chosen from the pool of professional managers according to their past performance and experience in the field, are capable of objectively balancing the interests of all parties when making decisions, which includes those of minority shareholders. Hence, a higher proportion of board member sought to be independent directors.

Conversely, directors who represent the government on the board could enable the government to identify misconduct in the decision-making procedure as well as to intervene in order to prevent harm being done. Nonetheless, limitations should be placed on the number of such directors. Therefore, this thesis suggests that directors representing the government should constitute a maximum of one third of the total board members, which is regarded as being sufficient to ensure that the government receives timely information on the corporation. This type of system is fundamentally

[213] M Shirley and J Nellis, 'Public Enterprise Reform the Lessons of Experience' (1991) The International Bank for Reconstruction and Development, The World Bank 10

intended to ensure that all interests in the boardroom remain balanced. Directors connected to the government are responsible for public management, whereas those that are independent add their professional expertise and experience to the board so that decisions can be made more efficiently. Except for the specific conditions explained above, this thesis is against any governmental intervention in corporate matters. The power to make decisions in all other circumstances should be given to the board for the purpose of improving corporate independence and governance principles. Therefore, an increased number of professional managers with sufficient business acumen should be appointed to the boards of this type of companies. Consequently, decisions pertaining to companies matters should increasingly be the board's responsibility based on their impartial business judgement.

As previously mentioned, the role of the Saudi government in the capital market is twofold. It is responsible for administrating the social economy, managing public governance, acting as the representative investor for state-owned assets, and applying the legal rights of a capital provider. As a result of this complexity, in its role as a controlling shareholder, the government has multiple targets. Therefore, the law should place strict limitations on the rights that the government exercises. New rules should clearly delineate the definition and scope of significant matters in which the government ought to be engaged, which include specific fundamental issues, such as:
(1) formulating and amending the company's articles of association; (2) increasing or decreasing the authorised capital; (3) separating or merging the company; and (4) insolvency and dissolution.

In addition, it is necessary to establish a department at the ministerial level that will represent companies owned by the state and implement an external supervisory mechanism responsible for overseeing the performance of the board. Companies owned by the state could be supervised more effectively if such a legal entity is considered to be purely a monitor, instead of both a regulator and monitor. Such a governmental supervision body should be restricted from intervening administratively. This is due to the fact that performing two roles simultaneously could lead to significant issues; therefore, it is proposed by this thesis that when implementing the subsequent reform, the government should divide the dual roles that it plays.

The abovementioned legal body will be responsible for formulating the articles of association for companies that are fully owned by the state as well as making any necessary amendments; alternatively, the board of directors could formulate the articles and seek approval from this proposed body. Thus, the final decision regarding the substance of corporate constitutions still rests with the government. This decision-making authority allows the government to maintain control of the corporation at a higher level than that of the directors through its authority to formulate or amend the constitution of the company. Resultantly, in its role as the market regulator, the government should have no powers to intervene, veto, or amend the board's decisions through a legal process, apart from in situations where their decisions contravene the laws and administrative rules of the firm's articles of association.

3.7 The Impact of Foreign Ownership on Saudi Firm Accountability

The decisive effect of foreign ownership on corporate governance and company accountability can be attributed to several qualitative and quantitative factors which I shall assess in this subsection. With regard to this, the analysis which follows analyses the advantages and challenges of foreign ownership to enhance the accountability of corporate governance and to propose potential reforms.

The Kingdom has passed several laws to fulfil its commitment to enhancing foreign ownership. The Saudi Arabian General Investment Authority (SAGIA) passed the Foreign Direct Investment Law in 2000 to open the playing field for foreigners seeking to increase their participation in the Kingdom's market.[214] To show its commitment in attracting international investors, foreigners were given eligibility for foreign funding from the Saudi industrial fund, at up to approximately 50% of the cost of the project.[215] In addition, Saudi Arabia's membership in the World Trade Organization (WTO) makes the legal environment more stable, and raises the confidence and attractiveness of Saudi corporations to foreign investors by convincing them they will not lose their money unjustly.[216] To advance the liberation of the economy and open up the market to a broader diversification, the Saudi stock market issued the permission to Arab Gulf countries (GCC) to purchase and own shares in listed companies, treating them like local investors with full accessibility in accordance with the GCC agreement.[217] In pursuit of encouraging companies to attract foreign investment, the Capital Market Authority

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[214] Saudi Arabian General Investment Authority (2000) The Foreign Investment Act, <http://www.sagia.gov.sa/Documents/Foreign_Investment_Act.pdf>

[215] *Saudi Arabia Investment and Business guide* (International Business Publications, 2011) 105

[216] 'Foreign Investment In Saudi Arabia' (2020) <https://www.lawteacher.net/free-law-essays/company-law/foreign-investment-in-saudi-arabia.php?cref=1> Accessed 9 December 2020

[217] 'Saudi Stock Exchange Opens to Qualified Foreign Investors' (2015) Saudi Arabian Business Council, <https://www.cliffordchance.com/briefings/2015/05/saudi_arabia_opensstockmarkettoqualifie.html> Accessed 12 December 202

(CMA) released a law that opened the equities market to foreign ownership for the first time. Individual investors may own a maximum of 10% of the listed company, and 49% of overall foreign combined assets in any single listed firm,[218] which is still considered too low. However, it is advantageous for the Saudi stock market to raise the limit for a single foreigner to own up to 20% of aSaudi company's shares. Also, the current rule of the Saudi CMA allows overall foreign ownership of single company to not exceed 49% of the equity-listed company. This percentage of ownership classifies foreign investors as having minority ownership, which is not favourable. Foreigners investing in Saudi Arabia recognize that minority ownership only provides weak protection and they would prefer to own controlling stakes to strengthen their presence in the company. As a result, it is advisable and a game-changer to enable foreign investors to possess majority shares in a company, specifically in companies that do not provide essential services to Saudi citizens.

Additional issue is that in 2015, the CMA issued new adjustments to the eligibility criteria of qualified foreign investors (QFI) by lowering the minimum amount of managed assets that foreigners must possess in order to invest in the Tadawal (the Saudi stock exchange) from 5 billion to 500 million US $. Investors must also have a five-year investment record in order to be eligible for QFI status; furthermore, to qualify as a QFI, the organization must be a bank, fund manager, or insurance company.[219] However, whilst this change has ensured smooth implementation of the QFI framework, it has limited the percentage of foreign capital flowing into the Saudi exchange market. With this rigid restriction of the criteria, now only nine foreigninvestors are approved by the CMA to work as QFIs, which is considered a small number and not sufficient.[220] The tightness of regulations in restricting ownership and the minimum requirement for qualification of overseas direct investors was justified bythe Saudi government to prevent any risk of destabilizing the market; however, some claim that these restrictions are too stringent, and hinder foreign individuals from joining the market directly. There is a need for more QFI institutions to facilitate the entry and the involvement of foreign investors in the Saudi stock market. Hence, in order to increase those institutions' participation, it is recommended that the CMA should relax the criteria of QFI eligibility by reducing to a reasonable amount the minimum assets that the QFI organization must possess.

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[218] Saudi Stock Change, <https://www.tadawul.com.sa/wps/portal/tadawul/home/>_Accessed 14 December 2020

[219] Rules for Qualified Foreign Financial Institutions Investment in Listed Securities, 2015, Article 6

[220] 'Saudi Stock Exchange Opens to Qualified Foreign Investors' (2015) Saudi Arabian Business Council, <https://www.cliffordchance.com/briefings/2015/05/saudi_arabia_opensstockmarkettoqualifie.html> Accessed 21 December 20

Another obstacle that the Saudi exchange needs to address is the fact that Saudi Arabia has not yet been placed on international indexes such as the MSCI Emerging Markets Index.[221] This prevents the opportunity to attract managed funds; investors base their evaluation actively on that index, and make the decision to invest in a company or not based on the information given by that global benchmark. Membership in the above index would bring the Saudi equities market up to international standard. Additional matter is that tougher regulations, including requiring listed firms to publish their annual reports in English to ensure that foreign investors can understand them, would make the country's market more transparent and investor-friendly.[222] These reforms, among others, are likely to result in Saudi Arabia being characterized as a mature, dynamic, and responsive market that is attractive to prominent, sophisticated international players.

One final issue that foreign investors face in Saudi Arabia is the uncertainty in the case of disputes. Most foreigners, especially those who are not Arabs, lack an understanding of Sharia law, which is still unwritten in modern codification. Additionally, settlement of disputes is usually time-consuming. The Saudi government should not underestimate this crucial factor, which discourages foreign investors from engaging with Saudi corporations. When foreigners assess the investment climate,they are looking for certainty, and they want to make sure that a mechanism for dispute settlement is in place. Therefore, the Saudi state must respond to this issue and establish effective independent settlement machinery, such as promoting an exit arbitration clause. This would advance flexibility and offer both parties the opportunity to choose between laws, and to choose arbitrators that they have confidence in and who possess commercial knowledge.

The reason for the development of arbitration is to permit parties from various cultural and legal environments to solve either their cross-border or domestic disputes without having to resort to litigation. Companies have, at a growing rate, applied arbitration in order to resolve corporate disputes, inclusive of those involving shareholders. Furthermore, another basic benefit of arbitration which firms frequently quote is the option of selecting an expert decision-maker who understands the essence of the dispute and solves it efficiently and successfully. Parties can reach a mutual agreement

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[221] F sheikh, *The legal Regime of foreign private investment in Sudan and Saudi Arabia* (2nd edn,Cambridge University press 2003) 42
[222] R McGee, *Corporate Governance in Transition Economies* (Springer Science and Business Media 2008) 132

as to how to choose their arbitrator.

It has become more common for corporations to resort to arbitration as a means of settling corporate disagreements. Corporations can establish an agreement for the purpose of arbitrating disputes among shareholders through the adoption of a binding arbitration provision within its bylaws or charter. Consequently, in the event that either the charter or bylaws necessitate arbitration of shareholder disputes, enforcement of an agreement to arbitrate is required. Nevertheless, this leads to the question as to who has the authority to include the arbitration clause within the bylaws or articles of incorporation. In fact, the original incorporators are capable of drafting the articles of incorporation.

In the context of the United States, it is possible to enforce an arbitration provision whether examined according to Delaware law or the Federal Arbitration Act. Corporations are now routinely including mandatory arbitration clauses according to the Federal Arbitration Act (FAA) and such approaches are increasing in prevalence.[223] The FAA identifies the required elements of an arbitration agreement in addition to the procedural processes that courts should adopt when directing parties to arbitration.[224] Section 2 of the FAA governs issues pertaining to whether agreements to arbitrate are valid, irrevocable and enforceable.[225] This represents the primary statutory edict that demonstrates the intention of Congress to allow arbitration agreements.

Likewise, in the Delaware Code, arbitration is generally approved as a process for resolving disputes. Specifically, it is provided by Section 349 that "the Court of Chancery shall have the power to arbitrate business disputes when the parties request a member of the Court of Chancery, or such other person as may be authorized under rules of the Court, to arbitrate a dispute."[226] Additionally, the Delaware General Corporation Law (DGCL) indicates that corporations incorporated within the state have the ability to utilise their bylaws or articles of incorporation to mandate that arbitration should be implemented in disputes between shareholders and corporations.[227] Consequently, such provisions have resulted in arbitration being successfully enforced in a significant amount of high-profile disagreements. For example, a suit involving Johnson & Johnson

[223] Z Clopton and V Winship, 'A Cooperative Federalism Approach to Shareholder Arbitration (2018) Yale Law Journal <https://www.yalelawjournal.org/forum/cooperative-federalism-shareholder- arbitration> Accessed 23 December 2020
[224] ibid
[225] The Federal Arbitration Act 2014, S 2
[226] The Delaware Code 2014, S 349
[227] The Delaware General Corporation Law 2013, S 13

and Merck & Co. was recently settled via arbitration with the payment amounting to $500 million.[228] In another case, the recent dispute between Chevron and Venezuela regarding its programme of nationalisation resulted in a settlement of $250 million.[229]

It should be recommended by the Saudi Stock Exchange that firms who aim to appeal to foreign investors should stipulate within their bylaws that the resolution of disagreements that occur among shareholders and the corporation or among minority shareholders and controlling shareholders will be achieved via arbitration. Nevertheless, a provision could be drafted by a corporation to be only applicable to specific disagreements. For example, it may be applicable to every claim or only to particular types of claims pertaining to foreign investors. Similar to other contractual terms, it is possible to write arbitration clauses to satisfy the unique requirements of the parties.

The last approach a firm can adopt to improve its company level standard and increase its attractiveness from the perspective of foreign investors is to become listed on the securities exchange of a different country, defined as cross-listing. This can be beneficial for firms as it can enhance their corporate governance as they willingly choose to embrace the more robust regulatory standards necessitated by the foreign exchange.[230] According to scholars, there are various different factors that prompt firms to choose the cross-listing option. For example, investors can be attracted as a result of the enhanced protection for shareholders and disclosure, capital costs can be reduced, liquidity can be enhanced via expanded trading, the investor base can be diversified and grown, the firm will become visible within the host country, and it will have increased access to analysts within that country.[231] Therefore, to reflect its modernisation efforts, it is advised that the government of Saudi Arabia should provide companies with the ability to cross-list in international stock markets in order to attract foreigner ownership.

3.8 Shareholder Activism to Enhance Saudi Firm Accountability

It is generally assumed that as activist owners, shareholders are able to monitor managerial behaviour, thereby encouraging efficient corporate governance and

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[228] Wall Street Journal (2011) <http:/ /online.wsj.com/article/SBJOOO 142405274

[229] D Charlie and C Nathan, 'Venezuela Pays Exxon $250 Million to Settle Arbitration Case, Bloomllerg Business week' (2012) <http://www.businessweek.com/news/> Accessed 19 November 2020

[230] N Amir, 'Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform' (2004) 22 Berkeley Journal of International Law 59

[231] P Stephen and Others 'The Effect of Cross-listing on Corporate Governance: A Review of the International Evidence' (2009) 17 Corporate Governance: An InternationalReview 338, 339

enhance the Accountability in the corporate sector.[232] Shareholder Activism involves the act of supervision and the attempts by Shareholders to implement changes in companies' organisational control framework.[233] A shareholder activist can usually be defined as an investor who attempts to change the current situation by their 'voice' without changing the control of the company.[234]

Shareholders must have full capacity to practise their right to influence management decisions and enhance company performance. There are a variety of ways to practise this activism, most importantly during the general meeting. This is considered the proper platform for shareholder activism, where shareholders have the opportunity to effectively participate in making decisions in key corporate strategies and operations. It is also possible for institutional shareholders to exert an indirect influence through proxy voting, shareholder proposals, private negotiations and dialog, and media campaigns.[235]

A variety of shareholders, including institutional investors such as pension funds, hedge funds, social activist groups and others, are increasingly becoming activists.Their activism covers a wide range of activities, including writing letters to management, calling for meetings with boards and other managers, and asking tough questions at annual meetings.[236] Thus, shareholder activism can refer to a variety of shareholders' actions that influence and guide management members in the company.

Proponents of the concept of shareholder activism argue that companies with engaged shareholders are more likely to be successful in the long term. When companies perform poorly shareholder activists are said to play the role of fire alarms, and their presence results in limitation of managerial complacency.[237] Shareholder activism has become an increasingly effective force, creating pressure on corporate management toincrease company wealth and provide social services. The last two decades have seen remarkable development of this notion, with activist shareholders emphasizing and exerting

[232] M Rubach and T Sebora, 'Determinants of institutional investor activism: A test of the Ryan-Schneider Model' (2009) 17 Journal of Managerial Issues 245, 247
[233] M Smith, 'Shareholder activism by institutional investors: Evidence from CalPERS. Journal of Finance' (1996) 51(1) Journal of Finance 227, 230
[234] S Gillan and L Starks, 'A survey of shareholder activism: Motivation and empirical evidence' (1998) 2SSRN Electronic Journal 3
[235] S Gillan and L Starks, 'Corporate governance proposals and shareholder activism: The role of institutional investors' (2000) 57(2) Journal of financial Economics 11
[236] M Becht and J Franks, 'Returns to Shareholder Activism: Evidence from a Clinical Study of the HermesUK Focus Fund' (2010) 22 the Review of Financial Studies 3094
[237] N Gantchev, 'the Costs of Shareholder Activism: Evidence from a Sequential Decision Model' (2012)107 Journal of Financial Economics 1

pressure on the management of poorly performing companies to improve performance and enhance shareholder value.

On the other hand, there are scholars who are still debating shareholder activism because of the free-riding problem. The dispersed ownership structure of a large firm can create free riders, which can deter shareholders from managerial supervision, increasing individual passivity. The free-riding concept refers to when shareholders with only a small stake in the firm have weak incentive to monitor the management of the company due to the small gain they enjoy, which results in placing this burden on the shareholder who possesses significant stock to engage in costly monitoring.[238]

Moreover, there are other criticisms. For instance, Black argued that while it can solve the monitoring problems associated with held firms, it can also constitute a disruptive, opportunistic, and useless mechanism. Shareholders' Activism is also criticized for perceiving activism interests in divergent ways. That is because shareholder activists' agendas are sometimes inconsistent in terms of their different activities.[239] Furthermore, it is argued that the activists lack sufficient proficiency to instruct professional management, and their frequent interference makes it difficult for the management to conduct their job. In addition. The opponents of this type of involvement argue that It would also go beyond the wisdom of separating control from managers, and not enable those directors who have special expertise and are equipped to make suitable decisions to take director roles.

However, the rationale of shareholder activism is not to take director roles; rather, the fundamental rationale is to form defensive tactics against managerial abuse.[240] Though there are merits to these arguments, most of these criticisms are not necessarily valid. Shareholder activism does not mean shifting power from management to shareholders in order to undermine managers in the firm. It means shareholders obtain the power to review the managers' behaviours, and in cases where the management fails to perform, shareholders step in and use their influence in order to rectify wrongdoing.

[238] C Spatt, 'Shareholder Voting and Corporate Governance: Economic Perspectives' (2007) U.S.Securities and Exchange Commission, <https://www.sec.gov/news/speech/2007/spch042007css.htm> Accessed 18 January 2020
[239] A Anand, *Shareholder Activism* (peter lang 2009) 30
[240] I Chiu, *Foundations, and anatomy of shareholder activism* (Oxford: Hart Publishing 2010) 7

Institutional shareholders are seen as an effective mechanism, working collectively to undertake responsibility for monitoring management and advancing the performance of corporate governance. Institutions have greater motivation to take on this role, as they can afford the essential costs of monitoring and proposal submission.[241] Institutions possess specialized expertise and are equipped with influential power, involving themselves actively and collectively in this process. Additionally, proxy contests require considerable extra expense from active owners, including paying for, preparing and distributing proxy papers.[242] This makes it harder for individual owners to be involved in this process.

Since the report of the Cadbury Committee in the UK, and across the world for a large number of years, calls for activism by institutional investors have been increasing. However, Unfortunately, current Saudi Arabian institutional investors in the equity market tend to be passive, and rarely coordinate with each other. In Saudi Arabia, the regulatory framework has not encouraged such activism; neither has it been manifested in the investment practices of a range of institutional shareholders. Indeed, neither the Saudi CL nor the Saudi CGR has considered the importance of shareholder activism or acknowledged the vital role played by institutional shareholders as responsible investors striving to enhance corporate practice.

This situation contrasts sharply with US and UK companies, where coordination between institutions occurs jointly in order to intensify their influence in disciplining managers and introducing tight scrutiny.[243] In the UK, an essential transformation in the corporate governance system took place in response to the growing number of shares being held by institutional shareholders, especially insurance companies and pension funds who had become the most powerful actors in publicly-traded companies. This resulted in a series of reforms to the soft regulations that have been shaped by the UK corporate governance scheme and by UK company laws.[244] The corporate governance framework in the UK offers substantial support for institutional shareholder activism.

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[241] Gillan and Starks (n235) 10

[242] D Larcker and B Tayan, *Corporate governance matters: A closer look at organizational choices and their consequences* (2nd edn, Pearson, 2015) 61

[243] B Black and J Coffee 'Hail Britannia? Institutional Investor Behavior Under Limited Regulation' (1994) 92 Michigan Law Review 1997, 2007

[244] M Goergen, L Renneboog and C Zhang, 'Do UK Institutional Shareholders Monitor their Investee Firms?' (2008) 8 Journal of Corporate Law Studies 3

One notable regulatory enhancement has thus been to encourage institutional investors to play a more substantial role in corporate governance and engage more heavily in stewardship behavior, issued in 2010 and its recent revised version in 2012, the UK Stewardship Code was issued by the UK legislature as an accompaniment to the UK Corporate Governance Code.[245] One of its primary aims has been to bolster the activism and engagement of institutional investors in companies through the provision of clear guidelines that offer such investors a high degree of protection in publicly- traded companies.

This self-regulatory measure employed in the UK would have a substantial influence on proposals encouraging activism among Saudi institutional investors. Based on comparable framework such as the UK Stewardship Code, the Saudi government must develop a fuller and more professional set of guidelines to increase the level and standard of engagement by institutional investors. However, the voluntary nature of the Stewardship Code is entirely appropriate in UK due to substantial institutional presence in the country, such an approach may be less effective in Saudi Arabia due to the close associations between controlling shareholders and company management and between institutional investors and their business associates. This makes themless effective as a system of checks and balances.[246] The presence of prevailing conflicts of interest in Saudi firm suggests that it is imperative for Saudi authorities to adopt a mandatory approach in this regard.

3.8.1 Institutional Shareholders Proxy Voting

The most essential tool of governance available to institutional investors wishing to involve the practice of corporate governance is that of voting. The value of the effective use of proxy voting rights has long been recognised by developed countries. When utilised efficiently by institutional shareholders, proxy voting guidelines can increase usage of the voting system. However, using proxy voting procedures to select representatives on the board of directors is difficult for individual shareholders to manage as they lack the requisite, skills, capability, and familiarity to handle voting materials and information. Consequently, the use of proxy voting rights by individual shareholders in Saudi Arabia as a mechanism of corporate governance may fail to reduce

[245] The UK Stewardship Code on Corporate Governance 2010, Financial Reporting Council
[246] I AlMuneef, *Corporate Governance Functions, Duties and Responsibilities of the Board of Directors* (Arabic edn, Dar Al Mouder 2006) 27

agency costs and may not serve as a viable and efficacious alternative to the professional skills employed by institutional shareholders and managers.

Moreover, even though there has recently been an increased emphasis on the use of proxy voting as a component of shareholder activism with respect to corporate governance, no general guidelines or specific instructions have been provided by the Saudi CGR as to how the proxy should vote on AGSM agenda items; nor are there any details on how proxy votes are to be submitted in the AGSM or the number of proxies that can be employed. Consequently, it may be extremely difficult for absent shareholders to vote. Company directors could therefore establish conditions so complex that they cannot be understood by some shareholders, as a result of which they are unable to vote down directors' resolutions and/or elect their preferred directors. The Saudi Capital Market Authority Board must therefore regulate voting by proxy under the CGR.

Another key component of reform that will increase the confidence institutional investors have in the integrity of the Saudi capital market is to expand the number of voting options through the secure use of telecommunications and other electronic methods of appointing proxies. The latter also increases efficiency by ensuring shareholder activism can be exercised in an effective manner, thus guaranteeing better standards of accountability and corporate governance. This thesis therefore recommends that Saudi institutional shareholders acknowledge electronic methods as a means of legalising distance voting by proxy.

Another important recommendation to make is that institutional investors must reveal their voting practices and policies on their websites or through other means accessible to the public. The UK Stewardship Code, for instance, motivates institutional shareholders to make such disclosures. Specifically, principle 1 states that institutional investors must disclose how proxy voting has been employed while principle 6 states that their voting policy must be explained.[247] However, no such requirements are imposed on institutional investors by Saudi Arabia. Disclosure of proxy voting policies and practices is therefore essential in Saudi regulatory reform as it provides a useful indicator of the degree of transparency among institutional shareholders and thus incorporates good corporate governance into the practices of investee companies.

[247] The UK Stewardship Code on Corporate Governance 2010, Principle 1

3.8.2 Institutional Shareholders Dialogue

Institutional investors and corporate managers should engage in some type of dialogue. Shareholders who have the opportunity to communicate effectively with corporate management will thus be capable of evaluating the performance of managers and determining whether promises are being kept by such managers. Institutional shareholders could exploit this communication channel to show theirsatisfaction or dissatisfaction with the management of the corporation. Additionally, in certain situations, it is likely that obtaining comments and feedback from investors according to their experiences would be beneficial for the company. The ability to assess the prevailing views among investors and the market by communicating with investors could enable firms to adjust their policies to correspond with the expectations, prospects and interests of investors. Lastly, it could be argued that dialogue could be used by institutional shareholders to request that managers explain specific events and data that could assist with enhancing the understanding of the company in the market. It is believed that this would subsequently lead to an improvement in market transparency as such that the company's actual performance is reflected.

On the other hand, dialogue has certain drawbacks. In general, dialogue can be costly, at a minimum because managers can lose valuable time that could have been used to improve the performance of the firm. Additionally, one of the alleged difficulties that dialogue creates is that this means of communication could be exploited by certain investors to pressurise corporate management to disclose information that competitors could potential use.[248] There is also the threat of insider trading if price sensitive information is disclosed to institutional investors with whom the firm engages in dialogue. Nevertheless, this point should not be exaggerated. When evaluating the pros and cons of a firm engaging in dialogue with institutional investors, it can generally be concluded that the cons are outweighed by the pros, conditional on the manner in which the dialogue occurs.

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[248] D Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (DTI Publications 2003) 27

Nonetheless, it could also be argued that while dialogue can generally be beneficial to both firms and institutional shareholders, shareholders should not be treated according to two tiers. This is the rationale behind the existing stance of the F.S.A. and Securities Exchange Commission (S.E.C.) in prohibiting selective disclosure within the UK. Dialogue among corporations and participants in the market is encouraged by the FSA, conditional on the fact that it does not violate the integrity of the market in any form, which could include enabling insider trading.[249] Indeed, dialogue can largely be beneficial to both firms and institutional shareholders., therefore, it is worthwhile for the Saudi policymakers to emphasise this concept In the regulatory reform.

3.9 The Impact of Shareholder General Meeting on Saudi Firm Accountability

The Saudi Company Law offers rights regarding general meetings that comply with the higher standard of the developed international corporate market. However, there are some issues that must be tackled and there is some omission of important factors and procedures that a regulator should pay attention to when revising the company law and its governance. In particular, SCGR 2017 fails to require the presence of directors at a general meeting and does not require any quorum regarding the number of directors needed to hold the meeting in a valid manner.

In addition, in Saudi Arabia, attendance of individual investors at general meetings is at a lower rate, due to the fact that their roles are ineffective. Moreover, it is not feasible for investors to cast their votes collectively and nominate a single director as a representative due to the high cost of preparing a proxy, which they cannot afford. Another reason behind the low attendance of individual shareholders in the annual assembly meeting is that they do not receive notice of meetings in an appropriate manner. The traditional methods for distributing the notices are outdated; sending them through the postal system or using newspapers to call for meetings is inadequate, due to the fact that the postal infrastructure is poor, and people are no longer interested in reading traditional newspapers.

Thus, it is recommended that companies update themselves; they can benefit from new technologies and use their creativity to target investors through internet applications or social media, which investors are increasingly using. Another way to persuade individual shareholders to attend or cast their votes collectively is to create a mechanism that

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[249] C Batchelor, *Disclosure Rules Cause Confusion: Critics Dear F.S.A. Curbs on Market Abuse willDiscourage Full Reporting and Increase Volatility* (Financial Times 2002) 48

makes the proxy process affordable and the cost minimal. scholars suggest a solution to this problem by introducing an electronic voting system.[250] This suggestion would serve investors who are geographically remote, whether inside the country or overseas.

Indeed, the most important right of shareholders is always exercised during the general meeting. For this reason, the Saudi regulators state a set of clear provisions in this regard. Saudi regulation establishes two general meeting types: the ordinary general meeting and the extraordinary general meeting. The SCGR 2017 identifies the competence of each type and mentions the procedures that must be followed. These general meetings are different from each other in terms of the topic that is discussed in the meeting, the quorum that must be reached in order to be considered eligible to hold the meeting, and the procedure that must be followed.

Interim shareholder meetings can be convened when certain circumstances arise that require decisions to be made by shareholders. Shareholders need to hold more than 10% of the shares as this ensures a balance between guaranteeing shareholder protection and protecting the company from the influence of less serious shareholders. However, the strictness of this threshold has been the subject of sustained criticism by numerous scholars.[251] This has resulted in Saudi Companies Law being revised to include this regulation and reduce the threshold to 5 percent. Article 90 in SCL 2015 anticipates when the general meeting must be convened and whose duty it is to request the meeting; it requires that the request be made by the board of directors or by auditors and shareholders who own at least 5% of the company assets.[252] Likewise, a ruling has been issued by the European Union stating that all member countries should reduce the threshold for being able to call an extraordinary meeting to five per cent.[253] The UK Companies Act, which formerly set a threshold ofat least ten per cent, was revised in line with this threshold.[254] Arguably, the position adopted by the SCGR in relation to this clause is therefore corresponding with international practices. However, it is difficult for minority shareholders in listed Saudi Arabian companies to reach the 5 percent threshold. The efforts of minority shareholders to organise shareholders' meetings can therefore be impeded, especially when controlling shareholders hold more than 95 percent of the shares of a listed company. This thesis therefore

[250] T Clarke, *International corporate governance: A comparative approach* (Routledge 2007) 73
[251] K Al Saeed, 'the Association between Firm-Specific Characteristics and Disclosure: The Case of Saudi Arabia' (2006) 21 (5) Managerial Auditing Journal 476, 491
[252] Saudi Company Law 2015, Article 90
[253] European Community Directive on Shareholders' Rights 2009
[254] The UK Companies Act 2006, S 303 (2)

recommends lowering the threshold to 3 percent.

however, the board of directors is the only body authorized to call the meeting: auditors and shareholders cannot call the meeting without board consent. Therefore, this provision makes it difficult for auditors and shareholders to go against board wishes and prevents these bodies from exercising their rights. For this reason, and in order to fill the gaps in the statute, SCL 2015 should provide clear guidelines regarding the convening of the meeting to allow a neutral body such as CMA to convene the meeting, especially when the board of directors refuses to respond.

Another important issue to be addressed is that the power Saudi Companies Law confers on the board of directors to scrutinise shareholders' proposals may be exploited by company insiders to bar minority shareholders from asserting their right to present a resolution to be considered at a shareholders' meeting. The board of directors can reject such proposals if they are adjudged to be 'outside the scheduled topics or scopes of the shareholders' meeting, or without specific and definite propositions'.[255] Several scholars have criticized this regulation on the grounds that it gives too much discretion to the board of directors in deciding whether to submit any resolution proposed by minority shareholders.[256]

Moreover, because of the provision that requires the board of directors to answer any question that is not harmful to the interests of the company,[257] directors could take advantage of this broad condition to refuse to answer reasonable matters and avoiding answering shareholder requests. Clear criteria should be introduced regarding what questions are considered harmful to the company in order to hold directors responsible for responding to appropriate inquiries. Furthermore, SCGR 2017 allows shareholders to present their resolutions to the company to be presented in a general meeting, but the law fails to specify an acceptable limit to the number of subjects or pages. The UK Company Act offers an outstanding provision limiting the number of acceptable words for consideration at a meeting to 1000;[258] the shareholder who exceeds this given limit must cover the expenses of the circulation of his papers.

In addition, the SCGR 2017 does not require keeping minutes of a general meeting for a definite period of time. As a result, a company may destroy these minutes shortly after

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[255] Saudi Companies Law 2015, Article 96
[256] M Al Jeber, *The Saudi Commercial Law* (Arabic edn, King Fahd National Library 2007) 68
[257] Article (15) of Corporate Governance Regulation in the Kingdom of Saudi Arabia, 2017
[258] The UK Companies Act 2006, S 292 (3)

the end of the meeting, thus preventing interested parties from obtaining and analysing these important documents, unlike in most developed countries, which require companies to preserve minutes of the general meeting for a sufficient time. In the UK for example, a company is required to keep such minutes for at least ten years, and these minutes should be available for inspection by any interested members of the company.[259]

Another area in need of reform is the fact that the board of a corporation provides all shareholders with the date, location, and the explanatory agenda, along with its annual financial report, at least twenty-five days prior to the general meeting.[260] The rationale for this is that it enables shareholders to successfully take part in meetings. The significance of this is shown in a legal case brought against the SAMBA Financial Group where the Capital Market Authority Board imposed a fine of $13,333 because the company published its annual financial report just 23 days before the general meeting on 8 February on 16 January 2011, two days short of the stipulated 25. The charge against the company was based on Article 26-H of the Listing Rules, which stipulates that: “The company should provide the Capital Market Authority and announce to the shareholders its annual accounts not less than 25 days before the date of the company’s annual general meeting”.[261]

This was a lawful penalty as shareholders needed adequate time to scrutinise the annual report and other relevant documents in order to make informed decisions at the general meeting. However, given the vast capital held by the company, this fine was insubstantial. Given the importance of this rule, the severity of the punishment should therefore be increased by The Capital Market Authority Board.

3.10 The Impact of Saudi Firm Accountability on Minority Ownership

It is important to define the concept of minority shareholder before engaging in evaluating its issues in the Saudi context. Saudi Corporate Governance Regulations define minority shareholders as those shareholders who represent a class of shareholders that does not control the company and hence they are unable to influence the company.[262] Majority shareholders usually have the power to control the firm using valuable resources, and to the extent that they can determine who will be on the board

[259] ibid, S 355 (2)
[260] Listing Rules 2017, Article 26 (H)
[261] ibid
[262] Corporate Governance Regulations in the Kingdom of Saudi Arabia, 2017, Article 1

and dismiss undesired ones. This leaves little say to the minority.

Unfortunately, minority shareholders in Saudi firms do not enjoy a strong position; they feel exposed by majority shareholders, often due to the shareholder concentration structure that exists in the region. This is opposite to the corporate environment in developed countries such as the UK and US, whose shares are divided and owned by minorities defined as dispersed shareholders. Under these circumstances, the UK and US do not need to focus on minority issues; all shareholders are a combination of individual shareholders, with no single owner who owns majority shares. The granting of general shareholder rights is the norm in these two countries. Acountry that operates under a concentration of ownership, as in the case of Saudi Arabia, should pay attention to this issue in order to attract minority investors, whether local or foreign, to invest in the stock market. Investors need to find out whether existing legal rights are sufficient to handle any apparent conflict, or whether they need to be restructured to offer fair treatment.[263]

In addition, majority shareholders use their power to indirectly determine the salaries of directors that they appoint and decide the dividend as well.[264] Expropriation also occurs during acquisitions and mergers, which frequently undermine the minority position. Moreover, Access to crucial information is not always available to minority shareholders at Saudi companies in a timely manner, which allows the majority to keep themselves updated and take advantage of the company, making the minority vulnerable. Furthermore, another form of minority shareholder expropriation is nepotism, which is a disadvantage especially in Saudi family firms, where owners usually nominee one of the family instead of appointing a qualified candidate from the valuable labour market. Minority shareholders, by contrast, cannot do anything to stop these ineffective nominations.[265]

The Saudi Arabia capital market offers some rights, but this is not yet sufficient. In particular, capital market gives minority shareholders who own 5% of shares only two rights. Article 14 states that “shareholders holding not less than 5% of the company shares are entitled to add one or more items to the agenda”.[266] Also, Saudi Companies Law Article 100 states that shareholders who own 5% can ask a judge to investigate

[263] D Szentkuti, *Minority Shareholder Protection: Germany, France, and the United Kingdom: A Comparative Overview* (2007) central European University

[264] R Rajak, 'The Oppression of Minority Shareholders' (2011) 35 the Modern Law Review 156, 163

[265] M Goergen, *International corporate governance* (Pearson 2012) 103

[266] Corporate Governance Regulation in the Kingdom of Saudi Arabia, 2017, Article 14

the company when there is the assumption of committing illegal acts.[267] However, these two rights are insufficient, as they do not extend to the entitlement of obtaining information or having protection support. Thus, minority owners must be offered a chain of provisions that enhance their protection standard from any abusive actions.

3.11 Shareholders Litigation against Board Members

To address any mishandling of company affairs and ensure directors are held accountable for any abuse of their powers towards shareholders, litigation is an essential remedial instrument in relation to corporate governance. The right of shareholders to initiate litigation against board members is important as it impels such members to answer to any claims of negligence and misconduct. Particularly, it enables minority shareholders to safeguard their own interests.[268] When a company is unwilling or unable to file a claim against one or some of its directors for any reason, several legal alternatives have been introduced in the developed world namely, derivative and personal actions.

In the UK, however, a rule established in Foss v Harbottle prevents individual shareholders from taking an action to court when a wrong is committed against a company.[269] No jurisdiction is given to a court to intervene in the legitimate internal management of companies. If any wrong is committed against a company, they will therefore need to sue. Neither individual shareholders nor a minority of shareholders are allowed to litigate in issues concerning the internal business of a company; decisions made on behalf of the company as to whether to bring an action before the court can only be made by the majority of shareholders. This is the basis of the rule in Foss v Harbottle, which serves to prevent shareholders filing suits considered unreasonable and litigating with respect to any internal irregularities in the running of the company or any wrong done to their company. The rationale underpinning the ruleis therefore to avoid multiple claims through a refusal to hear allegations made by individual shareholders regarding internal company business.

In the Saudi Arabia context, the 2015 Companies Law allows the shareholder to raise a personal suit against a director who caused damage to him or denied him the rights granted by the Saudi company law or the company's chart in order to obtain personal

[267] Saudi Companies Law 2015, Article 100
[268] S Worthington, 'Corporate Governance: Remedy and Ratifying Directors' Breaches' (2000) 116 Law Quarterly Review 13
[269] Foss v Harbottle (1843) 461, 67 ER 189

recovery from 'the wrongful act'.[270] Article 78 in SCL of the Saudi personal suit in corporation is relatively similar to Section 994 of the UK Companies Act. Section 994 indicates that shareholder can apply to the court by petition to raise a prejudicial claim of his interest in the company's affairs.[271] However, Article 78 of SCL and Section 994 of the UK Company Act have been criticized for their narrow approach, which only allowed shareholders to cover the wrongdoing done to him alone, leaving others who had been similarly damaged uncompensated.

In addition, the use of the term 'the wrongful act' is extremely broad and possibly ambiguous in its meaning. Thus, it will be interpreted by the court as they see fit. However, it is unlikely that any nonexpert minority shareholder will be able to explain specific features to the court. In addition, it cannot be assumed that judges possess the requisite knowledge when adjudicating on matters involving complicated corporate litigation.[272] It is therefore recommended that the term 'the wrongful act' should be defined by the Saudi regulator under the CL to eliminate any potential ambiguity, as this may limit the right of minority shareholders to initiate litigation against board members. The Saudi regulator could utilise UK measure that determine the 'the wrongful act' and to alter the right of minority shareholders to initiate litigation against board members. The UK Companies Act states that claims can be presented before the court in matters relating to negligence, omission, default, and a breach of duty or trust by board members or other relevant persons.[273] Thus, according to the Act, negligence, omission and a breach of duty or trust are considered wrongful acts.

Another alternative remedy for minority shareholders is the derivative action. several scholars arguably state that it is advantageous for the Saudi company law to adopt a derivative action provision similar to that made in Sections 260 to 264 of the 2006 UK CL Act; this precision is a statutory remedy that allows minority shareholders to bring a litigation on behalf of the company in the case where the company is unwilling to bring the action in a general meeting. Thus, all shareholders who were harmed by omission of their rights benefitted, rather than a single shareholder who raised the claim receiving all the benefits. Section 260 indicates that shareholders can bring derivative action only in the circumstance where the cause of action arises from negligence, fraud, or breach

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[270] The Saudi Companies Law 2015, Article 78
[271] The UK Companies Act 2006, S 994
[272] S Griffin, *Company Law Fundamental Principles* (4th edn, Pearson Education publishing 2006) 124
[273] The UK Companies Act 2006, S 260

of duty by company directors.[274]

The proponents claimed that the derivative action is considered an important measure of corporate governance, which can enhance the protection of shareholders' rights. However, it worth mentioning that bringing derivative action has always been complex and the procedure is considered costly and time consuming. This is why only a few cases of derivative action have been brought successfully.[275] The cost and the restrictions that accompany this type of litigation may arguably limit the effectiveness of this action. When it succeeds, the financial benefit of derivative action might seem substantial, but it is considered minimal to the claimant minority shareholder, who has had to endure the costs on behalf of the company. Thus, in this circumstance, taking derivative action is not encouraged.[276] However, despite the merits in this claim, it could be argued that if shareholders' benefits outweigh the costs, then it will bebeneficial to proceed in this prosecution.

An example that shows how difficult is for a minority shareholder to successfully sue under derivative action is provided by the Essar Energy resources company, which was listed on the London Stock Exchange in April 2010. 78 % of Essar was controlled and held by the Ruia family. For a multitude of reasons, substantial losses were suffered by the company, including a breakdown in negotiations with the Indian government over energy permits and an excessive debt burden.[277] Consequently, the share price fell by almost 75 per cent of its IPO valuation, as a result of which the blockholder took the decision to privatise the company. A buyout offer was then presented to minority shareholders, including UK institutions and insurance companies, at this low market valuation. The shareholders, along with a committee of independent Essar Energy directors challenged what they perceived to be an opportunistic offer and asked the blockholder to also pay attention to the concerns of minority shareholders. The blockholder, however, was unwilling to make any compromises, which meant that the minority shareholders were forced to accept the buyout offer given that the only alternative was that of impending delisting.[278] This case indicates to investors that an

[274] ibid

[275] G Letsas and C O'Cinneide, *Current Legal Problems 2010* (Oxford University Press 2011) 77

[276] A Keay, 'Public Enforcement of Directors' Duties' (2013) SSRN Electronic Journal <http://www.law.leeds.ac.uk/assets/files/research/cblp/conf-jan13/public-enforcement.pdf> Accessed 23 December 2020

[277] Essar Energy investors appeal to UK, India govts against takeover (2014) <https://www.newsonprojects.com/news?news_id=15746> Accessed 11 December 2019

[278] ibid

absence of accountability is an unfortunate derivative of minority ownership.[279]

3.12 Conclusion

A discussion of the agency problems associated with the dominant ownerships of the state, the families and foreign institutions were presented. The major drawbacks in state ownership have been attributed to several factors, including the heavy concentration of state ownership, the absence of managerial independence, the slow process of privatization due to the lack of clear regulations of this programme. Thus, several determinants and measures have been introduced to solve these underlying issues.

In addition, this research has found many shortcomings in the regulatory framework that deals with family firms, such as the absence of a formal internal structure, the lack of policies dealing with the management's generational transition, and the lack of clear guidelines for recruitment and promotion of family members. Thus, succession planning was suggested, and it was recommended to establish an alternative exchange market for small family companies with flexible rules.

Moreover, there are many restrictions hindering foreign ownership in corporate market, such as the limitation of shares that they are allowed to have, which are below the international standard. Therefore, reform is needed to increase the percentage of shares that foreigners are allowed to have, as well as to increase the possibility of enabling these firms to have some sort of participation in and supervision of the management decision.

Furthermore, this chapter has critically reviewed and addressed issues relevant to minority shareholders' rights in particular. As a consequence, revision of the Saudi LC is needed to review the provisions that address the minority shareholders' protections in order to make the recommended modification. The legal remedies for the minority shareholders must be clearly defined and set as compulsory.

[279] K Garner, 'Taking on the world toughest energy challenges' (2011) Dissertation, Santa Clara University

Chapter Four

Board of Directors Accountability in Saudi Firms

4.1 Introduction

The key issues associated with the existing structure of board accountability in the Kingdom of Saudi Arabia are pinpointed and discussed in this chapter. An adequate regulation is needed to ensure the accountability of the board, given the substantial discretionary powers that the board of directors possess. Indeed, the accountability of the boards of directors plays an essential role in robust corporate governance[280]– which is recognised to be optimally fulfilled by ensuring directors account for their decisions and behaviour. The Cadbury Report, which gave rise to the UK Corporate Governance Code, states that: 'The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.'[281] Thus, This field of law therefore needs to be reformed so that it increases the legal accountability of directors whilst ensuring they continue to exercise their prerogatives effectively in their corporate management duties.

A large number of shareholders in big companies are not proactively utilising their rights to ensure accountability is observed.[282] To compensate for this passive attitude, board accountability needs to be a core component within codes. However, such a passive attitude among shareholders may mean boards are not motivated to be accountable to a satisfactory level (if at all) – which could be detrimental to shareholders and, as a consequence, the performance of the company.

More substantive requirements are therefore required in regulations pertaining to board accountability. Given that the principle of 'comply or explain' in national corporate governance code is deficient, a failure to include adequate requirements could mean boards themselves decide whether their level of accountability is at adequate level. If it is left to directors to decide whether to 'comply or explain'; they will therefore determine what types of accountability they comply with, the level of explanation given, and how accountable they will be for their actions. However, it is often the case that explanations are either inadequate or simply not provided.[283]

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[280] A Young, 'Frameworks in regulating company directors: rethinking the philosophical foundations toenhance accountability' (2009) 30(12) Company Lawyer 3
[281] Cadbury Committee (n53)
[282] S Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford University Press 2008) 45
[283] M Moore, 'Whispering sweet nothings": The limitations of informal conformance in UK corporate governance'

Although in Saudi Arabia the provisions contained within the Corporate Governance Regulation place a substantial emphasis on board accountability and stipulate the responsibilities of boards, there is no specific consideration given as to what is meant by board accountability. Although the principle holds that the board is accountable to the shareholders and company, it lacks clarity with respect to how accountability can be guaranteed. There is no lucid explication as to how questions can be put to the board and its behaviour assessed, neither is there any statement regarding the penalties that may be imposed on a board in the event of it failing to discharge its duties. This is a substantive issue because a lack of clarity as to the precise nature of accountability makes it difficult to evaluate existing mechanisms associated with the actions that need to be taken to install accountability, and whether mechanisms are designed adequately to ensure accountability.

It is important to reiterate that to run businesses effectively, boards need a certain degree of flexibility; therefore, with respect to corporate governance, a balance needs to be struck between the accountability of the board and the power and authority it holds. Several scholars have argued that although accountability rightly exists to rectify mistakes, it must not work 'to destroy the genuine values of authority'.[284] The importance of such a balance in corporate governance has therefore been widely considered.[285]

To address this issue and to keep with the objective of this thesis, the preceding chapter analysed the legal framework of corporate governance of boards of directorsin Saudi-listed firms and identifies the core elements needed to ensure board accountability. This chapter will examine the roles and responsibilities granted to boards in order to evaluate their clarity and sufficiency. Board duties, including theduty of care, duty of loyalty and duty to act within the capacity of their power, will be investigated to explore whether their definitions and boundaries are as clear as those of their UK and US counterparts. In addition, this chapter will also look at UK and US corporate governance from a theoretical and evolutionary perspective to explore the practicality and drawbacks of directors' independency perspectives and to assess whether this concept is practical to Saudi companies or not. It will also discuss the importance of subcommittees in Saudi corporations and evaluate their standard design.

(2009) 9 Journal of Corporate Law Studies, 13

[284] H Hutchison, 'Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by The accountability/ Authority Paradigm' (2005) SSRN 1139

[285] Bainbridge (n282) 34

4.2 The Impact of Board of Directors on Firm Accountability

In all countries, the board of directors has the most important function in any listed company. Fama and Jensen point out that the board of directors can be regarded as the heart of corporate governance due to their role in controlling management and the decision-making process.[286] Cadbury states that 'boards are the link between shareholders and managers and between the company and the outside world. This is why the board is, undeniably, the centre of the governance system'.[287] Listed corporations are legally required to have a board of directors as the ultimate managerial authority to control and manage the corporation's affairs.[288] The board of directors represents the shareholders, thus the ultimate responsibility for the companyrests with this body. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put these into effect, supervising the management of the corporation and reporting to shareholders on their stewardships.[289]

In this respect, Saudi regulators recognise the significance of the board of directors in directing a corporation in the rightful direction. Articles 21 and 26 of the Saudi Corporate Governance Regulations (SCGR) specify the responsibilities to be undertaken by the board members for listed Saudi companies.[290] These responsibilities include:

-Convening the shareholders' general assembly meeting and reporting company performance.

-Determining budgets and the final account plan.

-Establishing internal control mechanisms.

-Regularly evaluating and deciding on the dismissal or appointment of senior managers of the company and dealing with any concerns related to their remuneration.

-Formulating strategic decisions regarding acquisition and disposal of company assets.

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[286] E Fama and M Jensen, 'Separation of Ownership and Control' (1983) 26 Journal of Law and Economics 301, 308
[287] Cadbury Committee (n53)
[288] B Cheffins, *Company Law: Theory, Structure and Operation* (Clarendon Press 1997) 84
[289] Cadbury Committee (n53) 24
[290] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 21-26

Considering the above, the responsibilities and power given to boards of directors in Saudi Arabia are mostly analogous to those in UK and US companies in term of the codification of the director's responsibilities and the clarification of the board's rights. However, there are some differences. A comparison between the Saudi Kingdom and the UK and the US regarding the powers given to boards of directors shows that while the latter two countries assign sufficient authority to board members as the agents of shareholders in managing the corporation, the Saudi approach is still imperfect and experiences some ambiguity and omission of needed reforms to facilitate board performance. Thus, an evaluation of these omissions in Saudi regulation will be discussed in this chapter in order to find better-recommended solutions.

4.3 The Impact of Board of Directors Structure on Saudi Firm Accountability

There are two main structures of boards of directors: the unitary board, which is one single board with directors elected in the annual general assembly,[291] and the dual board, which comprises two boards in one firm: the supervising board, whose board members are elected by shareholders to supervise the direction of business, and the executive board, whose members are appointed by the supervising board to manage the company.[292] Members of the executive board cannot be on the supervising board at the same time. Interested stakeholders such as employees or environmental representatives are given an opportunity to join the supervising board.

In recent studies, it has been questioned whether board systems consisting of one or two tiers have superiority. It has been argued that the dual board model has the most significant advantages because it gives stakeholders, whether employees or creditors, the opportunity to be on the board, enabling them to safeguard their interests.[293] In addition, proponents of a dual board model claim that this type of structure differentiates between executive and non-executive directors and between chief executive and board chairman.[294] Moreover, the model of governance comprising two tiers has both a supervisory board and an additional management board that increase the division between control and ownership.[295]

[291] Mallin (n27) 85
[292] Mallin (n27) 162
[293] Cadbury Committee (n53)
[294] G Maassen and F Bosch, 'On the Supposed Independence of Two-Tier Boards: Formal Structure and Reality in the Netherlands' (1999) 7 Corporate Governance: An International Review 31, 33
[295] F Ghezzi and C Malberti, 'The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law' (2008) 5(1) European Company and Financial Law Review 54

However, there are certain drawbacks that seem to be the primary reasons for the restricted distribution of two-tier boards, which can be summarised as: “Excessive formality, particularly with regard to the directorate's obligations to report to the supervisory board and the formal division of responsibility between managers and monitors, results in inefficiencies, such as unnecessary meetings and burdensome amounts of paperwork”.[296] Furthermore, additional drawbacks could emerge as a result of a possible power disparity between the two different levels of the boards. Additionally, the practice of excluding supervisory board members from management positions could lead to insufficient direct information, which they require for the development of an objective overview of the firm’s performance. This is particularly noticeable in cases where company management restricts their ability to acquire information through other channels, such as periodical meetings with employees, corporate auditors, clients, government auditors, suppliers and creditors.[297]

On the other hand, those who support the unitary board assert that it provides a closer relationship between internal and external directors, and increases the opportunity for better information flow between them.[298] The powers of directors in countries adopting a unitary board model are delegated from the owners they represent. Accordingly, board members are specifically responsible for representing the shareholders’ interests. Theoretically, the board exists to be an effective mechanism to maximise the interests of shareholders.

In this kind of board, both executive directors who are responsible for managing the business operations, and non-executive directors who indirectly supervise management, cooperate on the same board. This unification of the bodies responsible for managing and monitoring the firm represents one of the most significant aspects of the unitary model of governance.[299] Anglo-Saxon and common law countries such as the US and the UK favour a unitary board system, while the dual board system is widespread in civil law countries.[300] Saudi corporations’ boards, like those of the US and the UK, are

[296] L Aste, 'Reforming French Corporate Governance: A Return to the Two-tiered Board?' (1999) 32(1) George Washington Journal of International Law and Economics 10
[297] K Hopt and P Leyens, 'Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy' (2004) 1(2) EuropeanCompany and Financial Law Review 13
[298] ibid
[299] Ghezzi, and Malberti (n295) 54
[300] P Cornelius and B Kogut, *Corporate Governance and Capital Flows in a Global Economy* (OxfordUniversity Press 2003) 63

characterised by their unitary board system.[301]

4.4 Board of Directors Duties to Enhance Saudi Firm Accountability

This view of directors as agents of the shareholders has led to great powers and wide responsibilities being delegated to the board members beyond that of challenging of other shareholders at the company level. The wide range of authority granted to board members enables company directors to exploit their shareholders and mismanage the company. Thus, several regulations have imposed restrictions upon company directors to ensure they conduct their management roles appropriately. Directors' extensive corporate powers are subject to many restrictions imposed by law, company constitution and general meeting resolutions.[302] The relationship between directors and their corporations is based on trust. Boards have a duty to act in the best interest of the firm with high standards of honesty and good faith.[303] Directors who breach these obligations and extend their powers without legal authorisation are subject to penalties and are responsible for compensating any losses.

3.4.1 Duty of Care

One of the most recognised duties attached to the board member position is the duty of care. Duty of care is a fundamental priority in all corporate affairs. The director must act with reasonable care and necessary skill when making business decisions. Duty of care is defined as acting in an attentive and cautious manner towards firms, in a way that a reasonable person in the same position in the same situation would act.[304] The UK Companies Act states that board members are always required to act with skill and within reasonable expectations of diligent persons with their knowledge and experience.[305]

Whereas, Saudi Corporate Governance Regulations state that the board of directors must act in good faith with due diligence when carrying out corporate affairs.[306] Unfortunately, unlike the UK Companies Act, Saudi law does not specify criteria for this level of care, thereby giving careless and negligent directors the chance to hide behind

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[301] S Algoere and A Hasani, 'Saudi Arabia Regulations on Corporate Governance' (2019) 9 InternationalJournal of Asian Social Science 233, 229

[302] A Cahn and D Donald, *Directors' duties of loyalty, good faith and care* (Cambridge University Press 2018) 92

[303] 'Overview of Key Directors' Duties for UK Companies' <http://www.gannons.co.uk/services/corporate/companylaw/directors/overview-of-key-directors- duties-for-uk-companies/> Accessed 27 March 2020

[304] Nicholas Bourne, *Bourne in Company Law* (Cavendish Publishing Ltd 2011) 170

[305] The UK Companies Act 2006, S 174

[306] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 29

the ambiguity of this measure. Thus, this situation has hindered an effective implementation of the duty of care. Indeed, Saudi law declines to clarify the standard of diligence or the potential levels of skill and experience for directors. In addition, the omission of business judgment defence has resulted in difficulty holding boards of directors liable for violations of their due care duty. Saudi regulators should reform the concept of the duty of care to eliminate the current ambiguity and avoid careless behaviour on the board level. They should consider adopting the subjective standard of business judgment defence specifying the skills and level of experience that directors must have.

The business judgment rule defence has been used by the US jurisdiction to determine whether the duty of care that board members are expected to have towards the companies has been violated.[307] It stipulates that courts are expected to abide by the impartial, informed, and fair decisions made by directors and to avoid attributing any liability when such decisions result in undesirable return. It therefore affords directors the freedom to make effective decisions.[308] The business judgment rule also prohibits both shareholders and courts from impeding the directors in the exercise of their authority.[309] Indeed, shareholders elect the board to run their companies based on their business expertise, and the complex decisions made in business cannot be effectively assessed by courts. Such decisions depend on the sound judgement of individual directors and should be respected by courts. If any liability were to be imposed by courts for straightforward negligence, directors will feel less inclined to take risks and will exercise excessive caution to circumvent potential litigation. The business judgment rule can therefore ensure directors are not held liable for the negative consequences of the decisions they make.[310] Without such protection, directors are likely to be excessively averse to taking risks and this will diminish the ability of shareholders to accrue profits.

However, to make sound business judgments, directors need to ensure they are adequately informed and prepared prior to proposing any related actions, and to scrutinise and question all relevant information before making any decisions, this includes being appropriately briefed and fully prepared prior to meetings, interrogating senior management or advisors, asking for expert advice when needed, and making sure

[307] S Bainbridge 'the Business Judgment Rule as Abstention Doctrine' (2004) 83 Vanderbilt Law Review 83, 88
[308] ibid
[309] J Lynch, 'The Business Judgment Rule Reconsidered' (1981) 17 American Bar Association 452, 453
[310] A Melvin, 'the Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62 Fordham Law Review 437, 440

that the board have access to and have considered all relevant information prior to any decision-making process.[311] Moreover, as part of their duty of care, board meetings should facilitate an open exchange of views, and ensure that directors actively take part in a way that is meaningful.[312]

In relation to this duty of care, courts in US jurisdiction apply compound analysis when scrutinising the actions taken by corporate directors. Indeed, numerous complex tests are applied when reviewing how this duty of care is exercised. First, the decision taken by a director is reviewed by the court in accordance with the business judgment rule. This protects directors from liability as it assumes, they are acting in line with the expected duty of care. The burden is therefore on the plaintiff to refute this assumption by presenting factual evidence to suggest that one or more components of the business judgment rule is absent in the decision made by a board.[313] For instance, the plaintiff may provide evidence to show that a substantial corporate transaction was approved by the directors without seeking or considering any expert advice, a written synopsis of the transaction proposed, and key facts or terms relevant to the transaction.[314] If the plaintiff cannot refute the assumption that underpins the rule,the directors cannot be held liable for as the business judgment rule will continue to apply for as long as they act in a rational manner. However, if the plaintiff succeeds in challenging the rule, the onus is then placed on the directors to show that the transaction made was completely fair to the organisation and its shareholders.[315] If the action taken by the directors is not satisfying at least one component of the rule, the protection they enjoy as a result of the business judgment rule will be lost.[316]

Perhaps the most famous case in the US regarding the corporate duty of care is that of Smith v. Van Gorkom.[317] In this case, the Delaware Supreme Court proclaimed that, although there was no proof of bad faith, self-dealing fraud, or illegality, the business judgment rule did not protect the directors because they had not acquired sufficient information prior to making the decision to assent to the company being sold. This

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[311] S Lubben and A Darnell, 'Delaware’s Duty of Care' (2005) 32 SSRN Journal <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=698223> Accessed 17 February 2020

[312] ibid

[313] W Allen, J Jacobs and L Strine, 'Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law' (2001) 56 Business Lawyer 1287, 1290

[314] ibid

[315] ibid

[316] M Havenga, 'Directors' exploitation of corporate opportunities and the Companies Act 71 of 2008' (2013) The Journal of South African Law 12

[317] Smith v Van Gorkom (1985) 488 A.2d 858

meant that the directors were vulnerable to personal liability on a ruinous scale. In Van Gorkom, the directors of the Trans Union Corporation were accused by the plaintiff shareholders of breaching their duty of care by agreeing to a cash-out merger without notifying or discussing it with senior management or other board members. To secure approval from the board, Van Gorkom requested a special meeting without informing the other directors as to its purpose. He also requested a meeting of senior management beforehand. Except for two officers, no members of senior management or the board, had any existing knowledge of the merger that was proposed. No agreement was presented to the board for review nor did they receive a written synopsis of the proposed merger. After two hours of deliberation, the merger was proposed without any further inquiries being undertaken.[318] The court in Van Gorkom commenced its analysis with an explanation of the business judgment rule and the need for informed business judgments to safeguard this rule. The conclusion reached by the court was that the directors were grossly negligent as they had not conducted any inquiries regarding the inherent value of the company and had approved the merger in quick time based solely on a twenty-minute oral presentation by Van Gorkom. Thus, this decision did not constitute an informed business judgment.[319]

4.4.2 Duty of Loyalty

Duty of loyalty is a fundamental element of fiduciary duty. Board members are legally required to act in good faith while pursuing the interests of the shareholders.[320] The duty of loyalty could be expressed as a duty of trust, which also requires directors to apply their authority in an honest and equitable manner for the advantage of all shareholders inclusive of minority shareholders, while considering the wider aims of the firm to facilitate its success.[321] The concept of duty of loyalty evolved around the intention of faith, malice or conflict of interest, while duty of care addresses negligent behaviour.

Among potential conflicts of interest are circumstances in which a board member's neutral stance is compromised by material or moral interests for their own benefit or that of their friends or relatives.[322] For instance, a director may harm the interests of

[318] Ibid
[319] Ibid
[320] R Balotti and others 'Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law' (2009) 98 Harvard Law School 629, 640
[321] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 29
[322] F Strier, 'Conflicts of Interest in Corporate Governance' (2005) Journal of Corporate Citizenship 79, 84

his/her company by deriving benefits from a third party or by deliberately failing to declare their interests in a transaction. Moreover, a multi-director who works for a rival company is likely to experience a conflict of duties and to find their loyalties divided.[323] When serving two competitive companies, a director is required to act in an equitable and even-handed manner and any opportunities or information they acquire must be conveyed to both firms; this makes it almost difficult for a director to carryout these requirements effectively for each company.[324]

Taking this in consideration, Saudi company regulation emphasises the necessity of preventing conflicts of interest between directors and their corporations. It prohibits a board of directors from competing with the company or engaging in any insider dealing connected with the firm, unless they obtain approval from the company's general meeting.[325] In addition, SCL provisions enforce conflict of interest restrictions, for example board members have to obtain annual permission from the corporation in the general assembly to engage in any personal transactions with the corporation.[326] This means that personal transactions have never been outlawed under Saudi law as long as the director is granted authorisation from shareholders. Breach of this condition would lead to the director being liable for a penalty. The best example of thisis the case of a Saudi chemical firm, in which some board members acquired 15% ofthe shares of one of the company's subsidiaries without getting permission from the general meeting. The capital market authority found them guilty and imposed a fine of SR 50,000 as a penalty for breaching Article 28 of the listing rules.[327] This demonstrates that when board members trade in securities of the firm through inside knowledge, they are subject to several restrictions.

However, it can be argued that without adequate identification of the duty of loyalty in the Saudi kingdom, companies will not be protected adequately. moreover, in the absence of the good faith requirement, the central duty of loyalty is left undefined,[328] and of greater importance, with no suitable liability standard in place. In addition, there is no explicit mention to indirect conflict in Saudi Companies Law 2015. Such

[323] J Lowry, 'the Duty of Loyalty of Company Directors: Bridging the Accountability Gap through EfficientDisclosure' (2009) 68(3) Cambridge Law Journal 607, 610
[324] M Conaglen, 'The Nature and Function of Fiduciary Loyalty' (2006) 65 the Cambridge Law Journal 278
[325] Saudi Companies Law 2015, Article 74
[326] ibid
[327] Board Capital Market Authority issued 2009 <http://www.argaam.com/article/articledetail/127502/> Accessed 15 February 2020
[328] M Eisenberg, 'The Duty of Good Faith in American Corporate Law' (2006) 3 European Company and Financial Law Review 17

Indirect conflict may arise when the personal interests of a director conflict with his company: such as, being the major shareholder or supplier for a competitor company.[329] Indirect conflict may also be occur from people closely associated withthe director such as family members,[330] The failure of the law to clarify both the scope and meaning of direct and indirect interests creates another substantive gap in Saudi law, this may then be exploited by directors to serve their own interests.

Another drawback in Saudi Corporate Governance Regulation regarding Articles 20, several exceptions not considered a conflict of interest by the board. Such as, when the primary bidder is a board member and they have presented the best offer, they will be exempt from this restriction.[331] Such exemptions by the SCGR, have, however, been subject to wide criticism. In typical bidding, offers made by board members are almost certain to be the most successful in winning the bidding. This is because there is expectation on board members to be acquainted with the company's affairs and with information regarding that firm. Therefore, it is apparent that such exceptional terms are indeed unnecessary because they are harmful to accountability and equality, consequently allowing a board monopoly. Furthermore, the opening of a door by the SCGR to board members, enabling them to trade with the contracts of their own company is pointless. Therefore, such exceptional terms ought to be eliminated from the SCGR for the purpose of averting manipulation by senior executives and board members.

Therefore, the conflict of interest provision should be regulated in a restricted manner like that of the UK, which has the best practice in terms of clear definition and boundary of loyalty duty. The UK Companies Act indicates that directors must not engage in any direct or indirect interest that may conflict with interests of the firm, whether these exploitations are of property, opportunity or inside information.[332] This provision motivates directors to avoid business that does not favour the company,thus preventing possible indirect conflict. Moreover, this act requires directors of the company to exercise a duty of loyalty in all circumstances. Unlike the Saudi Companies Act, there is no mention of duty of loyalty. It is advantageous to clearly indicate this phrase because the intention is not only to avoid wrongdoing but also to actively carry

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[329] P Shine, 'Knowledge, Notice, Bad Faith and Dishonesty: Conceptual Uncertainty in Receipt Based Claims in Equitable Fraud' (2013) 24(8) International Company and Commercial Law Review 19
[330] ibid
[331] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 20
[332] The UK Companies Act 2006, S 175

out positive acts motivated by the sense of loyalty.

Duty Section 172 of the UK Companies Act states that 'a director of a company must act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole'.[333] Although this clearly asserts that companies must not act to serve only the interests of majority shareholders but the minority as well, it offers no explanation as to how to balance the divergent interests of majority and minority shareholders. However, one of the factors that directors must pay attention to under Section 172 is that of fairness among whole shareholders.

4.4.3 Duty to Act within Board's Powers

Saudi regulation prohibits directors from acting beyond their power and authority. Accordingly, Article 75 of the Saudi Companies Law points out that a corporation and its board of directors must not exceed the limit of its competence.[334] The Saudi Companies Law requires that the powers of boards are limited by the company clauses, articles of association and general meeting resolutions. These limitations of power resemble the best practices of UK corporate governance. The UK Companies Actstates that directors must act in accordance with the corporation articles of association and confine their authority to its restrictions.[335]

However, In the Saudi Arabia, as is the case with the majority of Anglo-American jurisdictions, the shareholders in the Annual General Meeting have only minimal power in terms of the actions they can take. In jurisdictions in which Anglo-American corporate law is applied, ownership and control of public companies is separated; thus, although shareholders may be deemed the owners of a company, it is the board of directors that has the control.[336] In the UK, where directors have extensive powers; shareholders can only intervene in the exercising of management power in exceptionally limited circumstances.[337] One of the powers shareholders have is to pass a resolution at general meetings. There have been several instances in the past where this took place. For example, 60% of Shell's shareholders voted against the executive pay plans of the board in 2010.[338] Although this type of event may provide an example of accountability where no formal consequences ensue, it does serve as warning to the board. In this instance,

[333] The UK Companies Act 2006, S 172
[334] Saudi Companies Law 2015, Article 75
[335] The UK Companies Act 2006, S 171
[336] F Easterbrook, *The Economic Structure of Corporate Law* (Harvard University Press 1996) 68–70
[337] A Keay, *Board Accountability in Corporate Governance* (Routledge 2015) 56
[338] A Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United

the strong vote by shareholders against the remuneration packages of executives resulted in the board refusing to increase the salaries of its top three executives for twelve months.[339] Other changes in the conduct of the board can also be initiated by shareholder disapproval at meetings.

Additionally, In the UK jurisdiction, shareholders can secure a majority vote to remove a director.[340] However, achieving such a removal is far from straightforward. It is only possible to call a meeting to vote on such a motion if members representing 5% of the paid-up company capital who hold the right to vote at general meetings ask for it.[341] A considerable amount of influence and organisation is needed to secure the necessary requests and obtain a majority vote in favour of removal. In large companies, small shareholders often lack the organisation and power to achieve this goal.[342] Similarly, through general meetings, shareholders, under Saudi law, have the right to pass an ordinary resolution in order to appoint directors.[343] However, in listed companies, the board can indirectly influence the appointment of directors. This is because recommending nominees for the board at the next general meeting of shareholders is one of the roles undertaken by the board's committee of nomination.[344]

Before the CGRs 2017 were established, the names and backgrounds of candidates for boards of directors in several listed companies had not been disclosed prior to elections.[345] This could be viewed as giving the directors an advantage in determining how shareholders vote as it limits the ability of the latter dispute the degree of control directors have over elections. Even though the new CGRs 2017 stipulate that companies must disclose in-depth information on nominees for board membership on their websites and also those of Tadawul,[346] directors continue to have the power to control voting at the general meeting. For instance, even though all shareholders are entitled to nominate a board member and then inform the board,[347] during the meeting they can only choose candidates recommended by the board.[348] This substantially limits the power of shareholders as the nomination committee is not under any obligation to

[339] ibid
[340] ibid
[341] The UK Companies Act 2006, S 168
[342] M Bennedsen and D Wolfenzon, 'The balance of power in closely held corporations' (2000) 58 Journal of Financial Economics 113, 130
[343] the Companies Law 2015, Article 68
[344] ibid
[345] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 65
[346] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 8
[347] ibid
[348] The Companies Law 2015, Article 68(2

nominate more candidates than there are seats available on the board of directors.[349] This casts doubt on the extent to which shareholders can influence any decision not to re-elect director due to his inadequate performance. As such, the control exerted by the board over the nomination process weakens the mechanism by which accountability can be enforced, thus diminishing the accountability of directors, particularly with respect to non-controlling shareholders.

As consequence, the wide range of powers and duties of a board affects the governance of a corporation and determines the future of a firm's management. Thus, Saudi legislation should pay considerable attention to the powers granted to directors to ensure compliance with all rules governing their managerial duties. The broad powers need to be monitored by the shareholders and the primary investors and retain the right to obstruct or apply some constraints to these board powers. specifically, they can stipulate that certain of actions be subject to their approval at the AGM. Furthermore, they can mandate the board to arrange an extraordinary general meeting (EGM) to make amendments to the articles of association and to include additional regulations that constrain the board's powers when necessary.

4.5 The Impact of Independent Directors on Saudi Firm Accountability

A business needs to have an effective board with a suitable composition of directors to achieve its objectives. Board composition has a direct effect on the firm's activities and the board's ability to oversee management. In this regard, the role non-executive directors (NEDS) play on behalf of the owner in monitoring management has been widely researched, and great concern over the effectiveness of non-executive directors has been expressed. Most studies have two distinct views: one view advocates for more NEDS in the boardroom, whereas the other does not favour the inclusion of external directors in managerial affairs. Those who are against including external directors claim that outsider directors are usually required to deal with complicated tasks based on insufficient information. Weir and Gaining state that non-executive directors tend to be less knowledgeable about company activities than executives.[350] This absence of adequate information is a result of the norms that discourage open discussion and the opportunity to challenge CEO proposals, making it difficult for external directors to communicate openly with internal managers.

[349] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 66

[350] C Weir and D Laing, 'the Performance-Governance Relationship: The Effects of Cadbury Complianceon UK Quoted Companies' (2000) 4 Journal of Management and Governance 265 267

Another defect of this mechanism is that non-executive members may not have sufficient time to play their roles effectively, resulting in ineffectual firm performance. Indeed, the part-time norms of independent directors make it hard for them to exercise their roles over company management. They also meet infrequently and crama full agenda into short meetings, thus having no time for extensive discussion. Also, opponents criticise outside directors for their dependence on inside executives for their appointment and remuneration.[351] Thus, their judgment might favour their executive partners at the expense of the shareholders, who should be the ultimate beneficiaries of their performance. Indeed, the CEO mostly controls the meeting process and agenda, thus playing a crucial role in influencing outside directors' behaviour. Additional shortcoming of this mechanism is that, the definition of anindependent director is still undeveloped and needs clarification from all angles. Bradney indicates that no definition of this perspective precludes an independentdirector from being a friend or member of the same clubs and associations.[352]

However, despite these above-mentioned drawbacks, the advantages of having non-executive directors on the board are supported by academics and would be an appropriate solution to improve corporate governance in the Saudi Kingdom. This could solve current defects that have resulted from the concentration of family and governmental ownership in the region. Fame and Jensen are advocates of non-executive directors, and they indicate that external directors act as referees in conflicts of interest between managers and the corporation.[353] Indeed, internal directors usually have internal knowledge about the company and might take advantage of that knowledge to pursue their own interests. Conversely, a non-executive would takecharge and lead when potential conflicts of interest arise, preventing managerial abusefrom happening. They are neutral because they have no business relationship with the company nor any commercial interests that may bias their judgment. Additionally, NEDS bring diverse experience, knowledge and skills to the boardroom, adding value to the firm's performance. This is because companies usually draw skilful and knowledgeable external directors with special expertise and experience in management. Other advocates praise independent directors' ability to contribute significantly to strategy

[351] J Charkham, *Keeping Good Company: A Study of Corporate Governance in Five* Countries (OxfordUniversity Press 1994) 234
[352] V Brudney, 'The Independent Director - Heavenly City or Potemkin Village?' (1982) 95 Harvard Law Review 597, 605
[353] E Fama and M Jensen, 'Separation of Ownership and Control' (1983) 29 Journal of Law and Economics 301, 307

development. They can play a vital role in strategic planning in areas where the interests of managers and the company may diverge, such as manager remuneration, succession planning and takeover defence.[354] Most importantly, a diverse board composition can greatly enhance the process of monitoring managers and protecting the interests of all shareholders, particularly minority ones.[355]

Thus, there is a trend towards involving more independent directors in US and UK companies. Following various legal reports and recommendations in an attempt to reform its corporate governance standard, the UK legislation currently relies on NEDS as an essential element in UK boards of quoted companies.[356] the Cadbury Report states that all quoted UK corporations should include internal and external directorson one board.[357] Figures show that most listed companies in the London Stock Exchange follow the recommendation for inclusion of NEDS, and their number has since greatly increased.[358] According to the Higgs Report, there are 4,610 NEDS sitting on the boards of 1,712 UK firms.[359] The high percentage of NEDS also applies to the US company system. The Sarbanes-Oxley Act (SOX) and the New York Stock Exchange Rules of Listing require a board to contain independent directors.[360]

In addition, both the UK Corporate Governance Code and the NYSE Listed Company Manual provide a comparatively identical set of criteria as to what constitutes independence. This would typically exclude the independence of a specific director in cases where they:

– have been an employee of the company or connected entity during the past few years

– have had a material business relationship with the company

– have received additional remuneration from the company

– are or have been connected with the company’s senior employees, advisers, directors, or auditors

[354] OECD (n83)

[355] R Johnson, R Hoskisson and M Hitt 'Board of director involvement in restructuring: The effect ofboard and managerial controls and characteristics' (2007) 14 Strategic Management Journal 33, 36

[356] K Keasey, S Thompson and M Wright, *Corporate Governance: Accountability, Enterprise, andInternational Comparisons* (John Wiley and Sons Ltd 2005) 112

[357] Cadbury Committee (n53)

[358] Charkham (n351) 234

[359] Higgs Report, 2003, Review of the Effectiveness of Non-Executive Directors, London, Department ofTrade and Industry 13

[360] New York Stock Exchange Listed Company Manual, S 303 A.04, 303 A.05, and 303 A.07

– are a significant shareholder (UK only).[361]

However, The NYSE listing authority provides their own criteria in an objective fashion and in obligatory approach.[362] Conversely, in the UK, the board decides whether each director is independent in judgment and character.[363] Nevertheless, a number of reasons explain why the monitoring role in the UK will be implemented less efficaciously than in the US. Firstly, under UK Company Act, although directors have a duty of both care and loyalty, lawsuits against external directors are extremely rare in the UK and markedly more frequent in the US.[364] Due to the fact that it is seldom for such directors to be held legally responsible for any failure to carry out their duties, they perceive their role as being more of an advisor than a monitor.[365] Secondly, there are fewer financial incentives offered to external directors in the UK to ensure they carry out their roles effectively. For instance, they own a comparatively small number of shares and their pay is lower than that of their US counterparts, which is often givenas a reason for the ineffectiveness of non-executives.[366]

Similarly, the Saudi legal system has followed the growing tendency in these two countries to have executive and independent directors on its boards.[367] The board composition in Saudi Arabia is similar to that of the corresponding UK and US systems. However, it should be noted that the proportion of independent directors in the Saudi kingdom is still small, especially in family- and government-owned corporations.[368] Capital market authority statistics show that there are 356 non-executive directors out of 1,108 listed companies.[369]

Saudi regulation contains several restrictions to limit the meaning of independence. Article 20 prevents people from becoming independent members if they own 5% or more of company equities, or if they have been an employee or have a partnership or material business relationship within the company, including as external auditors,

[361] UK Corporate Governance Code 2018, Article 10
[362] NYSE Listed Company Manual, S 303 A.02
[363] UK Corporate Governance Code 2018, Article 10
[364] J Dahya and J McConnell, 'Board composition, corporate performance, and the Cadbury Committee recommendations' (2007) 42 Journal of Financial and Quantitative Analysis 535, 555
[365] Cadbury Committee (n53)
[366] Higgs (n359)
[367] Charkham (n351) 234
[368] F AlMajed, 'A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective' (2008) School of Law, Manchester University
[369] A Zarban, M Abdullah and M Abdullateef, 'Corporate Governance and Board of Directors Responsibilities: The Case of Saudi Arabia' (2017) 5 International Journal of Accounting Research 5

suppliers or relatives of board members.[370] Another important restriction contained in Article 24 of the SCGR suggests that the majority of a board of directors should be non-executive, and one-third of the board ought to be independent.[371]

However, despite the increasing recognition of independent directors in Saudi legislation, there are still several drawbacks in the rules regarding director independence which need to be reformed with constructive restrictions and amendments. The SCGR omits the definition of particular responsibilities and roles for independent directors. It is recognised that one of the greatest benefits of having external directors is the vital role of independent judgment in strategic issues such as appointment and removal of the executive directors, succession planning and takeover defence. However, without these responsibilities being clearly stated in Saudi company regulation, external directors' contributions to the company will remain minimal and ineffective. Thus, the responsibility of an independent director to actively participate in and contribute to strategic policy should be included in the regulation and should be stated clearly as the best practice, as it is in the UK, which stipulates that non- executive directors are responsible for determining crucial subjects such as the company's future direction specifically in terms of remuneration and appointment and removal of the board.[372]

In addition, under Saudi law, the independent non-executive directors are appointed by nomination at the general assembly.[373] Consequently, those independent members come under the influence of controlling shareholders. This might result in affecting their status as independent, unlike UK law where nomination and dismissal of directors are carried out by the nomination committee.[374] Therefore, there should be a new provision that emphasises appointing and dismissing the independent members of the board by a separate legal body such as the nomination committee, so that these members do not become ineffective and consider expropriation. Apart from their appointment and dismissal, these directors should also be independent of any sort of business or other association which may substantially hinder the application of their independent judgment.

Moreover, it is currently acknowledged that separating the CEO and board chairman

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[370] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 20
[371] ibid Article 24
[372] UK Corporate Governance Code 2018, Article 17
[373] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 17
[374] UK Corporate Governance Code 2018, Article 10

roles could enhance the independence level of the board and limit the influence of the CEO upon them.[375] It would be unrealistic to expect that external directors could challenge the executives if the CEO controls the agenda of the meeting and the information that is released. Advocates of separation between these players point to the advantages of balancing power, strengthening accountability and increasing independent decision-making.[376] This is the case in the UK system, where most codes and recommendations regulating corporate governance have recommended the separation of the roles of CEO and chairman.[377] Also, UK Corporate Governance Code states that 'the division of responsibilities between the chairman and chief executive should be clearly set out in writing and agreed by the board'.[378] As a result, most UK-listed companies have complied with this provision. Similarly, Saudi Corporate Governance regulations acknowledge the importance of separation between the powers of CEO and chairman.[379] However, despite this recommendation in the SCGR, most Saudi-listed companies, especially family- and government-owned companies, do not comply with this provision. Separation between these two bodies is not compulsory, thus, corporations are not obliged to do to so. Thus, to improve independent directors' performance, Saudi law should impose mandatory clauses to separate the chairman position from the CEO position.

Another useful reform that should be introduced in Saudi law is the percentage of the independent directors in some board functions, such as the nomination, remuneration and audit committees. The best practice recognised in the UK and the US is to require a greater number of independent members on those committees. For instance, UK Corporate Governance Code refers to this suggestion and states that a nomination committee should be composed of a majority of independent directors.[380] US law goes further and requires exclusive composition of independent directors in these subcommittees.[381]

In addition, Unfortunately, Saudi law does not have regulations regarding the independent directors' qualifications to ensure that they have the appropriate education, training and expertise that their position requires. Thus, suitable guidance

[375] B James and C Jeffrey, 'Leadership structure: Separating the CEO and Chairman of the Board' (1997) 3 Journal of Corporate Finance 189, 191
[376] OECD (n83)
[377] UK Corporate Governance Code 2018, Principle G
[378] ibid
[379] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 24
[380] UK Corporate Governance Code 2018, Article 10
[381] NYSE Listed Company Manual, S 303 A.02

should be available. Several studies confirm that specialised and well-prepared directors are preferable because special skills are needed to monitor managers appropriately.[382] Taking this in consideration, corporations in the US mostly include NEDS who are professionals, academics and experts on their boards.[383] Thus, including those NEDS who have sufficient expertise would benefit companies.

Nevertheless, the part-time nature of non-executive directors in Saudi corporations is problematic in that it makes it infeasible for these directors to exercise their role over management when required. Independent directors in Saudi Arabia usually use their limited amount of time undertaking enormous tasks and positioning themselves simultaneously on other boards, which obstructs their role and leads to dissatisfactory performance. The time commitment is crucial in determining directors' contribution to the firm's accomplishments.[384] Thus, imposing time and membership limitations for independent directors is necessary to ensure that they perform with due consideration.

4.6 The Impact of Directors Subcommittees on Saudi Firm Accountability

Board subcommittees are becoming a fundamental characteristic of effective corporate governance worldwide. It is widely agreed that establishing subcommittees enhances the performance of a board.[385] The significance of board committees in the governance process lies in the fact that they enhance board accountability and ensure that board activities are independently monitored. In order to help the board with fulfilling its responsibilities in an effective manner and to make enhancements to the work conditions, it is necessary for the firm to found various different specialised committees in line with its requirements and specific situations. Such committees can increase the likelihood that company matters will be addressed in an objective and independent manner, specifically when possible conflicts of interest can occur.[386]

According to best practices of corporate governance, the following board committees should be established by a firm at a minimum: Audit Committee, Nomination Committee, and Remuneration or Compensation Committee. Consequently, SCGR

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[382] Jensen and Meckling (n135) 472
[383] M O'Sullivan, *Contests for corporate control: corporate governance and economic performance in theUnited States and Germany* (Oxford University Press 2000) 268
[384] ibid
[385] J Armour, S Deakin and S Konzelmann, 'Shareholder Primacy and the Trajectory of UK CorporateGovernance' (2003) 41 British Journal of Industrial Relations 531, 539
[386] A Alzeban, 'The Impact of Audit Committee Characteristics on the Implementation of Internal Audit Recommendations' Journal of International Accounting' (2015) 24 Auditing and Taxation 61, 69

recommends that boards delegate some of their authority to various subcommittees, namely the audit, remuneration and nomination committees which will be discussed deeply in the following subsection.

4.6.1 Audit Committee

The audit committee is the most important board committee, overseeing internal and external audit operations in the company. Their main objective is to evaluate the company's financial information to ensure that the company has suitable accounting standards. It protects the company from financial manipulation and ensures that auditing procedures remain consistent and compliant with law. In addition, the benefit of the audit committee is that it increases the reliability of company financial reporting and decreases potential illegal action or management fraud.[387] The Cadbury committee states that establishing an audit committee is a significant mechanism in developing corporate governance standards.[388] Also, the Smith Report mentions its importance and indicates that 'while all directors have a duty to act in the interests of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control'.[389]

Saudi Arabia has adopted a similar approach to that of the US and UK systems, with a slight difference. The SCGR of 2017 enacts new provisions and strictly requires that boards of directors must establish an audit committee in all listed companies. There should be at least three members on the audit committee, and at least one must be a professional with expertise in financial matters.[390] In addition, the SCGR recommends that shareholders in the general meeting should set up specific criteria regarding the nomination of audit committee members,[391] However, despite the recent reform and adoption of a suitable set of rules to facilitate the formulation of an audit committee, the recent financial crisis in major Saudi firms as a consequence of accounting manipulation has raised a question about the effectiveness and the sufficiency of Saudi audit committees in managing the accounting bodies. Several commentators have remarked on the effectiveness of the audit committee practice in Saudi firms.

[387] D McMullen, 'Audit committee performance: an investigation of the consequences associated with audit committee' (1996) 15 Auditing 5
[388] Cadbury Committee (n53)
[389] R Smith, 'Audit Committee Combined Code Guidance' (2003) The Financial Reporting Council Limited 8
[390] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 54
[391] ibid

Saudi Corporate Governance Regulations still needs further clarity on how and to what extent the audit committee should exercise its roles, and needs further empowerment of functions, compared to UK and US guidance. A recent study has evaluated the existing roles of the audit committee in the Saudi system and concluded that there is weaknesses in the formation and operation of audit committees in several respects, namely a shortage of accounting professionals, a lack of clear guidance on the scope of work, an absence of true independence for the committee members and poor communication between the committee and external auditors.3[392]

Therefore, it could be beneficial to have further requirements for the functions of Saudi audit committees, such as, SOX rules in the US. SOX Section 301(2) insists that an audit committee should have the ultimate responsibility for the nomination, remuneration and retention of any accounting firm employee.[393] In Saudi legislation the focus is only on the appointment of external auditors, excluding internal auditors. In addition, it is useful to impose a provision insisting on the audit committee reviewing financial statements regularly, as with the Blue Ribbon committee in the US, which requires the audit committee to review and discuss the company's financial statement not only annually but quarterly,[394] While the UK's Cadbury committee recommends the audit committee review the financial report every six months before submission to the board.[395]

However, in Saudi context, it is commonly recognised that a close relationship between audit committee members and executive managers is one of the key factors leading to corruption and scandals in major family and government Saudi corporations in recent years. Thus, it is vital for the Saudi government and family firms to observe and enforce real independence of audit committees to ensure integrity and neutrality in financial report monitoring.

Furthermore, participation in the audit committee is a significant task requiring high qualifications, training and skill. Therefore, the provision of SCGR requiring at least one member to have expertise in accounting or the financial profession should be amended to require all three members of the committee to have professional accounting

[392] A Twaijry, A Brierley and D Gwilliam, 'an Examination of the Role of Audit Committees in the Saudi Arabian Corporate Sector' (2002) 10 Corporate Governance: An International Review, 19

[393] The Sarbanes-Oxley Act, S 301(2)

[394] Blue Ribbon Committee, 'Report and recommendations of the Blue-Ribbon Committee on improving the effectiveness of corporate audit committees' (1999) New York: NYSE and NASD, 31

[395] Cadbury Committee

experience in order to be selected for committee seats. Complex accounting deals require highly qualified professionals with sufficient understanding of the issues. The Blue Ribbon committee in the US recommends that 'the audit committee should have at least three members who are financially literate'.[396] Moreover, SOX in the US further specifies several elements of financial expertise that audit committee members must have, namely understanding general principles of accounting, understanding audit committee functionality and having sufficient experience in auditing and evaluating financial reports and complex accounting affairs.[397] Specifying these conditions for Saudi corporate regulations would enhance the appointment process by placing highly qualified professionals on the audit committee.

Another issue is that the SCGR indicates that audit committee members are nominated by the general assembly based on the approval of the shareholders.[398] However, despite this regulation, most Saudi-listed companies have disregarded this condition. Most boards appoint members of the audit committee without obtaining approval from the general assembly of shareholders.[399] An illustration of this situation is the case of the Basic Chemical Industries Company, which was fined of SR 13,333 asa penalty for failing to seek out approval of the general meeting when nominating audit committee members.[400] However, companies will not comply with this provision unless the general jurisdiction increases observation and enforcement of this requirement as well as increases the severity of the punishment.

4.6.2 Remuneration Committee

The remuneration committee can be regarded as an corporate governance mechanism to prevent executive directors from unjustly determining their own remuneration levels.[401] The Greenburg Report points to the main objective of this legal body: boards of directors should establish remuneration committees composed of independent directors to determine any sort of compensation or special packages such as pension for executive directors.[402] Remuneration committees have been proven to have a positive effect on financial management by preventing unreasonable raises in managerial compensation. A study of 865 US firms from 2000 to 2005 revealed that further

[396] Blue Ribbon Committee (n349)
[397] The Sarbanes-Oxley Act, S 301(2)
[398] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 60
[399] Alzeban (n387) 9
[400] Capital Market Authority Board Issued Decision 2012, No. 7-1
[401] UK Corporate Governance Code 2018, Article 32
[402] R Greenbury, 'Directors' Remuneration: Report of a Study Group' (1995) 45

reduction and balance have been achieved since imposing the creation of remuneration committees on US-listed firms.[403]

In Saudi Arabia, the SCGR demands the board of directors to form a remuneration committee. The general assembly of shareholders is responsible for creating rules concerning the nomination of remuneration committee members, based on board recommendations.[404] In spite of SCGR's attempt to regulate the remuneration committee, regulation failed to specify important elements such as setting a minimum number of members and clarifying how remuneration committee members can determine the standard of the compensation for the board. These drawbacks open the question of the legitimacy of their decisions. It is advantageous to reform this clause in accordance with the Greenburg recommendation, which indicates that the remuneration committee should have at least three independent members or should otherwise state the reason why the committee employs fewer than three members.[405]

Furthermore, the absence of a pay-determination process for board compensation and lack of limitation on board directors' compensation has to change. Saudi regulation should address this overlooked issue in a more rigorous manner in order to help this committee find criteria when determine the board remuneration. Remuneration should be linked to the company and member performance.[406] The link between reward and performance has gained widespread acceptance in developed countries as an effective corporate governance practice, in response to the recent economic crisis resulting from executives receiving huge rewards while their companies suffer from bankruptcy.

4.6.3 Nomination Committee

The main responsibilities of nomination committee members are to determine the qualifications required for directors to serve on the board and, more crucially, to regularly review the performance of board members.[407] In the past, directors were nominated based on personal connections and relationships, which resulted in the failure to ensure independence of directors and led to the placement of incompetent directors on the board.[408] Thus, the formulation of the nomination committee will bring discipline to the appointment process and ensure a balance of skills, experience

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[403] ibid
[404] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 60
[405] Greenbury (n402) 45
[406] ibid
[407] UK Corporate Governance Code 2016, Article 17
[408] Mallin (n27) 107

and knowledge of chairmen and other senior managers.

With that in mind, Saudi regulation has required all Saudi public corporations to establish this committee. However, it could be acknowledged that the nomination committee carries the same provision as the remuneration committee in the SCGR. Therefore, it is preferable that the Saudi regulators separate these two committees from each other in the Companies regulations and standardise their roles separately.In addition, to enhance board efficiency and to lessen the influence of executive directors on the Saudi nomination committee, independent members should be appointed to this committee.

4.7 The Impact of Board Meeting Frequency and Size on Saudi Firm Accountability

The frequency of board meetings is an important corporate governance tool to enhance board performance and decision-making processes. Vafeas' study found a positive association between frequency of board meetings and effective firmperformance.[409] However, despite the importance of frequency of board meeting, unfortunately, in the Saudi Kingdom the Companies Law does not provide regulatory requirements on how often the board should convene each year. The accountability in regard to the allocation of an appropriate number of meetings currently lies with the board of directors due to the fact there are no regulations obliging them to organise the necessary meetings. This is unlike UK Corporate Governance Code, which demandsof the board to meet regularly to perform its responsibility efficiently.[410]

Thus, continuing to neglect board meeting frequency in the Saudi Kingdom will result in potential management manipulation and corruption. Therefore, it is best to specify the minimum number of board meetings in the SCGR as a mandatory clause. Although it is challenging to identify the suitable number of meetings that should be organised by the board on an annual basis, various reports have suggested that periodical board meetings should be conducted at a frequency of around four to six times per year in order to allow the directors to fulfil their responsibilities. [411]

On the other hand, the size of the board is the overall number of directors thatcomprise the board of a given corporate entity. The size of a board has a significant impact on the quality of corporate governance. The Higgs Report indicates that board size is an

[409] N Vafeas, 'Board Meeting Frequency and Firm Performance' (1999) 53 Journal of FinancialEconomics 113, 115
[410] UK Corporate Governance Code 2018, Principle D
[411] A Keay, *The enlightened shareholder value principle and corporate governance* (Routledge 2013) 93

essential factor in improving the firm's decision-making processes.[412] However, it is noteworthy that the corporate governance literature suggests that there is no one board size which fits all companies. In fact, the ideal board size not only varies from country to country but also from company to company, depending on company size.

Some scholars advocate larger boards, assuming that large boards will bring a diversity of opinions and vitality of experiences. Zahra and Pearce theoretically evaluate this concept and conclude that boards with large numbers of members are capable of supervising management effectively and are difficult for executive directors to dominate. In contrast, some opponents argued that larger boards can be inappropriate because they are associated with poor communication and delayed decision-making.[413] In addition, the Higgs Report criticised the idea of having large numbers of board members, recommending that board size should not be so large as to become cumbersome. They should be of adequate size, with balanced skills and experience.[414] Agency theory also indicates that larger boards may increase managerial costs.[415] Thus, although large board membership may be beneficial in terms of monitoring the company's activities, those benefits may be outweighed by cost and slower decision making. In addition, many studies have examined the size of boards and concluded that small boards seem to be more effective than larger ones. For example, Yermack investigated 452 large US companies and found that small boards were much better for company performance.[416] Another study conducted by Andres et al. used a sample of 450 companies in several countries and found that smaller boards were moreeffective in terms of coordination, communication and quick decision making.[417]

Saudi company law does not indicate ideal board size and has left it to the company's articles of association to specify the number of board members. This lack of limitations should change. Saudi regulators should indicate the minimum and maximum number of board members needed. The Higgs Report found that the average size of a board in UK companies is seven and the average large board has 12 members.[418] It might be

[412] S Zahra, 'Boards of directors and Corporate Financial Performance: A Review and Integrative Model' (1989) 15 Journal of Management 291, 311
[413] D Yermack, 'High Valuation of Companies with Small Boards of Directors' (1996) 40 Journal of Financial Economics 185, 189
[414] Higgs (n359)
[415] Vafeas (n409) 117
[416] Yermack (n413) 190
[417] P Andres, V Azofra and F Lopez, 'Corporate Boards in OECD Countries: Size, Composition, Functioningand Effectiveness' (2005) 13 Corporate Governance: An International Review 197, 199
[418] Higgs (n359)

useful to use the same average numbers of board members in successful UK companies for adoption in regulation of Saudi boards of directors, due to their proven success.

4.8 The Impact of Female Directors on Saudi Firm Accountability

Both the fair representation of genders and equal rights remain issues with respect to boards of directors. The subject has received increased focus in both academic circles and in the legislature, as most such board members are men, even in advanced nations.[419] Gender diversity on boards can present various advantages. Diversifying the composition of the board of directors is an important method of expanding the talent pool and appealing to new customers due to the fact that different groups and individuals can offer distinct abilities and proficiencies. Different researchers regard gender diversity to be an indication of the degree to which elite social networks are democratised, which can improve the culture of the board.[420] It is contended by Larkin et al. that females generally foster ethical attitudes inside organisations.[421] Hence, expanding the number of women on corporate boards could be an indication that firms conform to the principles of ethics and accountability. This will enhance the overall image of the firm and facilitate the acquisition of investor trust while also appealing to a broader scope of competent people.[422] Various studies have also assessed the association between females and practices of governance, corruption andequality in both public and private sectors,[423] and determined that females have less involvement in instances of corruption, and exhibit greater leadership traits of inclusivity and fairness.

In the context of UK, the aim of the government is to accomplish gender equality on boards and to increase the number of women functioning in the business environment.[424] Although the UK Code has yet to establish quotas for women, it necessitates and emphasises gender diversity in corporate boards in various sections, such as: “appointments made on merit, against objective criteria and with due regard

[419] G Mathisen, E Ogaard and T Marnburg, 'Women in the Boardroom: How Do Female Directors of Corporate Boards Perceive Boardroom Dynamics?' (2013) 116(1) Journal of Business Ethics 87, 96
[420] E Heemskerk and M Fennema , 'Women on Board: Female Board Membership as a Form of Elite Democratization' (2014) 15(2) Enterprise and Society 252, 258
[421] M Larkin, R Bernardi and S Bosco, 'Does Female Representation on Boards of Directors Associate with Increased Transparency and Ethical Behavior?' (2013) 13(1) Accounting and the Public Interest 132, 134
[422] ibid
[423] D Dollar, R Fisman and R Gatti, 'Are women really the “fairer” sex? Corruption and women in government' (2001) 46 Journal of Economic Behavior and Organization 423, 427
[424] L Martin, I Warren-Smith, J Scott and S Roper, 'Boards of directors and gender diversity in UK companies' (2008) 23(3) Gender in Management: An International Journal 194, 203

for the benefits of diversity on the board, including gender"[425] and "Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender".[426] As a result, the proportion of females on FTSE 100 boards increased two-fold from 2011 to 2015, and more than 30% of newly appointed board members were women.[427]

Nevertheless, In Saudi Arabia, less advancement has been made in regard to females reaching positions of leadership. The representation of women on boards is a significant problem for Saudi Arabian legislators as a result of the continual absence of women in positions of responsibility. Consequently, board composition must be addressed from a legalistic viewpoint similar to the UK Code, which obliges companies to have a certain level of female representation on the board of directors. Hence, this process of reforming boards could augment the effectiveness of the boards by enabling the introduction of various different viewpoints into the board process.

4.9 The accountability of Shariah Committee

To enhance trustworthiness and to meet the ethical expectations of consumers, most Islamic financial organisations have established systems of control that are comprised of in-house religious experts, frequently labelled as Shariah Committee.[428] Shariah Committee are critical for the Shariah governance framework as they are official entities that ensure that Islamic financial institutions (IFIs) are compliant with Shariah. Shariah Committee are pivotal in terms of Shariah oversight, as well as monitoring, auditing and distributing legal dictates.

Thus, with the objective of evaluating the Sharia governance framework and the associated problems, this section provides a brief discussion of the system of corporate governance from the perspective of Islam in regard to the Shariah Committee, which is considered to be the core aspect of the present discussion. This part endeavours to present the conceptual structure of Shariah Committee governance within IFIs in terms of four primary factors, namely the responsibility of the Shariah Committee, the Shariah Committee models, the nomination and qualification of the Shariah Committee, and the Shariah Committee process of compliance.

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[425] UK Corporate Governance Code 2018, Principle J
[426] ibid Article 23
[427] ibid
[428] T Gambling, R Jones and R Karim, 'Credible Organization: Self- Regulation v. External Standard-Setting in Islamic Banks and British Charities' (2008) 9(3) Financial Accountability and Management 195, 200

The objective of Shariah Committee is to supervise and manage the religious, moral, ethical and behavioural dimensions of corporate management. Additionally, Shariah Committee manage and oversee the religious aspects of the transactions, products and services provided by IFIs. The Committee is required to assess all decisions made by the board of directors as well as senior executives in order to guarantee that the institution complies with Shariah principles.[429] Furthermore, it is responsible for approving the articles of incorporation as well as all policies, codes of ethics and codes of conduct.[430] Moreover, they provide authorisation for all financial transactions and products to guarantee that they are compliant with Shariah.[431] Additionally, the Shariah Committee provide continual guidance to senior executives in regard to the application of Islamic regulations in regular transactions to prevent any ethical or religious conflicting situations prior to entering agreements with potential investors.[432]

Islamic financial organisations should refrain from engaging in any forms of Shariah prohibitions, including riba (interest), gharar (uncertainty), speculation of maysir (betting), and they should also adhere to the tenets of Islamic morals or the Islamic ethical code.[433] Drawing inspiration from their foundational aspects and the value orientation of stakeholders, Shariah Commission have fiduciary responsibilities in regard to every stakeholder of the IFIs.[433] Management of the corporation is not only motivated by the aim of maximising the profit gained by shareholders but is rather to enhance all stakeholders' welfare.[434]

The national regulatory institution responsible for issuing Shariah governance direction is the Saudi Arabian Monetary Authority which has issued the Shariah Governance Framework.[435] This mentioned regulatory framework are applicable to Saudi Islamic institutions.This Framework has established a total of nine chapters of Shariah corporate governance, where three are directly focused on the governance of Shariah Committee.

4.9.1 Appointment and Qualification of the Shariah Committee

The Shariah Committee is always made up of three or five Sharia experts. The members

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429 The Shariah Governance Framework for Local Banks Operating in Saudi Arabia 2020, Article 10
430 ibid
431 Ibid Article 11
432 ibid
433 M Bhatti and I Bhatti, 'Toward understanding Islamic corporate governance issues in Islamic finance'(2010) 2(1) Asian Politics and Policy 27
434 A Rahman and A Bukair, 'The influence of the Shariah supervision board on corporate social responsibility disclosure by Islamic banks of Gulf co-operation council countries' (2013) 6(2) Asian Journal of Business and Accounting 65, 66
435 The Shariah Governance Framework for Local Banks Operating in Saudi Arabia 2020

of this Committee are Muslim scholars who belong to reputable institutions.[436] Additionally, the Shariah Committee nominees have to meet qualifications criteria to be selected for the Committee seats. Differentiated from the board of directors, members of the Shariah Committee are professional jurists in the field of Islamic commercial jurisprudence and specialise in the area of Islamic financial institutions.[437] The Shariah Governance Framework permit the designation of individuals who specialise in Islamic financial institutions to be members of Shariah Committee, with the aim of enhancing the capability of the Committee to analyse and comprehend the financial institutions and associated functionality.[438]

However, the reality of the situation in regard to Shariah Committee members' qualifications was revealed by a study conducted on Islamic banking practices, which showed that 76.6% had training and qualifications, while only 8.6% were sufficiently knowledgeable on both Shariah and commercial law, whereas 11.4% were specialised in Shariah, law and economics.[439] This findings imply that there are problems surrounding the different criteria and qualifications of Shariah Committee. This factor could impact how effectively the Shariah Committee operates, specifically in terms of the provision of robust and definite Shariah edicts, as they are required to possess professional knowledge and expertise in Shariah along with adequate training.

Moreover, there is a lack of qualified Shariah academic who meet the criteria for being a Shariah Committee member. It was confirmed that there is an insufficient number of qualified Shariah academics to satisfy the increased needs of the IFIs.[440] The lack of such Shariah experts could lead to conflicts of interest in the event that one individual is a member of multiple Shariah Committees and could therefore exploit the information they acquire from theIFIs. It is contended by Bakr that when Sharia experts are involved in multiple Shariah Commissions, this generates conflicts of interest because it becomes difficult to deliver impartial opinionsfor two distinct IFIs, for instance in scenarios where new products are released by rival institutions.[441] For an extended period, various Shariah experts have taken advantage of the right to belong to multiple Shariah Committees with no form of limitation. Indeed, the prevailing conditions in numerous

[436] ibid Article 7
[437] ibid Article 8
[438] ibid
[439] M Hussain, A Shahmoradi, ' An Overview of Islamic Finance' (2015) International Monetary Fund 14
[440] S Garas, 'The conflicts of interest inside the Shari'a supervisory board' International' (2012) 5(2) Journal of Islamic and Middle Eastern Finance and Management 88, 89
[441] ibid

companies indicate that there are no constraints on Shariah Committee members preventing them from acting as committee members for different Islamic financial institutions. Consequently, this leads to Shariah Committees being perceived negatively due to the fact that issues surrounding confidentiality and conflicts of interest emerge.

In order to prevent problems with such conflicts of interest in Saudi firms, a legal provision must be established that clearly restricts individuals from serving on multiple Shariah Committees concurrently. It is recommended that IFIs are not permitted to designate any Shariah Committee member in a different IFI in the same sector. This policy additionally ensures that the Shariah Committee is fully available to provide effective guidance and monitoring to the IFI. Furthermore, it is advocated that a specialist in the area of Shariah with a fundamental understanding of finance should be recruited to become an impartial member and to perform the Shariah Committee functions.[442] This recommendation provides a practical solution for resolving the problem of shortages in this area. By recruiting such members, this will satisfy the need for Shariah experts by increasing the available number of Shariah Committee members.

Taking into account the diverse nature of practices of Islamic finance in various jurisdictions, the potential for conflicting fatwas or Shariah edicts is comparatively high, which could negatively impact the confidence of stakeholders in the sector.[443] This occurs as there is no professional code to which Shariah Committee members can adhere, apart from their comprehension and perception of Shariah. Furthermore, it can be assumed that there are differences between Shariah Committee members due to the variety of Islamic sects of Hanafi, Hanbali, Maliki and Shafi'I; hence, there can be discrepancies between Shariah Committee and management where their perspectives diverge.[444] Incompatible fatwas lead to tension and uncertainty among clients, employees, managers, and the board of directors. In this regard, continual efforts should be made to achieve the harmonisation of Shariah standards in order to maintain consistency. The concept of Sharia harmonisation, even though it has both positives and negatives, seems to be an effective strategy for achieving a specific degree of consistency that is critical from the perspective of the Islamic finance sector.[445]

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[442] R Grassa, 'Shari'ah governance system in Islamic financial institutions: new issues and challenges' (2013) 27(2) Arab Law Quarterly 171, 178

[443] ibid

[444] A Abu-Tapanjeh, 'Corporate governance from the Islamic perspective: a comparative analysis with OECD principles' (2009) 20(5) Critical Perspectives on Accounting 556, 562

[445] ibid

4.10 Conclusion

This chapter has analysed the accountability of the directors in Saudi Arabia corporate governance. The chapter has examined the legal framework of Saudi boards of directors and their responsibilities and duties under the Saudi CL and SCGRs in order to determining whether the board members' responsibilities are clearly defined and whether the board of governors' regulations ensures fairness for all shareholders. Recommendations for reforming the principles of the duty of care, duty of loyalty and duty to act within the board's powers have been set out. The problems and current remedies for the better nomination standard of board of directors have been identified. For this end, abuse of power by major shareholders can be eliminated by involving independent directors in board membership. Thus, the concept of directors' independence has been evaluated and the role of corporate governance in providing restrictions in this regard has been discussed. This chapter has also considered the role of audit, nomination and remuneration committees in Saudi corporate governance provisions and recommended several needed procedures to reform the drawbacks of their constructions. In addition, given its large major role in the Saudi financial corporations, the Shariah Committee has also been evaluated.

However, The Saudi approach is still imperfect and experiences some ambiguity and omission of needed procedures to facilitate board accountability. This view of directors as agents of the shareholders has led to great powers and wide responsibilities being delegated to the board members beyond challenging of shareholders at the company level. Thus, several recommendations have arisen from this chapter for the pursue to enhance the accountability of Saudi board of directors. Saudi regulators should reform the concept of the duty of care and consider adopting the subjective standard of business judgment defence, thus, if a director's action can be classified as a business judgment, the director is assumed not to be liable for what has been done or not done. In addition, it can be discussed that without adequate identification of the duty of loyalty in the Saudi kingdom, companies will not be protected adequately. Therefore, directors must not engage in any direct or indirect interest that may conflict with interests of the firm.

Moreover, there are still several drawbacks in the rules regarding director independence which need to be reformed with constructive restrictions and amendments. The responsibility of an independent director to actively participate in and contribute to strategic policy should be included in the regulation and should be stated clearly. Additionally, there should be a new provision that emphasizes appointing and dismissing the independent members of the board by a separate legal body such as the nomination committee in order to ensure real independence. Another useful reform that should be introduced is the percentage of the independent directors in some board functions, such as the nomination, remuneration and audit committees. The provision of SCGR requiring at least one member to have expertise in accounting or the financial profession should be amended to require all three members of the committee to have professional accounting experience. In addition, to improve independent directors' performance, Saudi law should impose mandatory clauses to separate the chairman position from the CEO position.

It is best to specify the minimum of number of board meetings in the SCGR as a mandatory clause. Also, Saudi regulators should indicate the minimum and maximum number of board members needed. Boards should be sufficiently large to incorporate the various different proficiencies required to fulfil its responsibilities but with adequate balance. Finally, the lack of female directors on a board has negative implications for the firm. Consequently, board composition must be addressed from a legalistic viewpoint to obliges companies to have a certain level of female representation on the board of directors.

Chapter Five

The Impact of Transparency Mechanisms on Firm Accountability

5.1 General View of Disclosure and Transparency

Chapter five evaluates the existing disclosure and transparency applications within the Saudi system of corporate governance. The rationale of this chapter is to determine potential ways to improve disclosure and Transparency legislation. All corporate governance codes contain principles relating to disclosure and engagement. This is indicative of the vital emphasis placed on communication as a means of ensuring corporate accountability. Thus, since transparency is a key component of corporate governance accountability, the specific aim of the following chapter is to evaluate the existing disclosure and transparency applications within the Saudi system of corporate governance. It endeavours to find answers to research question regarding the application of transparency and disclosure, specifically concerning Saudi Arabia. The chapter will be divided as follows: the first part will provide a general view of disclosure and transparency. The second part will examine the associations between the kinds of corporate ownership and transparency. Lastly, the core issues related to board attributes and additional firm properties will be highlighted in relation to corporate governance transparency.

5.1.1 Definition of Disclosure and Transparency

A comprehensive definition would be beneficial for creating efficient transparency necessities within the capital market. One definition asserts that disclosure and transparency imply that companies must publicly divulge their financial condition, activities, choices and other information pertaining to the firm which are of relevance to investors.[446] However, even though this definition incorporates key components of effective transparency, the definition particularly concentrates on shareholders and generally disregards other potential stakeholders who have an interest in the release of information. In another definition, disclosure is the release of any data by a firm to affect the judgements and choices of those who use this information.[447] This definition is more thorough than the first, as it incorporates a greater number of actors who have an interest in acquiring knowledge regarding the operations of the company.

[446] International Monetary Fund 'Report of the Working Group on Transparency and Accountability' (1998)
[447] S Fung, 'A Discussion of Management accounting information systems in a developing country' (2012)19 Journal of Accounting & Economics, 9

Nonetheless, it still fails to describe key aspects of qualified disclosure. On the other hand, various scholars have concentrated on outside actors and have disregarded those within the company. For example, Frost, Gordon and Pownall stated that disclosure is the dissemination of information regarding a specific entity to outside actors.[448] Additionally, according to Bushman, Chen, Engel and Smith, disclosure refers to how relevant the disclosures used by external investors are in terms of holding officers and directors accountable for their actions.[449]

Considering the limitations of the previous definitions, a more thorough definition is preferred in the context of this chapter. Therefore, the definition that will be used in this regard is that transparency makes necessary, trustworthy, applicable, high-quality and inclusive information accessible to the market at the appropriate time.[450] Based on this fundamental definition, the critical aspects of transparency are availability, trustworthiness, level of quality and applicability. Thus, the possible challenges faced with improved transparency laws can be considered based on these comprehensive and critical aspects, which are incorporated into the definition.

5.1.2 Importance of Disclosure and Transparency in the Saudi Stock Market

The concept of disclosure forms the core of virtually all statutes and codes of corporate governance. For instance, disclosure and transparency are considered key elements of corporate governance according to the Organization for Economic Cooperation and Development (OECD).[451] In this regard, Beekes and Brown found that firms with increased levels of CG provide more instructive disclosures.[452] Indeed, some have contended that transparency is possibly the aspect that is of the greatest importance, as the other components of 'fairness, accountability and responsibility'are reliant on increased degrees of information release.[453]

A firm that exercises complete disclosure enables shareholders to apply their rights more effectively. Additionally, regarding agency theory, increased transparency diminishes the level of information asymmetry among shareholders, increases their

[448] C Frost, E Gordon and G Pownall, 'Transparency, disclosure, and emerging market companies' accessto capital in global equity markets' (2005) 6
[449] R Bushman, Q Chen, E Engel and A Smith, 'Financial accounting information, organizational complexity and corporate governance systems' (2004) 37(2) Journal of Accounting and Economics, 12
[450] Mallin (n42) 288
[451] OECD (n83)
[452] W Beekes and P Brown, 'Do better-governed Australian firms make more informative disclosures?' (2006) 33 Journal of Business Finance and Accounting 422, 445
[453] Cadbury Committee (n53)

ability to access important information and in the process, creates the opportunity to scrutinise managers to determine whether their actions are directed at optimising shareholder wealth. Furthermore, in relation to stakeholder theory, improved transparency could help to reinforce the relationship network that exists among all the actors in a firm, thereby increasing the level of accountability within the firm.

Nevertheless, if complete disclosure is assured, any speculation that may exist will ultimately be mitigated and the ambiguity will be diminished.[454] Hence, disclosure and transparency are informative for market expectations and reinforce market stability in periods of uncertainty.[455] Furthermore, the degree to which information can be accessed in the appropriate location, in the appropriate manner and at the suitable time could be acknowledged as a crucial element in financial environments.[456]

Therefore, as previously mentioned, the most significant advantages of qualified disclosure are improved communications, enhanced trust in management, greater liquidity, lower levels of volatility, the prevention of fraud, diminished speculation, increased assessment from analysts and enhanced relationships with investors.[457] In this chapter, the significant effects of transparency on frameworks of corporate governance will be analysed.

5.1.4 The Consequence of Non-Disclosure in the Saudi Stock Market

There is a consensus that inadequate corporate disclosure and an absence of transparency were key contributory factors in financial scandals that have occurred around the globe. It has been claimed that ineffective corporate governance is connected with reduced levels of disclosure.[458] There are numerous potential risks, such as misrepresentation of the statements, reduced accessibility of the information, lack of information quality, and reduced quantity of statements.[459]

Studies on disclosure assume that reduced transparency causes increased information asymmetry among market players, as management will be more informed about the

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[454] F Westerhoff, 'Speculative Markets and the Effectiveness of Price Limits' (2003) 28(3) Journal of Economic Dynamics and Control 493, 504

[455] International Monetary Fund (n446)

[456] T Vishwanath and D Kaufmann, 'Toward Transparency: New Approaches and Their Application to Financial Markets' (2008) 16 The World Bank Research Observer 41, 43

[457] P Madhani, 'Value addition through good governance in corporate sector: Role of disclosure and transparency' (2009) SSRN 3

[458] K Lee, 'Corporate Voluntary Disclosure and the Separation of Cash Flow Rights from Control Rights' (2007) 28(4) Review of Quantitative Finance and Accounting 393, 413

[459] R Ingleby, 'Consent Orders: Disclosure Requirements' (1985) 44 The Cambridge Law Journal 18

firm's value than the investment community. Indeed, in firms where there is insufficient financial transparency and a lack of information disclosure, there is an increased likelihood that managers will exploit their superior knowledge for their own interests of control, which will eventually cause a rise in agency costs. One explanation for this is that agency conflicts are triggered by unequal knowledge of essential information among the different actors. Furthermore, insufficient disclosure can cause a lack of disclosure of associated-party transactions, hiding the debts of large corporations via associated-party transactions and inadequate disclosure of liabilities, particularly loan guarantees given to related and unrelated parties.

Among other negative ramifications, insufficient transparency can cause insider trading, and conflicts of interest within the financial market. As an example of this fact,legal action was taken against the Saudi Cement Company due to violations of this provision, as in its 2011 board yearly financial report it did not disclose a debt amounting to around $120,000,000 that it had acquired from the SAMBA Financial Group. Resultantly, on 26th March 2011,[460] the Capital Market Authority Board fined the company $13,333 according to Article 43-B-2 of the Saudi Listing Rules, which assert that any form of debt that exists and exceeds 10% of the book value of the firm's net assets must be incorporated into the board's yearly financial reporting.[461] One could speculate that the size of the penalty imposed should have been greater, as the firm that violated the regulations had the intention to conceal certain financial statements within its board's yearly financial report. Consequently, the Capital Market Authority should have imposed a larger or different kind of sanction, rather than a fine that was trivial compared to the benefit gained from this concealment.

Hence, in more serious situations, insufficient compliance with or limitations in satisfying the disclosure necessities can instigate criminal proceedings against the breaching firm. The illegal aspect of the lack of disclosure, whether purposeful or not, is not only based on the lack of submittal of the necessary documents or mistakes in the contents of those documents, but also the accusation of the intent to deceive, misstate, hide, cheat, avoid or evade efforts to offer information to shareholders and additional stakeholders that could have critical importance for decision-making processes. Therefore, transparency necessities should be reinforced through effective deterrents and enforcement frameworks in situations where inaccurate or deceptive information

[460] The Appeal Committeefor the Resolution of Securities Conflicts Issued Decision (2011) No. 888-L-D1-2011
[461] The Saudi Listing Rules 2017, Article 43-B-2

is provided.[462] Regulators of stock markets should be conscious of the potential loopholes that exist in market regulations and should take extra precautions to eradicate abnormal misrepresentation and deficient disclosure.

5.1.5 The Difficulty Associated with Disclosing Information in the Saudi Stock Market

On the other hand, an increased degree of transparency could lead to certain negative impacts within financial markets. The primary drawback of transparency is unnecessary costs. Even though there are significant advantages to augmenting transparency by passing through more instructive disclosure, companies do not divulgeall aspects of their proprietary information, as such disclosure is not free from cost. Consequently, disclosure is regarded as a logical trade-off between the advantages and costs; managers must make decisions to ascertain the volume and kind of disclosure that optimises the benefits in combination with reasonable costs.[463] According to Elliott and Jacobson, the costs associated with disclosure incorporate those related to collecting, processing, auditing and distributing the statements.[464] Hence, the costs involved with the preparation of such information could have considerable effects on the volume and type of disclosure, as the production of this information is not without cost.

Therefore, when making decisions regarding the type of information disclosed by firms, management must consider both the advantages and costs of these actions, and subsequently determine the amount and the kind of information that will be suitable for release. Any information disseminated should have worth for investors and be specifically selected for market participants. A balance should be achieved between the information that will be disclosed and the associated costs. If this is not the case, information disclosure will impose further burdens on firms.

The objective of disclosure statements is quality rather than quantity.[465] It is recommended that relevant key information should be disclosed to users to help them in the assessment of their companies. Information is regarded as being dependable if it can impact users' decisions.[466] Therefore, "more is better" cannot be accepted as the optimal policy to increase Saudi transparency standards. Borgia (2007) concluded that if a person has a particular desire to conceal information, the ideal option is to bury it in

[462] M Gelter and M Siems, 'Judicial Federalism in the ECJ's Berlusconi Case: Towards More Credible Corporate Governance and Financial Reporting?' (2005) 46 Harvard International Law Journal 487, 493
[463] ibid
[464] R Elliott and P Jacobson, 'Costs and Benefits of Business information' (1994) 8(4) Accounting Horizons 80, 82
[465] ibid
[466] ibid

a great volume of data.[467] Indeed, This suggests that policymakers should generate optimal transparency that considers costs and advantages before requesting information from firms in financial markets.

Another concern is that an increased degree of transparency allows competitors increased access to beneficial information, which could jeopardise the firm's competitive edge. These drawbacks could lead to firms incurring competitive costs.[468] A firm's competitive position could be negatively impacted by the volume of information that is revealed.[469] Publicly disclosing certain information, such as costs of production and the profit levels of a particular business line, could also encourage employees within the company to demand higher levels of compensation; customers could demand reduced prices and the firm's negotiating position within the market could be weakened. Furthermore, the disclosure of information about novel products could facilitate the production of similar products by rivals.[470] However, the real impact of revealing specific proprietary information on the level of competitiveness is hard to determine.

Although the general public is entitled to access certain vital information regarding a company's performance, the company is entitled to refuse to publish some aspects of private information such as the firm's management strategies and trade secrets. For instance, companies are entitled to conceal some information in financial markets such as technical information or trade secrets which ought to be hidden and not be made accessible to the general public for strategic and competitive reasons. It is essential to have a balance between confidential information and essential information; otherwise, the anticipated benefits could be overcome by the potential disadvantages of transparency.

Because of this, the Companies Act (2006) stipulates that there is no need to disclose information regarding forthcoming developments or issues under negotiation.[471] This statement supplies a degree of protection for companies against some of the negative impacts of presenting this extremely confidential information. Therefore, managers

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[467] F Borgia, 'Corporate Governance and Transparency: The Role of Disclosure in Preventing New financial scandals and crimes' (2005) American University 22

[468] E Benjamin and S Michael, 'Transparency and Corporate Governance' (2007) SSRN Electronic Journal, <http://www.nber.org/papers/w12875> Accessed May 2020

[469] M Carney, E Gedajlovic and S Sur, 'Corporate Governance and Stakeholder Conflict' (2011) 15 Journal of Management & Governance 483, 501

[470] Elliott and Jacobson (464) 85

[471] The UK Companies Act 2006, S 417

are entitled to refuse to disclose certain information if they believe that such disclosures would be detrimental to the firm; consequently, they should assess the possible drawbacks of confidential information to determine which particular disclosure would or would not be harmful to divulge to competitors.[472]

Therefore, it would be recommended if the principal elements of information privacy were distinctly identified. Article 26 of The IASB (2010) permits disclosure requirements to be relinquished when the issuer believes that the disclosure would be harmful to him/her, and such omission would be unlikely to mislead investors' evaluation of the securities.[473] Such a measure may be required, particularly in the case of highly competitive companies which have industrial secrets. Thus, this provision could certainly be suitable for Saudi firms in order to avoid disclosing information that has a significant effect on public interest while at the same time sustaining confidentiality.

An additional concern is that the complex nature of transparency rules could present challenges with understanding. The adoption of numerous transparency regulations may be ineffective if market players or the users of information do not comprehend them. Generally, language that is highly complex and technical creates difficulties in terms of the public's understanding of regulations. Therefore, this could negatively affect the degree of transparency that exists within financial markets.[474] Secondly, the degree of transparency that exists in world financial markets is compromised, since information is normally only published in the English language.[475] Thus, it could be challenging for Saudi shareholders to understand the disclosed information as a result of language differences.

Therefore, although large volumes of information may be revealed in financial markets, there could still be a reduction in the degree of transparency as the inherent complexities could negatively impact the transparency efficiency and its clarity. The ability to access information is irrelevant if the users of this information cannot comprehend the information that has been published. Hence, even though the market could have a high degree of transparency, users might be unable to interpret and

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[472] FASB, 'Improving Business Reporting: Insights into Enhancing Voluntary Disclosures' SteeringCommittee Report, Business Reporting Research Project (2001) Financial Accounting Standards Board 15
[473] IASB, The Conceptual Framework for Financial Reporting (2010) Article 26
[474] C Bradley, 'Transparency is the New Opacity: Constructing Financial Regulation after the Crisis' (2011) 1 American University Business Law Review 10
[475] ibid

respond to the information they have accessed.[476] Consequently, past studies have suggested that this language-related 'obstacle' seems to prevent the transferral or interpretation of the advised international corporate governance conventions. Hence, the CMA should propose the issuance of an increased number of publications on the subject of corporate governance disclosure in the Arabic language.

An additional challenge is that even when regulations are in place, complete disclosure is not assured. An explanation for this is that corporate reporting regulation intends to ensure that external investment communities can access the minimum amount of information required in the investment decision-making process.[477] Fundamentally, managers have the complex responsibility to decide the extent to which information should be revealed. However, when they conceal important information, it can be challenging to statistically estimate them in the markets.[478] Moreover, in settings where voluntary disclosure is permitted, listed company managers often make public disclosures for reputational or operational reasons; for example, to encourage higher security prices or raise new capital.

All these above-mentioned factors could negatively affect the degree of transparency, even in situations where the information is available. Hence, policymakers should take these challenges into account and establish optimised transparency requirements.

5.1.6 Degree of Compliance with Disclosure Provisions in Saudi Arabia

The CMA is mandated to investigate and take appropriate enforcement actions in the event that disclosure provisions are violated. For instance, in 2006, a total of 83 cases were referred to the CMA, some of which were via shareholders' referral reports.[479] A large proportion of these examples were related to manipulation of the market and disclosure postponement. The administrative resolution and punishments that the CMA can employ include the daily suspension of trading activity, warnings, punishment, and cease orders.[480]

For example, legal action was taken against the Southern Province Cement Company,

[476] T Vishwanath and D Kaufmann, 'Toward Transparency: New Approaches and Their Application to Financial Markets' (2008) 16 The World Bank Research Observer 41, 44

[477] H Wolk, J Francis and M Tearney, *Accounting Theory: A Conceptual and Institutional Approach*(1992) South Western Publishing 5

[478] ibid

[479] World Bank 'Corporate Governance Country Assessment: Kingdom of Saudi Arabia' (2009) <http://www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf> Accessed 10 October 2020

[480] ibid

which released information on its profits pertaining to the second quarter of 2008, by publishing on the internet a speech given by the board chairman during the firm's general meeting. Consequently, the Capital Market Authority Board imposed a fine of $13,333, as the firm's directors did not formally notify the CMA or the stock exchange prior to unofficially announcing its profits online.[481] This judgement was founded on Article 44 of the Listing Rules, which stipulates that firms are obliged to declare, via electronic applications, their interim and annual accounting information once approved by the board, and these statements should not be given to stakeholders before being announced on the stock exchange.[482] Additionally, the verdict was based on the SCGR (Article 15), which requires that the financial market ought to be promptly notified of the outcomes by the firm's general meeting.[483] Undeniably, this legal action as well as the fine that was levied were justified. Therefore, the acts of disclosing the board's yearly financial report, forecasted profits or other important firm statements prior to notifying these official entities should be subject to discipline so as to guarantee that the market functions in an equitable manner.

nonetheless, despite the fact that Article 49 of the Saudi CML states that manipulation of the market is any action that generates an erroneous or deceptive market impression or the value of securities.[484] Despite this provision, the majority of firms in Saudi Arabia fail to satisfy the requirements regarding the disclosure of information. This kind of conduct is widespread in the country due to the weakness of the CMA supervision and the structure of concentrated ownership.[485] These conditions have motivated key speculators to implement market manipulation, disseminate rumours, and conduct fake transactions.

Moreover, the degree of compliance with the specifications of non-financial disclosure has been defined as poor. In general, Saudi firms reveal information associated with non-financial matters, but the volume of information disclosed is low in comparison to similar firms in developed countries. This could be clarified by there being no general comprehension of the significance and perceived advantages of corporate non- financial disclosure, the lack of compulsion to reveal this type of statements, the lack of strength

[481] The Capital Market Authority Board Issued Decision (27 June 2011) 833/l/d3
[482] The Listing Rules 2017, Article 44
[483] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 15
[484] Saudi Capital Market Law 2003, Article 49
[485] M Alsaadi, B Tijjani and K Falgi, 'Corporate Governance and Quality of Financial Reporting of Listed Firms: Evidence from Saudi Arabia' (2021) 392, 404

of the accounting sector, and the absence of obligatory disclosure requirements.

Several researchers have tried to statistically analyse the degree to which firms are compliant with corporate governance standards within Saudi Arabia. According to Dudley, it is widely acknowledged that manipulation of financial markets almost definitely occurs in various parts of the Saudi financial market.[486] Although regulations have been implemented, the CMA does not effectively enforce them, and it frequently turns to imposing and gathering trivial fines from companies that have contravened the disclosure rules. Nevertheless, irrespective of the disciplinary measures, firms continue to violate the stock market regulations. This could be because the fines imposed are not sufficiently high in comparison to the net profits the companies can gain from these actions, and therefore they do not act as a deterrent.

Al-Janadi et al. (2013) developed a restricted corporate governance index to investigate the degree of compliance with effective governance disclosure practices among 87 companies in 2006 and 2007. Their findings demonstrated that only 42% of companies listed on the Saudi Stock Exchange disclosed information regarding their corporate governance practices.[487] Hence, this poor degree of compliance indicates that efforts to enforce the regulations must be further reinforced. Consequently, the establishment of a "compliance and enforcement committee" within the CMA to oversee the levels of compliance among trading companies on an ongoing basis could be an important first step in this regard.

5.2 The Connection between Ownership Structure and Corporate Disclosure

Previous research has established a connection between the number of disclosures and key features of a firm, such as its size, ownership, and liquidity. Extant research has shown that the amount and quality of disclosure by corporate governance is influenced by the ownership framework.[488] Indeed, Eng and Mak confirmed that the overseeing level, and consequently the disclosure level, are determined by the ownership framework,[489] while other scholars established a definite connection between the structure of ownership and disclosure of information.[490]

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[486] Dominic Dudley, 'Riyadh Tightens Market Regulation' (2013) Meed Editorial

[487] Y Al-Janadi, A Rahman and N Omar, 'Corporate Governance Mechanisms and Voluntary Disclosure in Saudi Arabia' (2013) 4(4) Research Journal of Finance and Accounting 25

[488] Q Rafique and M Khalique, 'Corporate Governance: Disclosure and Transparency' (2011) SSRN Electronic Journal < 10.2139/ssrn.1862644> Accessed 23 October 2020

[489] L Eng and Y Mak, 'Corporate governance and voluntary disclosure' (2003) 22 Journal of Accounting and Public Policy 325, 340

[490] B JesperL and T Plenborg, 'Value Relevance of Voluntary Disclosure in the Annual Report' (2008) 48 Accounting

Given the significance attached to ownership and its associated variables, the next section, therefore, considers in more detail the relationship between currentstandards of corporate disclosure in Saudi Arabia and structures of ownership. Four categories of ownership structure will be considered: director, family, institutional and governmental ownership.

5.2.1 Director Ownership and Corporate Transparency

The reason why director ownership matters is that the directors have an important role in determining policies associated with corporate governance disclosure.[491] There have, however, been few studies concerning the evaluation in Saudi Arabia of the connection between corporate disclosure and managerial ownership. It is therefore important to assess this relationship, especially regarding the extent to which Saudi firms comply with the rules.

In the Saudi context, Article 90 of the SCGR stipulates that boards should provide details of any interests, choices and subscription entitlements held by senior executives, company directors and their relatives in a firm's debt instruments or sharesand its subsidiaries, including any changes which may have happened during the previous financial year.[492] As an illustration of the enforcement of this concept, legal action was taken against the Saudi Telecom Company (STC) for violating these rules because it failed to include the interests, preferences, and donation rights held by senior executives and board members in its 2009 yearly financial report. In compliance with Article 45 of the Listing Rules, the Capital Market Authority Board levied a statutory fine of $26,666 on the company.[493]

One explanation for this is provided by agency theory, which implies that higher levels of management ownership give firms less reason to disclose information.[494] Demsetz and Lehn also claim that there may be competing conflicting interests between internal and external shareholders.[495] Consequently, director ownership can make agency problems worse. Since directors possess a larger amount of information concerning the

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and Finance 159, 176

[491] C Chalevas, 'The Effect of the Mandatory Adoption of Corporate Governance Mechanisms on Executive Compensation' (2011) 46 (2) The International Journal of Accounting 138, 144

[492] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 90

[493] The Capital Market Authority Board Issued Decision (27 June 2010) 783/l/d1

[494] ibid

[495] H Demsetz and K Lehn, 'The Structure of Corporate Ownership: Causes and Consequences' (1985) 93 (6) Journal of Political Economy 1155, 1176

firm than the external shareholders do,[496] this will encourage them to make use of insider information, to the detriment of external shareholders.[497] McConnell and Servaes also indicate that the board may use such information for their personal financial gain, rather than doing what is in the firm's best interests.[498] Additional empirical evidence from many research studies has indicated a negative connection between disclosure and managerial ownership. For example, using a corporate governance index, Hussainey and Al-Najjar studied 130 firms in companies inthe UK and found that when there is an increase in managerial ownership, firms were even less likely to make disclosures.[499]

However, not all researchers agree that the association between director ownership and the disclosure level is entirely negative. Some have conducted research that has shown the relationship to be positive, because it minimises conflicts of interest between shareholders and directors. managerial ownership lowers both agency and monitoring costs.[500] Jensen and Meckling also contend that director ownership provides an equivalent level of protection for both directors and external shareholders as they have similar interests.[501] Taking both arguments into consideration, research investigating the impact of director ownership on firm performance has yielded mixed outcomes; consequently, the nature of the association between disclosure and director ownership is difficult to predict.

5.1.1 Institutional Ownership and Corporate Transparency

In Saudi Arabia, few studies have explored the link between corporate governance disclosure and institutional ownership. Therefore, the following paragraphs will aim to establish the degree to which corporate disclosure can be strengthened by institutional investors. Research evaluating the main role occupied by institutionalinvestors in the enhancement of corporate governance and the encouragement of disclosure and transparency has yielded mixed results.

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[496] L Bebchuk and M Weisbach, 'The State of Corporate Governance Research' (2010) 23(3) The Reviewof Financial Studies 939, 951
[497] Demsetz (n495) 1176
[498] McConnell and Servaes (n81) 603
[499] K Hussainey and B Al-Najjar, 'Understanding the Determinants of Risk Metrics/ISS Ratings of the Quality of UK Companies' Corporate Governance Practice' (2012) 29(4) Canadian Journal of Administrative Sciences 366, 368
[500] Madhani (n457)
[501] Jensen and Meckling (n135) 474

Several scholars have suggested that firms in which numerous shares are owned by institutional investors have a greater likelihood of disclosing such information appropriately. This is because these investors can oversee management effectively and can decrease any agency problems, which is not the case for individual investors. Substantive ownership of equity provides institutional investors with undisputable power and rights in capital markets, enabling them to have a powerful effect on a firm's transparency level. According to Donnelly and Mulcahy (2008), institutional investors can assess the financial decisions taken by management more effectively than small shareholders.[502] Concerning the latter benefit, they are also better equipped to interpret the information on disclosure contained in annual reports asthey have the skills to conduct a complex financial analysis.[503] It, therefore, followsthat an increase in the number of institutional investors will enhance the quality of disclosure.

This claim is supported by numerous experiential studies that have identified a definite connection between corporate disclosure and the degree of institutional ownership. Hussainey and Al-Najjar (2012) identified a decisive association between institutional investors and corporate disclosure in a study of 130 companies in the United Kingdom from 2003 to 2009. Many transnational studies have also yielded similar results.[504] For example, in a study of 23 countries from 2003-2008, Aggarwal et al. (2011) discovered that firms with greater levels of institutional ownership have more potential of exhibiting better corporate governance.[505]

However, other studies have discovered the opposite to be the case, claiming anadverse association between corporate disclosure and institutional ownership.[506] The findings of many empirical pieces of research in emerging countries suggest several factors that may account for this negative relationship. For example, if institutions ownlarge portion of a company, they may either discourage voluntary disclosure or manipulate it to serve their own interests. This, inevitably, will be at other shareholders' expense and will therefore increase agency cost.[507] Results similar to this finding have been found

[502] A Lubis, 'Factors Affecting the Area of Voluntary Disclosure in Annual Report' (2011) SSRN Electronic Journal, <10.2139/ssrn.1913064> Accessed 1 May 2020
[503] ibid
[504] Hussainey and Al-Najjar (n499) 370
[505] Aggarwal et al (n136) 160
[506] E García-Meca and J Sánchez-Ballesta, 'The Association of Board Independence and Ownership Concentration with Voluntary Disclosure: A Meta-analysis' (2010) 19(3) European Accounting Review, 603, 621
[507] Jensen and Meckling (n135) 472

specifically in Saudi Arabia. For instance, Alsaeed (2006)produced a disclosure index of 20 voluntary provisions to assess disclosure levels in 40 Saudi-listed companies. He found that institutional ownership had no correlation with appropriate disclosure.[508] Alsaeed's study, however, suffers from several limitations. For example, the small sample limits the degree to which the results may be generalised.

Given the mixed research findings in this regard, the only reasonable claim that can be made is that large institutional investors will certainly engage in monitoring but, once moderate ownership is attained, such engagement will decline and they will be more persuaded to make decisions that serve their interests once they have the dominant ownership.[509] Thus, the actions of investors are dependent on their size as a block.[510] The role such institutional investors play in lessening information asymmetry and agency cost is also dependent on the ownership structure of a firm. In a widely-owned firm, institutional investors can compel managers to provide them with additional corporate information so that they can assess the company with respect to its performance.[511] The agency theory discussed previously shows that, to defuse the agency conflicts that arise between the diverse interests of multiple institutions, increased levels of disclosure will be required when institutional ownership is diffuse rather than concentrated.

Taking the fact that Saudi Arabia is an emerging economy into consideration, Institutional ownership in Saudi Arabia has historically been low,[512] and the CMA has made no attempt to encourage a greater number of shares held by institutions to improve transparency in the CG standards in Saudi companies. Thus, it is recommended that the Saudi CG code puts pressure on institutional investors to encourage corporations to implement strong corporate governance practices and increase corporate governance disclosure.

The challenge is therefore to find a means of increasing the active involvement of Saudi institutional shareholders with regard to enhancing the level of qualified disclosure. To achieve this, institutional investors should be active and should regularly add more pressure on firms to disclose information that is of better quality. However, they need

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[508] Alsaeed (n487) 403
[509] ibid
[510] N Mintchik, A Wang and G Zhang, 'Institutional Investor Preferences for Analyst Forecast Accuracy: Which Institutions Care?' (2014) 6(1) International Review of Accounting, Banking and Finance 30
[511] ibid
[512] Al-Janadi and Rahman (n489) 29

to acquire a more influential block of shares if they are to encourage companies to engage in corporate governance with increased levels of transparency. Recently, levels of transparency have risen in developed countries, primarily due to shareholder activism in corporate governance. shareholder activism in the US has been advocated and espoused by institutional investors to improve corporate governance associated with disclosure.[513]

Larger creditors or banks are better equipped to fulfil these perspectives because they have the ability to intervene in the crucial decisions taken by firms.[514] Also, blockholders such as those administering investment trusts and pension funds, hold substantial amounts of equity in companies and their subsidiaries. Indeed, high ownership of investment funds may have a notable effect on a firm's value as an indication of their effective engagement and monitoring.

Moreover, in this respect, the UK Combined Code stipulates that institutional investors should implement the following actions: 1. Engage in discussion in firms. Institutional shareholders must commence discussion with firms according to the mutual understanding of their goals. 2. Institutional shareholders must evaluate seriously all the elements revealed to them when assessing a company's governance arrangements, especially those related to the composition and framework of the board.[515] This provision would be beneficial if it is adapted to the Saudi context.

Nonetheless, The primary channel of communication used by a large number of listed company boards In the UK is that of private meetings with institutional shareholders.[516] Such meetings continue to be supported by policy makers on the grounds that engaging in this type of exchange is the optimal way to enhance standards of corporate governance. Principle E.1 of the UK Corporate Governance Code stipulates that it is the directors' responsibility to take steps to guarantee that such a discussion takes place with shareholders and that it is satisfactory.[517] The UK Code does not, however, delineate the range and nature of the issue falling under governance and strategy that are considered suitable topics to be discussed with principal investors at private

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[513] A Zouari and I Rebaï, 'Institutional Ownership Differences and Earnings Management: A Neural Networks Approach' (2009) 34 International Research Journal of Finance and Economics, 42, 44

[514] M Ruiz-Mallorquí and D Santana-Martín, 'Dominant institutional owners and firm value' (2011) 35 (1) J. Bank. Finance 118, 120

[515] Financial Reporting Council 2006, Article 19 and 20

[516] J Steve, 'FSA Crackdown on Cash for CEO Access' (2013) Financial Times <https://www.ft.com/content/084a4bdc-84db-11e2-891d-00144feabdc0> Accessed 14 May 2020

[517] UK Corporate Governance Code 2018, Principle E.1

meetings. Nor does it identify the strategic content and form of governance deemed price sensitive that must therefore be publicly disclosed in compliance with continuous disclosure regimes. The level of this loose limitation in this regard constitutes a substantial problem.

Embedded within the current regulatory structure in the UK are provisions that penalise insider trading in order to offset potential transfers of wealth to traders who possess inside information.[518] For companies whose private communication structures are well-established, they typically ensure compliance with these regimes by contending that information passed on through private channels is not considerably price sensitive and simply offers an extended explanation of content that is disclosed publicly. However, it is hard to determine whether such arguments are valid as most exchanges between the market and corporations take place in private and such communications cannot be overseen by an independent body. Based on such forceful evidence, any recommendations that advocate communication on matters related to governance at private meetings with institutional investors can be called into question.Regulators and policy makers must therefore limit and tighten the allowance and the endorsement of communication between companies and selected investors at closed meetings.

5.1.2 Family Ownership and Corporate Transparency

A low level of disclosure has, in many research studies, been attributed to family ownership.[519] Members of families usually have direct availability of information relating to the firm.[520] Members of companies with family connections may also withhold corporate governance information to ensure their safety and protection. Consequently, it may not be in the interests of a family who are large shareholders to compel listed companies to raise their level of disclosure.[521] It is, therefore, reasonable to conclude that the ratio of family members on a board will have an adverse correlation with the disclosure of corporate governance. This indicates that levels of transparency in Saudi Arabian companies will be significantly affected by the extent of family ownership. Therefore, regulators and policymakers should take into consideration that it is important to define the maximum number of members who will become directors of listed family firms.

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[518] UK Financial Conduct Authority Handbook, DTR 2.2.1
[519] B Quattrociocchi, S Sergiacomi and F Mercuri, 'The influence of corporate board on non-financial disclosure according to the main organizational theories' (2020) Research and development studies 11
[520] ibid
[521] ibid

5.1.3 Government Ownership and Corporate Transparency

According to stakeholder theory, state ownership will have a strong impact on governance disclosure. This is particularly true in developing nations where governmental concentrated ownership is much broader.[522] In Saudi Arabia, the government has a substantial stake in major private and public companies, primarily through organisations such as the General Organization for Social Insurance (GOSI), Public Investment Fund (PIF), and Public Pension Agency (PPA). The firms in which Saudi Arabia has high levels of ownership are worth 42 per cent of the Saudi stock market's overall value.[523] However, despite this high ownership, few studies have assessed the effect of government ownership on corporate disclosure in Saudi Arabia. To address this deficit, the current subsection aims to explore this relationship in relation to the quality of transparency in Saudi Arabia.

Researchers have found that the disclosure level has a negative connection with the state ownership level.[524] This implies that Saudi Arabian governments either fail to persuade companies to raise their levels of disclosure or are ineffective in doing so.Low disclosure levels are likely to be a feature of companies with political affiliations, as powerful members will protect them from penalties for low disclosure.[525] Moreover, some scholars have suggested that government ownership naturally results in governmental involvement in the everyday operation of the company, the consequence of which may be that directors and CEOs might be given jobs irrespective of qualifications and experience on disclosure process.[526] Therefore, political affiliations must be limited to a certain proportion to avoid impeding corporate governance disclosures. The Saudi GCR that address corporate governance have no limits on how many board members are allowed to have political affiliations.

5.1.4 The Impact of Company Size on Corporate Transparency

Research exploring the connection between corporate governance and corporate disclosure has often used company size as one of the key variables that determine the

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[522] Ibid
[523] D Stefano, *Board of Directors: A Review of Practices and Empirical Research* (Virtus Interpress 2020)59
[524] k Samaha and K Dahawy, 'Factors influencing corporate disclosure transparency in the active sharetrading firms: an explanatory study' (2010) 10 Research in Accounting in Emerging Economies, 87, 94
[525] P Chaney, M Faccio, and D Parsley, 'The Quality of Accounting Information in Politically Connected Firms' (2011) 51 Journal of Accounting and Economics 59, 60
[526] ibid

transparency standard. They have shown that company size certainly has a positive association with disclosure.[527] Watson et al. (2002c) found that, compared to smaller companies, larger companies in the UK will disclose more ratios.[528] This is because larger organisations may have more reasons to influence disclosure practices than smaller organisations.[529] For example, the costs of disclosure are lower for large companies as smaller companies will be more financially impacted by the need to spend money on information gathering, printing, and publishing.[530] Consequently, it is larger firms with a greater number of resources and more money that will probably be better able to afford an analysis and subsequent publication of disclosure information. Another possible justification is that such companies are operationally complex: they produce a wide range of products and have substantial geographical reach, being listed on global stock exchanges.

5.2 The Association of Board of Directors' Characteristics on Corporate Transparency

Senior executives and board members have responsibility for overseeing the policies of the company, including transparency and disclosure.[531] Unfortunately, irrespective of this necessity, the Saudi CGR does not stipulate the board's function in facilitating dependable disclosure. While, practice in the United Kingdom CG has been more explicit regarding the board's function in attaining a high standard of transparency. The UK Corporate Governance Code (2018) requires that the principal responsibility of the board is to offer an impartial, equitable and comprehensible evaluation of the firm's situation and expectations. The UK Corporate Governance Code has applied serious consideration to the transparency and disclosure of the annual reports of the board, thereby supplying numerous guidelines concerning these components, particularly the board's transparency and disclosure requirements in its annual reports, as follows:[532]

1) An interpretation of the board's major activities.

2) A portrayal of principal designs and decisions of the board of directors.

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[527] ibid

[528] A Watson, P Shrives and C Marston, 'Voluntary disclosure of accounting ratios in the UK' (2002) 34 British Accounting Review 289, 297

[529] T Cooke and R Wallace, 'Financial Disclosure Regulation and its Environment: A Review and Further Analysis' (1990) 9(2) Journal of Accounting and Public Policy 79, 102

[530] M Chavent and Others 'Disclosure and Determinants Studies: An ExtensionUsing the Divisive Clustering Method (DIV)' (2005) 15(2) European Accounting Review 8

[531] T Vishwanath and D Kaufmann, 'Toward Transparency: New Approaches and Their Application to Financial Markets' (2008) 16 The World Bank Research Observer, Oxford University Press 41, 49

[532] G Furstenberg, `Hopes and delusions of transparency` (2001) 12 North American Journal of Economics and Finance 105, 117

3) An understanding of any significant variations between the operating outcomes of the past year or any prediction made by the directors.

Thus, the directors' attributes are significant in establishing efficient corporate disclosure.[533]

Thus, the corporate governance mechanisms which will be examined in this section include (i) independent directors; (ii) the size of the board; and (iii) an audit committee to assess the connection between these mechanisms and corporate disclosure.

5.2.1 The Impact of Proportion of Independent Directors on the Board Transparency

When the number of independent non-executive directors increases, the rate of overseeing disclosure will also increase.[534] This argument can be justified because independent non-executive directors have no connection with the company as managers and executive directors do; consequently, they represent the shareholders' interests independently.[535] We should anticipate greater voluntary disclosure when a larger number of independent (external) directors are board members, as a way to minimise the risk they may encounter in a situation where there is poor management on the part of inside directors' or if the insider provides misleading information.[536]

Non-executive directors bring improved ideas to a corporation through their more comprehensive business knowledge.[537] Therefore, this concept may imply that a large percentage of independent directors leads to a greater extent of disclosure. Beasley discovered that firms with a low proportion of independent directors had a high likelihood of producing fraudulent financial statements. On the other side, it was revealed that companies with a greater proportion of independent directors were had a considerably lower potential of producing fraudulent statements.[538]

By contrast with the positivity which previous studies have accepted, certain researchers conclude that companies which have a considerable percentage of non- executive directors may subsequently reduce the disclosure level. For instance, a sample of around 400 large companies in the United States was investigated by Agrawal and

[533] ibid
[534] J Forker, 'Corporate governance and disclosure quality' (1992) 22 Accounting and Business Research 111, 120
[535] K Pincus, M Rusbarsky, and J Wong, 'Voluntary formation of audit committees among NASDAQ firms' (1989) 8(4) Journal of Accounting and Public Policy 260, 239
[536] S Lim, Z Matolcsy and D Chow, 'The association between board composition and different types of voluntary disclosure' (2007) 16(3) European Accounting Review 555, 578
[537] V Taurngana, 'The Impact of Listing Status and selected Company Characteristics on Voluntary Disclosure in the United Kingdom' (1997) PhD Thesis, Napier University 134
[538] Beasley (n37) 445

Knoeber, who found an inverse link between company transparency and the ratio of independent directors, they showed that in firms where independent members dominated the board, company transparency was lower.[539] Likewise, in research conducted by Tauringana and Mangena (2009) on the level of firm reporting by 32 corporate sector firms in the United Kingdom, the connection between the disclosure level and the percentage of non-executive directors was discovered to be low. They asserted that in a company with a larger ratio of non-independent directors, the managers may influence these directors, consequently, a qualified standard in the annual reports may not be encouraged or compelled.[540] Moreover, Al-Abbas investigation of the impact of independent directors on companies listed in Saudi Arabia revealed no relevant connection between the percentage of independent directors and the degree of transparency standard.[541]

This conforms to the theoretical prediction of a lower level of interaction between the company's senior managers and independent directors who are less familiar with the firm's operation.[542] When considering the aforementioned disadvantage, the method to reduce the possibility of negative involvement of independent directors is to encourage corporations to have a balanced ratio of independent directors and insider directors would probably have a positive connection with accountability and transparency.

It is worth mentioning that the attention given to Saudi companies' independent directors is comparatively new. Consequently, regulators and policymakers ought to encourage a greater number of independent non-executives in listed firms in order to be balanced, with that of insiders, since at present there are humble number of independent directors in the majority of Saudi companies.

5.2.2 The Impact of Corporate Board Size on Corporate Transparency

Whenever a board consists of a large number of members, its overseeing ability and proficiency increases.[543] There is a connection between the board's size and the existence of members who are independent, knowledgeable and experienced.[544]

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[539] A Agrawal and Knoeber (n24) 385

[540] V Taupingana and M Mangena, 'The Influence of the Business Review on Key Performance Indicators Reporting in the UK Media Sector' (2009) The Institute of Chartered Accountants of Scotland 18

[541] M Al-Abbas, 'Corporate Governance and Earning Management: An Empirical Study of the Saudi Market' (2009) 15(1) Journal of American Academy of Business 20

[542] G Nicholson and G Kiel, 'Can Directors Impact Performance? A Case-Based Test of Three Theories of Corporate Governance' (2007) 15(4) Corporate Governance: An International Review 585, 596

[543] R Hidalgo, E García-Meca and I Martínez, 'Corporate governance and intellectual capital disclosure' (2011) 100(3) Journal of Business Ethics, 483, 486

[544] Alsaadi, Tijjani and Falgi (n485) 406

Directors who possess financial and accounting expertise may be needed by a large company to understand some of the disclosed information. It is more likely that this type of experienced directors will be found on larger boards with a greater diversity of proficiency.

A study that analysed the impact of corporate governance on capital disclosure involved eight corporate governance attributes, including the size of the board. The findings revealed a decisive effect of the size of a large board on capital disclosure.[545] Likewise, a study did a quantitative analysis (from 2004 to 2010) of 80 Saudi-listed companies, the study found a positive impact of the large board size on the level of compliance with the disclosure requirements.[546] Moreover, Al-Nodel and Hussainey (2010) investigated company performance and board size in 37 Saudi-listed companies from October 2005 to January 2006. They found that a decisive connection exists between the size of the board and the degree of compliance with disclosure requirements.[547] These studies suggest that in the case of larger boards, it is possible to sustain quality when the directors have a broad range of expertise. The majority of researchers are in agreement regarding the significance of knowledge diversification among the members of large board size.

5.2.3 The Impact of Audit Committee Characteristics on Corporate Transparency

The audit committee, which is considered to be a corporate governance mechanism, is categorised as a significant variable for overseeing company disclosures and transparency. This committee's major function is, in its role as a sub-committee of the board, to oversee the reporting procedures of both financial and non-financial information. The overseeing function of the audit committee can, from the viewpoint of the agency theory, be regarded as an instrument to moderate agency cost.[548] According to the Cadbury Report, the audit committee monitors the directors' performance and their management, especially on issues connected with corporate governance disclosure.[549] Furthermore, to protect the shareholders' interests, the audit committee oversees the internal and external auditors.[550]

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[545] Hidalgo and García-Meca (n543) 486

[546] W Albassam, 'Corporate governance, voluntary disclosure, and financial performance: ban empirical analysis of Saudi listed firms using a mixed-methods research design' (2014) University of Glasgow 183, 194

[547] Al-Nodel and Hussainey (n2) 12

[548] S Ho and K Wong, 'A study of the relationship between corporate governance structures and the extent of voluntary disclosure' (2001) 10(2) Journal of International Accounting, Auditing and Taxation 139, 144

[549] Cadbury Committee (n53)

[550] ibid

The audit committee members must be sufficiently experienced in finance to undertake their duties and to attain an efficient review of financial reporting. In the United States, corporations must have one or more financial experts as members of their audit committee. If this stipulation is ignored, they are not permitted to be listed on the New York Stock Exchange (NYSE) or the National Association of Securities Dealers Automated Quotations (NASDAQ).[551] This distinctly implies that it is probable that a director and financial experts will address any financial concerns of the management. This can suggest that the market regards the audit committee members' financial proficiency as improving disclosure quality.[552]

Furthermore, to attain its objectives, the audit committee ought to be independent of the company's management.[553] An audit committee's independence is evaluated as the percentage of independent non-executive directors who serve on that committee. The FRC advises that a minimum of three (two for smaller companies) audit committee members ought to be independent non-executive directors.[554] Moreover, an audit committee's size positively determines the level of disclosures in large public listed corporations' annual reports. Li et al. (2008) analysed the connection between the audit committee's size in the annual reports of 100 UK companies from high intellectual capital sectors which are listed on the London Stock Exchange (LSE) for the financial year March 2004 to February 2005. The findings demonstrate that the size of audit committee membership have a decisive effect on intellectual capital disclosure.[555] This confirms that where an audit committee size is large, there may be better protection of the stakeholders' interests.

Despite the aforementioned advantages of forming an audit committee, unfortunately, Saudi corporations are not required by the country's CGR to identify the audit committee function to oversee continuous compliance with CG provisions. Therefore, it is important to recommend that Saudi Arabia could adopt the conditions on audit committees produced by the FRC (2012) which recognises the audit committee's function concerning account reporting. At the directors' request, the audit committee

[551] McConnell and H Servaes, (n81) 598
[552] ibid 28
[553] J Bedard, L Chtourou, and L Courteau, 'The Effect of Audit Committee Expertise, Independence, and Activity on Aggressive Earnings Management' (2004) 23(2) A Journal of Practice and Theory 24
[554] FRC, 'Rising to the challenge: A review of narrative reporting by UK listedCompanies' (2009) Financial Reporting Council
[555] J Li, R Pike and R Haniffa, 'Intellectual capital disclosure and corporate governance structure in UK firms' (2008) 38(2) Accounting and Business Research 137, 140

ought to review the yearly accounts and report and also give guidance to the board as to whether it is generally equitable, objective, and understandable, and also supply the required information for stakeholders to evaluate the firm's performance as well las its business paradigm and strategy.[556] Furthermore, the US Sarbanes Oxley Act (SOX) has particular needs for initiating audit committees by the companies. Section 301(2) stipulates that the audit committee should be directly responsible for the compensation, appointment and retention of the accounting body within the company where it is employed, and also to prepare or produce an audit report or associated information. Additionally, the audit committee's function involves the supervision of the audit function of the accounting company.[557] Taking these mentioned provisions in consideration, the Saudi regulatory method should reform its standards to guarantee a suitable transparency standard as well as recommend the need to appoint qualified audit committee members in the company. Such a recommendation guarantees a distinct definition of the functions of an audit committee. Each member of such a committee must abide by these necessities to guarantee that the environment between the external auditors and the company is free of conflict.

5.3 The Impact of the Quality of Disclosure on Corporate Transparency

Several questions will therefore need to be answered; for instance, the information and extent of what companies need to report. Other questions include how, when and to whom the corporation ought to disclose information. Increased levels of transparency can have a beneficial impact on corporate governance and financial markets. However, this does not mean that all forms of information are made publicly available. The key factor to consider is the type of information that is made available, as certain information will need to be prioritised. By ascertaining which information should be prioritised, policymakers can limit 'information excessiveness' in financial markets and enhance the quality of information disclosed. In other words, to obtainthe anticipated benefits of improved transparency, it is better to concentrate on vital information that will positively influence the decisions made by investors rather than simply waste money on redundant information.

When improved quality information is accessible in the market, stakeholders, economic agents and the general public will have better knowledge of any risks and a clearer

[556] FRC, Guidance on Audit Committees 2012, Financial reporting Council
[557] Sarbanes Oxley Act 2002 in the US, S 301(2)

understanding of the firm's present position. Nevertheless, as a result of some potential difficulties in transparency legislation, the creation of effective transparency requirements is not an easy task and needs considerable effort from policymakers. Therefore, optimal transparency standards need to be established; however, the principal challenge is the way in which this may be achieved. This difficulty can be understood with regard to the aforementioned transparency problems. Therefore, it is vital for the Saudi regulator and accounting authorities to pay greater attention to presenting solutions that assist in overcoming those limitations while simultaneously concentrating on enhancing sufficient information disclosure.

Optimal transparency should have a particularly positive effect on information users' decision-makers. This is in order to initiate an environment where necessary information is accessible in the appropriate location and format as well as in a well- timed manner. Optimal transparency can be attained by utilising distinct terminology which increases the availability of the information supplied, reducing the usage of complicated technical terms, respecting all information users' common interests and ensuring the disclosure of balanced information. Moreover, the particular dimensions for the quality of the disclosed information include understandability, accessibility, as well comparability over time.[558] For this purpose, the abovementioned instruments that increase the likelihood of producing high quality of disclosure will be discussed in- depth in the next section.

5.3.1 Understandability

Financial information must be presented in an understandable way to shareholders with a satisfactory understanding of financial and business activities and accounting. The IASB shows that the financial information should be understandable and extensive.[559] Furthermore, the IASB Exposure Draft on an enhanced Conceptual Framework for Financial Reporting (2008) describes comprehensibility as the standard of information which allows the meaning to be understood.[560] It is advantageous for Saudi corporate governance regulations to adapt IASB provisions in this regard.

It is crucial to have clear legal terminology for the shareholders. Therefore, it is worthy

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[558] S Brammer and S Pavelin, 'Factors Influencing the Quality of Corporate Environmental Disclosure'(2008) 17(2) Business Strategy and the Environment 120, 134

[559] IASB, The conceptual framework for financial reporting (2010)

[560] IASB, Exposure Draft on an improved Conceptual Framework for Financial Reporting: The Objective ofFinancial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information

of mention that the number of adopted regulations does not matter unless these rules are comprehended and applied by the market participants. In view of this, a study that conducted a survey in Saudi Arabia to measure the difficulty of the readability of annual reports revealed that most respondents encountered problems in comprehending directors' annual reports.[561] Directors' annual reports should be both logical and understandable, because the majority of shareholders are unfamiliar with legal and financial terminology,[562] thus, it is essential to make reports comprehensible and simpler to understand. In addition, language barriers can restrict the transparency level. Although English is broadly accepted as the common language for Saudi national companies' annual reports, it may be insufficient to enable financial markets to be attractive for every participant. Consequently, it may be beneficial to use the Arabic language to disclose information, thus motivating a larger number of people to invest in financial markets.

5.3.2 Timing in Financial Reporting Disclosure

Since timely financial reporting disclosure improves equality among investors to enable them to obtain accounting information without needing to seek other sources, this is most certainly important and necessary.[563] Furthermore, it reduces unpredictability in decisions regarding investment. Naser et al. (2003), from this perspective, showed that they regard the timeliness of corporate reporting as a significant factor that has an impact on users' awareness of accounting information.[564] Consequently, if the information is regarded as being accessible to decision-makers in such a time that it can affect their decisions, it is considered to be timely.[565]

Nevertheless, despite the significance of timely financial reporting disclosure in Saudi Arabia, several researchers suggest that financial reporting and disclosure are not opportune.[566] A study in connection with this investigates whether corporate governance mechanisms in MENA, especially in Saudi Arabia, have any link with opportune financial reporting disclosure. Its findings imply that financial reporting

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561 M Habbash, K Hussainey and A Awad, 'The determinants of voluntary disclosure in Saudi Arabia: an empirical study' (2016) 12(3) International Journal of Accounting and Performance Evaluation 21
562 ibid
563 E Bamber, L Bamber and M Schoderbek, 'Audit structure and other determinants of audit report lag: An empirical analysis' (1993) 12(1) Journal of Practice and Theory 11
564 K Naser and R Nuseibhi, 'Users' perception of corporate reporting: evidence from Saudi Arabia' (2003) 35(2) The British Accounting Review 149, 160
565 C Botosan, 'Discussion of a framework for the analysis of firm risk communication' (2004) 39 (3) The International Journal of Accounting 289, 294
566 Habbash, K Hussainey and A Awad (n561) 21

timeliness is needed in developing nations, especially Saudi Arabia, where this is more urgently needed than in other nations, since financial statements are the only dependable information sources which is accessible to investors.[567]

Article 43 of the Listing Rules stipulates the requirement of a company to notify both the public and the Capital Market Authority, without delay, of any important advancements in its activities that are not in the public domain and which could influence the company's liabilities and assets, or its basic business operation.[568] However, in the legal case brought against the Al Masafi Saudi Arabian Company in violation of this requirement, the company postponed informing the stock exchange and the Capital Market Authority of the announcement of its directors. This postponement was caused by the firm having a general meeting on 13 July 2008 to authorise increasing the capital. The company caused this violation by not declaringthis situation until 27 July 2008. As a result of this, the Capital Market Authority Board imposed a fine of $26,666 in conformity with Article 43-A of the aforementioned Listing Rules.[569] Both the fine and the legal case are lawful because the firm increased its capital without immediately informing either the stock exchange or the Capital Market Authority of this increase.

5.3.3 Accessibility

Shareholders as information users, in the current highly visible information era, are not expected to encounter any difficulties in obtaining necessary information within the market because of technological development, particularly the internet. Numerous Saudi companies have commenced utilising modern communication methods, such as the internet, to facilitate shareholders and other interested individuals in obtaining the information that they need in order to reach investment decisions.[570] This can be regarded as a step towards easing access to information as well as supplying understandable reports. Nevertheless, in Saudi Arabia, as a developing nation, the use of the internet is less common than it is in developed nations. Therefore, lawmakers in Saudi Arabia ought to make it a compulsory requirement for companies to be familiar with new disclosure methods, such as enhancing electronic storage and distribution.

5.4 Conclusion

This chapter's objective was to investigate whether or not the transparency and

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[567] ibid
[568] Saudi Listing Rules 2004, Article 24-26
[569] The Capital Market Authority Board Issued Decision, (13 June 2008) 310/L/D1
[570] Habbash, K Hussainey and A Awad (n561) 21

disclosure requests are adequately met and whether publicly listed Saudi companies have effectively conformed to the disclosure of good GC practices. Nevertheless, as a result of certain obstacles and restrictions in the Saudi market, the sufficiency of transparency level is considered poor. Some of the hindrances which exacerbate the implementation of enhanced transparency are that the majority of firms in SaudiArabia fail to satisfy the requirements regarding the disclosure of information. Thiskind of conduct is widespread in the country due to the weakness of the CMA supervision and the structure of concentrated ownership. These conditions have motivated key speculators to implement market manipulation, disseminate rumors, and conduct fake transactions.

Moreover, the degree of compliance with the specifications of non-financial disclosure has been defined as poor. This could be explained by the fact that there is a general lack of comprehension of the significance of the advantages of corporate non-financial disclosure and the lack of compulsion to reveal this type of information. Moreover, the amount and quality of disclosure by corporate governance is influenced by the ownership framework. However, a low level of disclosure has been attributed to family ownership. there is less likelihood of family corporations to disclose than there was of non-family corporations.

Various recommendations to enhance the transparency framework in Saudi Arabia have emerged from this chapter:

In terms of content, the disclosure statements' objective must focus on quality rather than quantity. This suggests that policymakers should consider costs and advantages prior to requesting information from firms in financial markets. Establishing a compliance and enforcement committee within the CMA to oversee the levels of compliance among trading companies on an ongoing basis could be an important first step in this regard.

It is evident that directors' annual reports should be both logical and understandable because the majority of stakeholders are unfamiliar with legal and financial terminology, thus, making it comprehensible to understand is essential. In addition, accessibility to such information has a detrimental impact on companies' competitive status. Therefore, transparency should be restricted only for companies' secrecy and confidentiality. Also, lawmakers in Saudi Arabia should make it a compulsory requirement for companies to enhance utilizing modern communication methods like the Internet.

Moreover, it is recommended that regulators and policymakers put pressure on institutional investors to encourage corporations to increase and implement strong corporate governance disclosure. Lastly, The Saudi regulatory method should reform its standards to appoint qualified audit committee members in the company with the purpose of guaranteeing a suitable transparency standard.

Chapter Six

The Impact of Saudi External Corporate Governance Mechanism on Firm Accountability

6.1 Introduction

The corporate governance structure has been discussed in previous chapters together with a number of key areas, namely shareholder ownership structure, institutional activism, the effectiveness of non-executive directors, subcommittees and board accountability. However, this chapter seeks to investigate the accountability of the external regulatory bodies that are responsible for regulating the stock market and enforcing the accountability of the corporate governance framework. The efficiency of their policies is essential to the successes or the failure of the corporate sectors in the Kingdom. Indeed, the regulatory bodies play an important role as they are responsible for promoting the corporate governance, especially when considering the fact that Saudi market is similar to the emerging markets which have no features of a long- established financial institutional infrastructure to deal with corporate matters.

Indeed, there is an increasingly strong association between corporate governance and the accountability of corporate external regulatory bodies. Therefore, for policy makers in the field of corporate governance, there is a pressing need for updated principles and codes of best practice. Thus, this function can occur through the values and standards of external regulatory bodies that assume the moral responsibility to enhance the accountability standards in corporate governance frameworks.

There are multiple elements pertaining to the accountability of external regulatory bodies, such as monitoring operations, applying sanctions, account scrutiny, and responding to investors. The existence of multiple external regulatory bodies can, however, hinder effective corporate accountability. Each body must therefore have clearly specified responsibilities and objectives if the present and future policy making of corporate regulations is to be reformed. To implement and deliver policy and strategic management, such agencies must also have a degree of independence.

An evaluation of the Capital Market Authority (CMA) is assessed, since this regulatory body is the capital market’s sole regulatory authority, including the responsibility to supervise the performance of the Saudi Stock Exchange. However, the CMA is impeded by excessive governmental interferences mostly from the CMA board members who were nominated by the government and work to care about the state interest instead of focusing on the market interests. This situation impedes the effectiveness of the CMA board management because government officials may lack sufficient business knowledge or speciality to supervise complex financial constructions.

In addition, profound assessment of The Saudi Stock Exchange (SSE) role in organising the corporate governance regulation is presented. The SSE is considered the main entity to deal with corporate sectors and its Listing Rules can be regarded as being particularly important when setting the business domain and corporate governance. However, there is a drawback regarding the Saudi Stock Exchange role and its duty, which is the overlapping of roles between the SSE and the CMA to monitor the stock market.

This chapter will also explore the corporate judicial system of Saudi Arabia since it is the most powerful external factor that formed and enforced the corporate governance framework, in order to see to what extent, it applies sanctions and enforces corporate law. The investigation will extend to the process of the independence and the capability of the judges to manage the complexity of corporate governance.

6.2 The Regulatory Bodies of the Saudi Corporate Governance

During the year of 2008, those Saudis who invested in the stock market were hurt by the crisis, and since then, many investors have lost confidence in this market. Thus, it is only the regulatory authorities who can restore the confidence of investors and shareholders and give immediate responsive action to any crisis or scandal in the market. That was done by the United States Congress when it passed the Sarbanes- Oxley Act immediately after the scandal that happened in Enron.[571] The Congress was responsible for imposing effective rules that could prevent such scandals in the future and tackle the legal vacuum in the corporate regulations.[572]

Therefore, it is necessary to give an evaluation of the principal factors of associated authorities that influence Saudi corporate governance Regulations. Regarding the association between external legal institutions and corporate governance, the Economic and Development Cooperation in their statement has stated that because of the weak

[571] Y Li, 'The Case Analysis of The Scandal of Enron' (2010) 5 International Journal of Business and Management 37
[572] C Coglianese, T Healey, E Keating and M Michael, 'The Role of Government in Corporate Governance Regulatory Publicly Program Report' (2004) 1 New York University Journal of Law and Business 11

infrastructures in Saudi Arabia, the legal and regulatory institutions are becoming fundamental instruments of corporate governance in this country.[573] In other words, these institutions can have an important role in transforming the Saudi corporate system from a relationship-based technique to a rule-based one.[574] It has been said that sufficient corporate regulations and competent judges tend to attract companies to incorporate in states which offer those strong favourable legal features.[575] For instance, Delaware in the United States (US) has attracted most of the biggest capital companies in the nation because of its favourable legislation infrastructure and its reliable enforcement mechanisms.[576]

The prime bodies governing and ministering the legal framework of Saudi corporate governance can be divided into four major bodies: the consultative council (Shura), the Ministry of Commerce and Industry, the CMA, the Saudi Stock Exchange and the Saudi Organisation for Certified Public Accountants. Considering the importance of these external governance institutions, each of these legal structures will be discussed in the following subsection to evaluate their role in advancing corporate performance and in preventing mismanagement by managers, and to determine the jurisdiction of these bodies and examine whether there are any associations between them.

These legal bodies have the authority to lay down commercial and financial statutory laws and regulations. However, it can be recognised that even though those legal authorities are separated, they are overlapped in a manner that seems complex,[577] particularly between the executive and consultative authorities. Indeed, it is quite hard to distinguish between the role of these three authorities to regulate corporate law and related business regulations.[578] However, to prevent this overlap, the executive, legislative and judiciary regulative power should be separated, and the boundary of the area they regulate should be clear and definite. The way of ensuring separation between these vital bodies will be discussed in the following subsection.

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[573] The Importance of Good Corporate Governance for The Middle East and North Africa, Report of MENA- OECD Investment Program, <www.oecd.org/mena/investment>

[574] C Oman, S Fries and W Buiter, 'Corporate Governance in Developing, Transition and Emerging-Market Economies' (2004) OECD Development Centre Policy Briefs 33

[575] P Angelini and N Cetorelli, 'The Effects of Regulatory Reform on Competition in the Banking Industry'(2003) 35 Journal of Money, Credit, and Banking 663, 680

[576] L Black, 'Why Corporations Choose Delaware' (2007) Delaware Department of State

[577] A Al-Jarbou, 'Judicial Independence: Case Study of Saudi Arabia' (2004) 19 Arab Law Quarterly 5, 18

[578] A Echague and E Burke, 'Strong Foundations? The Imperative for Reform in Saudi Arabia' (2009) Working Paper 6

6.3 The Consultative Council (Shura) Role in Corporate Governance Regulation

The Shura Council was established in 1992. It is Saudi Arabia's legislative body. Article No.15 of the Consultative Council Law describes the role of the council in its responsibility for issuing law and regulation, determining the general plan for the economic and social welfare of people, reviewing international treaties and interpreting the law.[579] The Consultative Council possesses legislative supremacy through which it expresses its opinions on general policies as referred by the Council of Ministers.[580]

However, the process of regulating business affairs in this vital legislative body (Shura) is so slow that interested members of Shura who suggest such reform find it difficult to unite a majority of the members of Shura to pass regulation. This slow pace happens because all members of Shura are independent, since the notion of democracy is absent. Scholars have challenged the effectiveness of regulatory reform if it does not happen independently. A study by Berkman et al. concludes that the reformative regulations may be operative only if the firms are not closely associated with the state.[581] Despite the recognition of this recommendation, most Saudi corporations are still controlled by the Saudi government, thus making it difficult for the Shura members to separate the business sector interest from the state interest.

In addition, to speed up the slow process of regulating in the Shura and to guarantee continuous improvements in corporate legislation, the Consultative Council can delegate the regulation of Companies Law and its reform to a secondary legislative body.[582] Two methods exist of managing the corporate governance structure legislation. Firstly, is the primary legislative, which is generated by the Consultative Council, whereas the second model is market driven and regards self-regulation, which is independent of state intervention. The second paradigm operates under the influence of public pressure, such as interested institutional investors; it also operates as an independent body, such as the Stock Exchange and the Capital Market Authority. This process has been the case in the UK and the US, where these two countries rely heavily on secondary legislation made by institutional activism and independent legal organisations. In the UK, the secondary legislation happens when parliament delegates

[579] Shura Council Law 1992, Article 15

[580] Consultative Council Law 1992, Royal Order No. A-91

[581] S Goo, *Minority Shareholders' Protection* (Routledge 2012) 59

[582] Delegated Powers and Regulatory Reform Committee in its Special Report 'Strengthened statutory procedures for the scrutiny of delegated powers' (Third Report, Session 2012–13)

law-making power to independent local authorities or semi-public organisations.[583] Among the most important UK corporate governance codes that were passed through secondary legislation are the Stewardship Code 2010, which is regulated and published by an independent semi-public organisation called the Financial Reporting Council (FRC). This committee was chaired by Adrian Cadbury.[584] This delegation to secondary legislation has three advantages: 1) it reduces the statutory burden on the parliament; 2) regulations are quicker to pass by avoiding the lengthy phases involved in parliamentary processes; and 3) it benefits from the expertise of people who understand the complexity of stock market operations.[585]

Thus, it is recommended that the legislative bodies in Saudi Arabia should delegate the role of legalising the corporate sector to specified semi-public institutes. These institutes must then deal with the reform of corporate laws to eliminate slow regulation intervention and excessive bureaucracy, provide needed regulation and enforcement, and introduce modern methods in management and ensure a suitable climate free from political exploitation. As indicated by Cathleen L. Casey, the commissioner of the SEC in the US, the corporate sector needs a strong, forceful, independent regulator to encourage collective compliance by all business participants.[586]

6.4 The Saudi Capital Market Authority (CMA) Role in Corporate Governance Regulation

After the founding of the CMA in 2003, this new body became the capital market's only regulatory authority, including the responsibility to look after how the firms listed on the Saudi Stock Exchange perform. The CMA had become the most important external instrument of corporate governance reform in the country. Committing to its fundamental role, the CMA issued vital regulations relating to corporate governance practice. These regulations include the market law, listing rules, investment fundsrules, merger and acquisition rules, market conduct regulations, and most importantly,the Corporate Governance Regulations 2017. The Saudi Corporate Governance Regulations 2017 contain 19 articles involving several corporate governance topicssuch as: shareholders' rights, directors' duties, transparency and disclosure. The CMA has both executive and legislative empowerment to organise the security market and to pass any

[583] J Martin, *English Legal System* (5th edn, Hodder Education Group 2007) 85
[584] Mallin (n42) 84
[585] ibid
[586] SEC, 'Strategic Plan for Fiscal Year 2010-2015', US Securities and Exchange Commission

necessary regulations to accomplish its responsibilities and sustain its reliability. For this objective, the CMA formalised a general department of corporate governance to be responsible for the implementation of corporate governance through the following duties:

- To lay down the regulations of the corporate governance rules that apply to publicly traded companies.

-To increase the protection of stock investors from fraud, manipulation or any other illegal practices.

-To increase the effectiveness of the transparency in the capital market.[587]

However, despite the fact that the CMA has clear missions and objectives as mentioned above, and despite the establishment of corporate governance regulations which seek to enhance the stock market, the strength of this regulatory body compared to the developed world is low and still needs some reforms to enhance its roles in guiding the security market.

In particular, the Saudi Companies Law indicates that the CMA has financial and administrative independence.[588] This means that the CMA depends on its financial budget and resource instead of relying on the allocation from the Saudi Arabian Monetary Authority. Furthermore, its board is nominated by the CMA itself, without any influence of the government. However, regardless of this regulation, the practicein Saudi corporations is not reflective of the above statement, and the CMA remains a ministry-level unit that has to report to the Council of Ministers and still depends heavily on the government for financial resources instead of relying on its own revenue. The Saudi Market Authority is funded partially by the state and partially by the private sector according to Article No. 13 of Capital Market Law 2003, which establishes this authority's financial resources, including fees charged by the Market Authority for services and fees for using its facilities.[589] Also, administrative independence does not exist, since board appointments are nominated by the Saudi state.

Indeed, the CMA is impeded by excessive governmental interference, mostly from the CMA board members who were nominated by the government and who work to take care of the state interests instead of focusing on the market interests. This conflict of

[587] Saudi Capital Market Law 2003, Article 26
[588] Saudi Capital Market Law 2003, Article 4
[589] Saudi Capital Market Law 2003, Article 13

interest affects the CMA's ability to supervise and regulate the corporate sectors efficiently.[590] One example of negative intervention by the state is the existing practice that prevents foreigners from investing directly in the Saudi stock market, despite the market needs for these investments to provide more finance to Saudi companies. Also, the unique domination of state-owned enterprises in the Saudi listed market has resulted in increasing the close link between the CMA and the internal government, which gives the government special power to both become a main player and a referee. This dual role negatively affects the independence of this vital authority. This defective issue resembles that of the US Securities and Exchange Commission (SEC), where the SEC is directed by both self-regulation and government regulation, an anomaly which has been criticised by many. For instance, Langevoort points out in initiating laws as a response to numerous internal and external changing incentives,the SEC works in a complicated political ecology.[591] Therefore, to prevent this drawback, the Saudi Capital Market Authority ought to be financially and managerially independent of political intervention. This authority should not be influenced by any external factors. However, this task of protecting a regulatory body from inappropriatepolitical intervention is hard to achieve in emerging countries where the market has long been dominated by a self-serving group.

Thus, it is recommended that Saudi Arabia follow the UK Financial Conduct Authority (FCA) structure in this regard, because the FCA is approved to be run independently of the government and is therefore not influenced by any political agenda. It is also funded entirely by the business sector.[592] Thus, this financial independence could lead to independent operation. Also, the Saudi Capital Market Authority should preserve adequate financial reserves to guarantee long-term stability and rely on business funds instead of on the Saudi government fund.

The CMA is governed by a board comprising five members, all of whom are selected by the prime minister, and their remuneration is predetermined by royal order.[593] This way of nomination and the direct relationship between the CMA board and the prime minister is the basis for political criteria, rather than qualifications, when nominating board members. This situation impedes the effectiveness of the CMA management

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[590] A Al-Matari, K Al-Swidi and B Fadzil, 'Corporate Governance and Performance of Saudi Arabia ListedCompanies' 2012 9(1) British Journal of Arts and Social Sciences 8

[591] D Langevoort, 'The SEC as A Lawmaker: Choices About Investor Protection in The Face of Uncertainty'(2006) SSRN Electronic Journal 32

[592] <http://www.fca.org.uk/about>

[593] Saudi Capital Market Law 2003, Article 7

board, because government officials may lack sufficient business knowledge or techniques to supervise complex financial constructions. Thus, it is certainly expected that the CMA will struggles to conduct its vital mission in the absence of professional expertise and financial experts. the CMA board members mostly come from state agencies and know little about complex accounting and finance. This situation will endanger the entire market, because the CMA board is influential and has vast power to issue or amend any piece of stock market regulation. For example, the CMA board has the power to enact merger and acquisition regulation, investment fund regulation, security business rules, market conduct regulation, a corporate governance code and listing regulations.[594] Hence, the CMA board is considered the starting point for the rule-making of corporate governance, so performing due diligence before membersare nominated should be a priority to guarantee qualified members are placed on the CMA board.

Hence, the Saudi state should give the CMA the freedom to nominate qualified members to its board, and if necessary, consult the government agencies for their nomination and ask for their approval. Saudi regulation could benefit from the UK rules in how they appoint the FCA board members. Numerous agencies appoint the board members who control the FCA, namely the UK Treasury Bank of England deputy and the Secretary of State along with a few members of the FCA itself.[595] However, the appointment of those members is required to conform to the Code of Practice for Ministerial Appointments to Public Bodies 2012.[596] Thus, if the Saudi government wants to have a role for the appointment of the CMA boards, the Code of Practice for Ministerial Appointments must be established first, and the appointments should be divided between the state and the CMA itself.

Moreover, the FCA board in the UK currently consists of four executive members and eight non-executive ones.[597] The positions of chairman and chief executive are separated from each other.[598] Additionally, the remuneration of non-executive board members is predetermined by the Treasury of the UK, while the FCA is the one responsible for determining the executive board members' remuneration.[599] This

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[594] B Gouda and A Gouda, 'The Saudi Securities Law: Regulation of the Tadawul, Stock Market, Issuers, and Securities Professionals Under the Saudi CML 2003' (2012) 18 Annual Survey of International andComp Law 9
[595] Langevoort, (n591) 32
[596] The Code of Practice for Ministerial Appointment to Public Bodies 2012
[597] L Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations,and the Public,* (Berrett Koehler Publishers 2012) 77
[598] ibid
[599] S Alpesh, *Corporate Governance for Main Market and AIM Companies* (White Paper, London StockExchange

determination of the remuneration of the FCA board is suitable for the Saudi CMA to consider because it helps to ensure the independence of the CMA. Indeed, the current practice of allowing the prime minister, through royal order,[600] to determine the board members' salaries has to be changed in order to guarantee independence.

Another issue that the CMA needs to pay attention to is that its supervision and enforcement roles are still not restricted enough to help with organising the stock market. In a recent case presented to the Saudi Committee for Resolution of Securities Disputes, the Capital Market Authority (CMA) accused the respondent of advertising and practising the securities business by providing advice on the shares of the companies listed in the exchange without obtaining a licence from the CMA. His actions violated Article No. 5 of the Securities Business Regulations stipulates that no one should conduct securities business without being permitted to do so by the appropriate authority.[601]

For the above reasons, the CMA issued its Decision No. (1373/L/D1/2014),[602] imposing a fine of SR. 20,000 for violating the above-mentioned provisions. However, the CMA 's decision can be considered unsatisfactory because upon studying the decision, along with its merits, it is found that the CMA did not rule for restricted decisions. The imposed fine is not sufficient and not consistent with the actions and practices alleged to be committed by the respondent as well as their consequences, because these violations caused serious impacts on the market and investors as well. The practice of the securities business without a licence can cause fraud and manipulation. Therefore, this illegal practice requires issuing strict decisions to deter violators and achieve the prevention desired. However, this result will only be achieved by increasing the supervision and by intensifying the punishment for this type of violation to avoid its reoccurrence.

Another challenge that the CMA needs to address is that Saudi regulatory authority needs a new enforceable framework to give attention to the execution of corporate governance principles. The Saudi Corporate Governance Regulations (SCGRs) is advisory rather than mandatory, Thus, publicly-traded firms are under no obligation to enforce most of the previsions of the Saudi Corporate Governance Rules; but rather, they should indicate the reason for any non-implementation in the annual reports to the

2012) 53

[600] Saudi Capital Market Law 2003, Article 7

[601] The Securities Business Regulations 2003, Article 5

[602] The Committee for Resolution of Securities Disputes Decision (2014) No 201/34

board of directors. This resembles the English “Comply or Explain” corporate governance system.[603] Under the Comply or Explain approach, Companies cannot face sanctions for non-compliance; they can only be held accountable once they fail to disclose their explanation for why they did not obey the voluntary provisions.[604]

However, there are several concerns surrounding the approach of the Comply or Explain provisions in Saudi corporate regulation. Thus, the Saudi regulatory authority should change its status to be more obligatory, like that of the US corporate governance code, which supports mandatory measures when regulating corporate governance. Legislation in the US supplies enforcement provisions with stringent sanctions and different tort remedies that add to the deterrent. Furthermore, if the mandatory previsions have been in place for years, and market participants are aware of the rules including punishments in the case of breach, the system will show consistency and will have certain predictability. The listing rules requirement enacted by the New York Stock Exchange made the corporate rules and codes a more obligatory and enforceable standard.[605] Many scholars are in favour of the US system and the nature of its enforcement and criticise the Comply or Explain approach in corporate regulation. Andrew Keay criticizes the Comply or Explain system because it is not reported to a regulatory authority which can assess the companies’ reports; it is reported to shareholders who are usually not involved in monitoring their companies.[606] Also, MacNeil points out the disadvantages of this approach. She indicates that in the Comply or Explain system, there is the possibility of poor explanations, different opinions between shareholders and management and also between shareholders themselves as to which approach is right, and the lack of the shareholders’ engagement to deal with such explanations.[607]

Hence, the Saudi regulators should impose several provisions necessary in order to manage the imperfection of the Comply or Explain principle and amend the voluntary provisions that have been mostly omitted by companies, changing them to compulsory ones like those in the US corporate framework. Specific topics are better dealt with

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[603] UK Corporate Governance Code 2010, Principle 4-5

[604] A Keay ‘Comply or Explain: In Need of Greater Regulatory Oversight’ (2012) Working Paper, SSRN <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2144132> Accessed 8 January 2021

[605] J Norton and J Rickford, *Corporate Governance Post-Enron: Comparative and International Perspectives* (British Institute of International and Comparative Law 2006) 69

[606] Keay (n604)

[607] I MacNeil and X Li, ‘“Comply or Explain”: Market Discipline and Non-Compliance with the Combined Code," Corporate Governance:’ (2006) 14 An International Review 2

through mandatory legislation. Those subjects are, among others, the protection of minority shareholders, the liability of directors, corporate transparency, reporting and disclosure duties, the characterization of independent directors, and the designation of director rights and duties.

Adequate accountability is not improved by applying the 'comply or explain' principle for several reasons. In research on the practise of this approach and the Combined Code, Sridhar and Valentina found that if a company explains but does not comply, the quality of such explanations is extremely problematic.[608] If a company explains but does not comply, it is hard for shareholders to determine whether such an explanation is adequate or correct, and therefore they will be unclear as to the actions, if any, they need to take. Even if explanations are provided, they are not scrutinised often enough. In a large empirical study of 245 British non-financial companies, Arcot and Bruno, and Antoine found that shareholders, particularly those in companies that are widely held, pay insufficient attention to the standard of explanations offered.[609] In addition, shareholders may not be aware that directors are failing to comply and therefore will not ask for an explanation or initiate any actions against the firm.

Thus, the more vague or incomplete the explanations (for non-compliance) the poorer the level of accountability. Another disadvantage of the 'comply or explain' principle is that directors may choose to explain, rather than comply. Consequently, directors may assume there to be no punitive outcomes for non-compliance, and thus accountability is almost entirely lost. Moreover, it costs substantial money to monitor thetruthfulness of explanations, which is why shareholders tend not intervene in theevent of the performance of the company being substandard.[610] Failure of the 'comply or explain' approach to function properly means that shareholders will lack caution when it comes to non-compliance or the explanations given for this.[611]

Consequently, the onus is on shareholders to oversee and take an action with respect to the behaviour of directors and their unwillingness to comply or explain. Companies are given no instruction or direction as to the type of explanation required. Thus, in order for the current 'comply or explain' mechanism to be an effective means of ensuring

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608 S Arcot and V Bruno, 'In Letter but not in Spirit: An Analysis of Corporate Governance in the UK' (2006) <http://ssrn.com/abstract=819784> accessed 1 February 2021

609 S Arcot, V Bruno and A Faure-Grimaud, 'Corporate Governance in the UK: Is the Comply or Explain Approach Working?' (2009) <http://ssrn.com/abstract=1532290> Accessed 8 January 2021

610 ibid

611 MacNeil (n607) 2

accountability, a clear definition as to what constitutes an explanation needs to be provided by the market. However, this is extremely challenging as there are no clear criteria that can be drawn on to assess whether explanations are sufficient.Therefore, the market authority rather than shareholders would have the task of checking compliance As a Listing Authority, it should be the responsibility of The Financial Services Authority to assess the adequacy and veracity of the explanations that listed companies make regarding their compliance.[612] Indeed, it is apparent that action is necessary in order to amend this situation. The market authority should takea more active role in monitoring and to check whether corporations are complying, and if not, whether their explanations are sufficient.[613] This could potentially be useful in enhancing accountability.

Another challenge facing effective performance of the Saudi CMA is the overlap of roles between CMA and Ministry of Commerce and Industry causing some contradictions between their frameworks of corporate regulations. There is sometimes doubt as to who ought to oversee and track the firms' obedience. One of these contradictions is that Article No. 88 of Companies Law 2015 requires notice of meeting twenty-five days before the annual general meeting, whereas SCGRs requires only twenty-one days.[614] Also, discrepancies exist between Article No. 79 of Companies Law 2015, which allows the directors to appoint the chairman of the board and its chief executive from among themselves. According to this article, one board member could occupy both positions, whereas in Saudi Corporate Governance Regulations, it is prohibited to conjoin those positions.[615] Moreover, in these two laws the types of sanctions for non-compliance have different punishment systems which could be considered conflicted. Hence, the CMA and Ministry of Commerce and Industry ought to collaborate in order to ensure that contradictions in their rules are minimised, and to avoid any overlap between them. Indeed, the corporate governance framework should undoubtedly assign the duties among various regulatory and supervisory authorities in Saudi Kingdom.

Another drawback of the CMA authority is that the monitoring role of the CMA is still weak, and the Corporate Governance Regulations leave the CMA free from any

[612] ibid
[613] FRC, "Review of the Effectiveness of the Combined Code: Summary of the Main Points Raised inResponses to the March 2009 Call for Evidence", (2009)
[614] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 13
[615] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 28

accountability to monitor any statements or announcements issued by firms. Thus, the CMA does not have a responsibility for tracking the compliance of companies with the corporate governance regulation and to monitor their legal performance. A study conducted by the Saudi Chamber of Commerce and Industry indicates that an ineffective monitoring mechanism that resulted in ineffective application of corporate governance in firms is regarded as a factor that leads to the business corruption now noticed in the Saudi Stock Market.[616]

One example is the case that was presented against the CMA, where the CMA announced the issuance of the CMA board decision that included its consent to allow the company to hold RS 35,000,000 for public offering, despite the company violation of the Capital Market Law as represented by the action of not depositing the whole capital, not fulfilling licensing requirements and not completing the legal form for the company. Thus, the claimant alleged that the CMA violated the Capital Market Law as well as the Listing Rules, as it did not revise and examine the documents submitted by the company, or its financial statements or prospectus, and it agreed to the issuance of these shares despite the existence of unreasonable contradictions and violations.[617] However, despite this omission and the CMA's failure to exercise its mission, the Committee for Resolution of Securities Disputes decided not to hold the CMA accountable, because it is not the CMA's responsibility to look after such firm announcements.

In this case, the CMA does not assume any liability for the content of the prospectus, or the non-inclusion of any important information announced on their websites. The CMA and the Saudi Stock Exchange are not held accountable for the substance of this prospectus. The Company is the one statutorily responsible for disclosing any substantial development, according to 48/B of the Capital Market Law, which states: 'The Authority shall have no responsibility for the omission in prospectuses, periodical reports, advertisements, or any other document filed with it by any party of any important information or data or for including misleading information or data'[618]. This provision is considered to be defective at it allows the CMA to avoid taking serious measures to monitor such statements published on its website, even if they mislead investors. Indeed, this case indicates that the mentoring role of the CMA is still weak and still relies on 48/B of the Capital Market Law provision, which leaves the CMA free from any

[616] The Council for Saudi Chambers of Commerce and Industry See <http://www.csc.org.sa
[617] The Committee for Resolution of Securities Disputes Decision (2015) No 144/34
[618] the Capital Market Law 2003, Article 48

accountability for any statements or announcements issued on its own website or that of the stock exchange, even if the announcements are deceiving.

Thus, this situation has to be changed, and it is recommended that the CMA revise its monitoring role and tighten its criteria to preserve the rights of investors and to enhance its supervisory role. As the US Securities and Exchange Commissioner has stated, the Corporate Market Authority has to enforce compliance by engaging in the investigation of illegal behaviours such as insider trading and market manipulation.[619] Additionally, the CMA should enforce its fraud detection techniques and impose tight risk detection examinations of companies' financial matters.[620]

6.5 The Role of the Saudi Stock Exchange (SSE) in Corporate Governance Regulation

The SSE is considered the main entity to deal with corporate sectors, and its Listing Rules can be regarded as being particularly important when setting the business domain and corporate governance. The Stock Exchange can be described as a marketplace where trading is conducted in commodities, derivatives, securities as well as other financial instruments.[621]

Therefore, with the clear objective of determining the regulations that are essential for the market to run, in 2003, the Saudi CMA undertook to organise the stock market and established the Saudi Stock Exchange (SSE).[622] Through the Saudi Stock Exchange, the Saudi market accomplished a high level of security and stability. This has attracted local families and governmental business to go public and list their stocks on the Saudi Stock Exchange Index. Nowadays, 179 corporations are listed on the Saudi Stock Exchange, and all of them deal in different business sectors and have different capitalization sizes.[623]

The Saudi Stock Exchange is managed by a board of nine directors appointed by royal decree upon the nomination of the CMA. Three of them represent governmental agencies, four represent brokerage agencies and two come from listed companies.[624]

The Stock Market Exchange undertakes many regulatory and monitoring tasks which are organized as follows:

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619 SEC, 'Strategic Plan for Fiscal Year 2010-2015', US Securities and Exchange Commission
620 ibid
621 Saudi Capital Market Law 2003, Article 1
622 Saudi Capital Market Law 2003, Article 4
623 Saudi Stock market Authority (2017) Annual Statical Report
624 Saudi Stock market Authority (2019) Annual Statical Report

- To ensure efficiency and fairness in market activities.

-To provide education and awareness to investors.

- To formulate the qualification criteria of conduct for practitioners in the stock market industry.

- To impose disciplinary penalties on violations of law or administrative regulation.[625]

These duties of the SSE and its technical mechanisms provide the necessary protection and bring many benefits to stock investors. However, at the present time various factors have led to greater complexity in the Stock Exchange.

Stock Market Exchange has the responsibility to manage the issue of Insider Dealing, which is regarded as a major kind of direct risk for corporations. Insider dealing, which involves information not in the public domain, has a lengthy history, and the majority of nations have a particular way of opposing it. The United Kingdom identifies insider dealing as being a breach of confidence; it is considered a criminal offense in the UK and is punishable by a severe fine and up to seven years of imprisonment.[626] Likewise in Saudi legislature, Article 57, named “Sanctions and Penalties for Violations”, insider dealing is punishable with a maximum five-year prison sentence.[627]

However, with regard to insider dealing in the UK, between 2009 and 2014, as many as 24 convictions were upheld by the Financial Conduct Authority (FCA),[628] whereas there have been no convictions in Saudi Arabia involving insider dealing. This is possibly because, in cases of insider dealing, the process required to prosecute is both complex and lengthy. It is hard for regulators and investigators to prove that suspicious transactions of insider dealing are illegal, because it is usually difficult to observe these or to demonstrate the malicious intentions of the parties who are involved in insider dealing. In particular, in a hedge fund, where specialists constantly trade huge blocks of securities, and typically have extensive documentation of research and analysis to support every judgment, it is especially difficult to investigate insider dealing in this situation. Tracey McDermott, the FCA’s Director of Enforcement and Financial Crime, emphasized this by saying that investigations into insider dealing are both time-consuming and complicated. However, there is a commitment to embarking on the

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[625] Saudi Capital Market Law 2003, Article 5
[626] The Listing Rules of London Stock Exchange, Systems and Trading, 2018, G 1512
[627] Saudi Capital Market Law 2003, Article 57
[628] <http://www.fca.org.uk/news/former-moore-capital-trader-pleads-guilty-to-insider-dealing> accessed 17 January 2021

meticulous analytical work needed for such cases to come to court.[629]

Nevertheless, another issue concerning the function of SSE is that one of its vital roles, as stated in the SSE code, is to provide education to economic agents. However,although the SSE has followed most of the high standards in regulations, it has done little to educate stock investors. There is slight or no education on the subject of the stock market, and low levels of financial literacy in Saudi corporations.[630] Also, this situation is worse for Saudi women across the country because they miss more financial education opportunities than men.[631] Saudis are still far behind developed countries in this respect.

Due to the low levels of financial education and the lack of familiarity with financial markets and stock products, most of the developed countries have been encouraging financial education as part of their shareholder protection policies.[632] The rationale for involving financial education in most of the developed world stems from the recognition of the complexity of financial markets and stock products along with high financial risks being shifted to the investors. As a result, financial education has become an essential element added to stock market regulations worldwide. Finance ministers of APEC during a conference in Russia in 2012 acknowledged the importance of financial literacy as a critical mechanism in the 21st century to enhance economic growth and support protections for investors'.[633] Thus, it is advantageous if Saudi Arabia pursues vigorous and consistent education about stock markets designed for different targeted audiences, such as financial industry associations, business families and other institutional businesses preparing to list their stock on the exchange. Therefore, constant education would enhance the equality and advance the eligibility of stock investors, which will lead to the potential for economic growth in the Kingdom.

Another drawback regarding the Saudi Stock Exchange role and its duty is the overlapping of the roles of the SSE and the CMA to monitor the stock market. The case number 123/34, which was presented to the Saudi Committee for Resolution of

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[629] ibid

[630] S Mian, 'Examining the level of financial literacy among Saudi investors and its impact on financial decisions' (2014) (4) International Journal of Accounting and Financial Reporting, 17

[631] OECD 'Woman and financial Education Evidence, policy response and Guidance' (2014)

[632] Russian Finance Minister and OECD Secretary-General Launch the Study at the G20 Summit (2013) <http://www.oecd.org/finance/financial-education/advancing-national-strategies-for- financial-education.htm> Accessed 25 January 2021

[633] APEC, <http://www.apec.org/Meeting-Papers/Ministerial-Statements/Finance/2013_finance.aspx> Accessed 25 January 2021

Securities Disputes, illustrates this overlapping. The claimants purchased shares after the company announced on the Tadawul website on 26th January 2013 that it had fulfilled all licencing requirements. After that, the CMA suspended trading in the company's shares on Wednesday 6th of February 2013, and capital was seized for more than 42 days without stating clear reasons for this to its shareholders. This resulted in financial damage to the capital and the savings of thousands of traders. Thus, the claimants asked for compensation from the CMA for the loss they experienced, which resulted from the CMA’s failure to achieve its mission to monitor such statements for newly incorporated companies, since its role is to approve the incorporation of newly established firms upon their fulfilment of CMA requirements.

However, the CMA demonstrated that the announcement under consideration should be made by the company on the SSE official website, not the CMA official website. Accordingly, the responsibility lies with the SSE to check such statements being delivered to them. Also, the CMA links the fault to the company because the company is statutorily responsible for disclosing any substantial development as provided by the said controls. As such, the CMA assumes no responsibility in this regard.[634]

This case is an indicator of the overlapping of roles between the CMA and the Stock Exchange, since both failed to monitor the company’s statement announced on the Stock Exchange Website. It can be seen in this case that the CMA tried to put the blame on the Stock Exchange, even though this responsibility is divided between them. The CMA kept silent regarding the announcement under consideration, without warning or making any declarations for shareholders. It should be noted that this omission from the CMA contradicts its role to protect shareholders from all unsound and unfair matters and practices. Therefore, the CMA and SSE should take responsibility to supervise all matters relevant to the exchange directly.

6.6 Saudi Commercial Courts Dealing with Securities Disputes and its Role to Corporate Governance Regulations

In the overall corporate governance reform, the judicial process is an essential component for all concerned parties—the directors, shareholders, and state legislative bodies. Nevertheless, regarding the enforcement of the duties of boards and their standards of accountability, investors, as the owners of businesses, will have particular expectations with regard to the role of courts. The outcomes of litigation in disputes that

[634] The Committee for Resolution of Securities Disputes Decision (2015) No 123/34

concern internal corporate affairs have the potential to greatly improve corporation law in the Kingdom of Saudi Arabia. Moreover, judge-made law implemented case-by-case within the framework of such an act will enhance the accountability of corporate governance.

Therefore, it is important to highlight the major aspects of the court process in Saudi Arabia, as the following subsection will present. Analysing the judicial bodies is important in the context of this thesis as they ensure that efficient corporate governance is applied and enforced in Saudi Arabia. Within the field of corporate governance, the function of the courts and their power to apply punishments and enforce laws are crucial aspects. It is imperative that investors possess a clear vision regarding judicial power so as to enhance their confidence in the investment process.

Taking this into consideration, changes to corporate legislation in Saudi Arabia need to be reinforced with suitable judicial processes. These must adequately respond to the rapid evolving legal situation within this field. In this respect, introducing the Law of Judiciary in 2007 was the foundation for the changes that occurred in the Saudi judiciary process. A number of processes have subsequently been introduced in this legislation, such as the formation of commercial courts within the overall judiciary. There are a range of specialist commercial courts, incorporating first of all the commercial courts and commercial appellate circuits.[635] These commercial courts deal with any legal violation of Saudi company regulations.[636] The establishment of a specialised commercial court is regarded as a crucial development comparable to reforms undertaken in other civil law nations.

However, successful implementation of the recent Saudi judicial reform agenda to its full extent is a more difficult process than it might appear. This is because of the fact that introduction of the Commercial Court Regulation has partly been opposed by the Sharia court judges. This opposition stems from the concern that they might incorporate the measures which do not exactly comply with Shari'a Law.[637] Judges of the new commercial courts will persist in their refusal to adhere to the statutes that conflict with Islamic outlooks.[638] Insurance contract legality under Islamic law remains, for instance, a contentious aspect. This might restrict the extent to which such contracts

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[635] The Judicial Law 2007, Article (9 and 16)

[636] The Law of Procedures before Sharaih Courts Procedures 2013, Article 35

[637] A Al-Ghadyan, 'The Judiciary in Saudi Arabia' (1998) 13 Arab Law Quarterly, 8

[638] M Murphy and J Smolarski, ‘Religion and CSR: An Islamic “Political” Model of Corporate Governance’(2018) 59 Business and Society 823, 845

are imposed, depending on the specific judge overseeing each case. It can be similarly stated that identifying the limited liability of shareholders remains a contentious subject among Islamic scholars.[639] Thus, it cannot be guaranteed that shareholders' rights in companies will be upheld if they conflict with Islamic law. It is anticipated that this aspect will have unfavourable consequences on the judicial process and undermine its operations in the short-term future.

Other corporate courts within the Saudi judicial system are the Committee for the Resolution of Securities Disputes (CRSD) and the Securities Conflict Appeal Committee, which are considered as quasi-judicial financial commissions and undertake crucial functions in enforcing corporate governance in the Kingdom of Saudi Arabia. Article 25, Paragraph (a) of the Capital Market Law permits CRSD to undertake its responsibilities. CRSD possesses the authority to examine conflicts in addition to taking judgements and applying punishments.[640] The core objective of such committees is to safeguard market equity and shareholding investors and to provide resolutions to any conflicts that result from not abiding by the CML legislation.[641]

A further significant aspect that could enhance corporations' best practice is the autonomy of the judicial body. However, there are some limitations that can impact the autonomy of the judicial process in Saudi Arabia; these include the fact that the administrative and budgetary power of these Quasi-Judicial Committees is still held by the executive body.[642] Indeed, there is a debate regarding the extent to which judicial courts truly are independent, due to the fact that some courts undertake simultaneously the roles of prosecution and enforcement. According to Article 57 of the Capital Market Law, the CMA is granted the power to file a lawsuit against companies in violation of Articles 49 and 50, which decide issues pertaining to insider trading and fraud, both articles grant the CMA the power to establish rules defining the acts and take charge to review violations.[643] Thus, in these cases the CMA simultaneously serves as claimant, legislator, inspector, judge, and jury. The Committee for the Resolution of Securities Disputes is regarded as an entity that is independent of the CMA. However, in practice, the CMA appoints individuals. This means that realistically the Committee members function in a similar way to employees administrated by CMA. A further notable

[639] H Masud, 'Takaful: An Innovative Approach to Insurance and Islamic Finance' (2011) 32 J. Int'l L 1133, 1134
[640] Saudi Capital Market Law 2003, Article 25
[641] ibid
[642] F Abdullah *'UPDATE: A Brief Overview of the Saudi Arabian Legal System'* (New York University Schoolof Law 2015) 10
[643] Saudi Capital Market Law 2003, Article 49-50

explanation for the limited degree of judicial autonomy relates to the Saudi Capital Market Authority's decision is that CRSD can only hear cases when CMA provides their consent; the defendants are not allowed to present their case to CRSD prior to them filing their case with the Capital Market Authority. The CMA has a 90-day period to consider the matter. Claimants are not permitted to proceed directly to CRSD during this time.[644] Consequently, the Capital Market Authority interference in the Committee's independence is evident. Therefore, it would be preferable for the committee on Dispute Resolution to work autonomously from the Saudi Capital Market Authority in order to guarantee an unbiased perspective.

Enhancing these committees by converting them into authentic courts is an alternative route to resolve the negative impacts of the judicial dilemma created by semi-judicial committees in the Kingdom of Saudi Arabia. Such committees would need to be recognised as part of the judicial authority by the Saudi legal system as courts with all the associated independence, powers, and authority they entail. As such, the nature of the decisions made, along with the appointment of members, their tenures, and work locations, must be broadly equivalent to those in the judicial authority. Furthermore, committee members must be recruited from among highly qualified individuals in line with standards aligning with the roles of a judicial authority and the particular jurisdictions they are responsible for.

Another issue of concern is that the Saudi commercial judicial system process is very slow and continues to show disappointing rates of resolution of litigations and lengthy duration of time required for proceedings, which influences corporate governance enforcement negatively. The explanation for its slow operation is the large number of suits being referred to it by the commercial courts and the administrative courts, alongside the lack of sufficient judges in relation to the large number of suits. For example, it is apparent that the number of judges in Saudi Arabia is roughly 1,250 (based on figures from recent statistics), and they are responsible for handling roughly 800,000 suits annually.[645] Consequently, there is just one judge to cover 32,000 residents on average; whereas the neighbouring countries of Saudi Arabia have one judge per 3,000 citizens.[646] Consequently, the lack of judges within the Saudi judicial system is a notable reason as to why corporate dispute resolution process does not always function as

[644] Resolution of Securities Disputes Proceedings Regulations 2011, Article 40
[645] <http://www.moj.gov.sa/ar-sa/Pages/Default.aspx> (accessed 10 February 2020)
[646] S Alshahrani, 'Dispute resolution methods in the construction industry sector in the Kingdom of Saudi Arabia' (2017) 138 MATEC Web of Conferences 4

efficiently as it might. Consequently, it was acknowledged that a large quantity of suits need extensively qualified judicial staffs to oversee them, which has consequent implications for the necessity to reconsider recruitment levels.[647] This is crucial because if this matter is not addressed then there will be disadvantageous implications for litigants against companies. indeed, there is an urgent importance to speed up the process of litigation in commercial courts.

Furthermore, judges are not provided with the necessary levels of education and training in order to handle complicated corporate legal matters.[648] It is common for Saudi Arabian judges to receive training in Islamic law without undertaking the study of modern legal subjects, including civil procedure and statutory law.[649] An addition factor is that the corporate law module at the Law School of all Saudi universities did not include corporate governance in an academic course until now.[650]

In response to this issue, it has been indicated by The World Bank that certain conditions must be fulfilled so as to enhance business investment. One of the conditions stipulated is improving the training provided to judges.[651] Consequently, judges who have a connection to security market disputes should receive adequate training regarding corporate matters. For this purpose, Saudi Arabia should introduce an Institute for Judiciary and Legal Studies to offer training and additional legal education for individuals in the judiciary authority. Additionally, it is necessary for judges to be provided with appropriate training in both Islamic and statutory based law so that they can function effectively.

Additionally, a further concern is the complexity in obtaining information about corporate law cases from the Committees of the Resolution of Securities Disputes, because the courts' and semi-judicial tribunals' judgement in cases is not produced or made accessible to the public or even to lawyers and judges.[652] This lack of judicial transparency prevents the public from having full awareness of the judicial process and prevents lawyers from anticipating judicial verdicts in relation to a specific legal matter. Additionally, the lack of information available in relation to previous cases prevents judges from being able to refer back to previous verdicts to establish precedents. This

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[647] ibid
[648] ibid
[649] ibid
[650] M Al-Jarbou, 'The Role of Traditionalists and Modernists in the Development of the Saudi Legal System' (2007) 21 Arab Law Quarterly 191, 194
[651] The World Bank Legal Department, Initiative in Legal and Judicial Reform (2015) 35
[652] Alshahrani (n646) 4

increases the likelihood of inconsistency regarding judicial decisions. Consequently, it is recommended that verdicts connected to corporate judgement should be made publicly available, allowing decisions in relation to corporate related matters to be better understood.

6.7 Conclusion

This chapter endeavoured to respond to the research question concerning how the Saudi regulatory authorities impact upon the creation of appropriate corporate governance regulations. Further examination was applied to the position of the CMA and its General Department of Corporate Governance. The Saudi Stock Exchange rules were also discussed in relation to improving corporate governance.

Primarily, an analysis of the Saudi external corporate bodies indicates the requirement for reform, since these institutions provide no foundation for good corporate governance generally because of extreme state intervention. In addition, a review of the identifying attributes of Saudi legislature and the principal state authorities on corporate regulation shows some overlap between them which could result in an atmosphere of legal confusion and uncertainty, thereby adversely affecting the corporate governance regulations. Furthermore, an analysis was undertaken relating to the function of judicial authorities in enforcing corporate governance related disputes. In Saudi Arabia the judges may face difficulty with regard to corporate governance since the judges do not have sufficient qualifications to deal with complex corporate matters.

Several recommendations to enhance the accountability of Saudi external corporate governance mechanism have emerged from this chapter:

The CMA board is considered the starting point for the rulemaking of corporate governance, so performing due diligence before members are nominated should be a priority to guarantee qualified members are placed on the CMA board. Hence, Saudi state should give the CMA the freedom to nominate qualified members to its board without any interference. Also, the Saudi Capital Market Authority should be financially and managerially independent of political intervention. This authority should not be influenced by any external factors.

Commerce and Industry Ministry and CMA should coordinate with each other to ensure that contradictions in their regulations is minimized to avoid any overlap between them. Indeed, the corporate governance framework should undoubtedly articulate the division of duties among different supervisory and regulatory authorities in Saudi Kingdom. Additionally, the CMA should enforce its fraud detection techniques and impose tight risk detection examinations of companies' financial matters.

A further significant aspect that could enhance corporations' best practice is the autonomy of the judicial body. However, the Capital Market Authority interference on the dispute resolution committee independence is evident. Thus, enhancing this committee by converting them into authentic courts is an alternative route to resolve the negative impacts of the judicial dilemma created by this semi-judicial committees in the Kingdom. Additionally, judges should be specialised in the topic of corporate governance, since this is a novel concept in the Saudi Arabian business domain, in order to guarantee that they have the ability to manage any corporate governance case that is presented to them.

Chapter Seven

Conclusion and Recommendation

The chapter provides a summary of the beforehand discussed chapters. Additionally, it emphasises the study's contribution to the current literature, and it provides recommendations for further reforms. This chapter will close with a brief discussion about the feasible applicability of the suggested recommendations; it will also make proposals for a roadmap in which this topic can be extended for further research.

7.1 Conclusion

The principal objective of this study was to investigate the scope of corporate governance practice in Saudi Arabia in listed companies on the Saudi stock exchange in order to examine the suitability of that practice by examining core issues; for example, the shareholders' accountability, the sufficiency of transparency, the liability of the directors, the adequacy of enforcement of corporate regulations. The rationale behind the objective of this research is to enhance the accountability of corporate governance in Saudi Arabia and identify its weaknesses and its strengths to determine whether reforms are needed and whether vital comparative solutions are justified and can be adapted and well fitted to this country.

Chapter one revealed that the rising corporate scandals, incompetence, malpractice, and fraud due to insufficient regulations have resulted in significant collapse and tremendous losses in the Saudi financial market. Despite the introduction of tight measures and comprehensive reforms in the pursuit of change, Saudi Arabia still experience the barriers which have slowed the development in corporate governance in the country. The existing barriers are a result of negligence and ineffective insights companied by outdated rules and the absence of an adequate and enforceable corporate governance framework.

Thus, a comparative methodology approach was adopted to offer an abundantly richer choice of model solutions than a legal study focused on a single country.[653] The data was obtained using the library–based information and an analytical study based on regulations, codes, and cases in addition to secondary sources such as articles, books and journals. The comparative methodology approach can evaluate the possibilities of coordination between systems. The comparative study enhances the harmonization of law and expands the understanding of laws beyond political boundaries.[654] Most importantly, comparative methodology is an appropriate approach to use when scholars are looking outside their own countries to explore different legal approaches.

In this research, the American and British models were chosen based on their comparative success and worldwide influence. In comparison to other developed countries, the US and the UK share the advantage of having the strongest corporate systems accompanied by the largest performance and returns. These systems display the highest standards of shareholders protection. A significant aspect of the US and UK systems is the fairness to the minority shareholders. The US enforcement legal system is the most robust and most favorable due to the high standards for judicial activism. The systems also share an active securities market with high standards of disclosure and transparency. Unlike the UK approach, the US corporate governance principles are naturally more prescriptive for it operates on rules rather than policies and mandatory requirements rather than voluntary codes.

Literature on corporate governance implies that both external and internal mechanisms occupy a crucial function in enhancing the performance and value of a company.[655] Internal control mechanisms include: ownership structure, company compensation, boards of directors.[656] However, external control mechanisms are inclusive of: the legal system, the corporate control market. Internal and external corporate governance mechanisms are essential as they manage the difficulties which emanate from separating control and ownership.

The current literature emphasised Islamic business law since the Kingdom of Saudi Arabia is a totally sovereign Arab Islamic state. Saudi Arabia observes Islamic law (Shariah) while at the same time adopting a modern western legal system where it does

[653] Zweigert and Kötz (n9)
[654] ibid
[655] Bhagat and Black (n23)
[656] Agrawal and Knoeber (n24)

not conflict with Islamic principles. Consequently, it is absolutely necessary to address the effects of Islam when analyzing corporate governance in Saudi Arabia. The Islamic business principles are not codified into a specific civil code; rather, they are spread throughout the holy book of Islam.

This chapter also highlighted the Saudi regulatory landscape of the corporate sector. The kingdom of Saudi Arabia has made considerable progress in setting up corporate market mechanisms. In pursuit of enforcing capital market law and recovering from the crisis which occurred in 2006, a creation of the Capital Market Authority (CMA) was instituted accompanied by the issuance of an inclusive code called (the Corporate Governance Regulation in the Kingdom of Saudi Arabia). Furthermore, the Saudi Ministry of Commerce and Industry enacted the Capital Market Law of 2003, amended in 2016, to provide an inclusive framework for the capital market. Moreover, the Saudi Stock Exchange (Tadawal) was formed in March 2007. The fundamental mission of Tadawal is to act as a securities exchange and depository. Its legal status and all its responsibilities are clearly defined in the Capital Market Law (CML). Lastly, Saudi Arabia published the new Law of Companies in December 2015.

Chapter two discussed the corporate governance theoretical framework which comprised of different theories that provide insights into the subject matter. This theoretical framework includes agency theory, stakeholder theory, stewardship theory, the Nexus of Contracts and Resource Dependence theories. These theorieslead to the recognition that corporate governance encompasses economic, legal, and social themes.

Based on agency theory, the separation of capital owners from managers results in the agency issue. Problems with the agency arise where the manger advances his self-interest over the shareholder's interest and causes conflicts in the relationship.[657] Moreover, the agency problems occur when the shareholders use significant power to abuse the minority shareholders who own a small percentage of shares. Conversely, companies with effective corporate governance mechanisms may have the capability to reduce agency costs. Consequently, the potential impact of anticipated difficulties in Saudi companies on performance and commercial accountability, thereby accentuating the importance for an agency theoretical structure in Saudi Arabia in order to produce some beneficial insights for enhancing corporate governance.

[657] Cadbury Committee (n53)

For stakeholder theory, the company is accountable for a wide range of constituents other than shareholders. Stakeholder theory indicates that companies cannot operate in isolation from the various stockholders who have crucial roles to play. The main aim of the approach is to encourage stakeholders to participate in decision making, to exert legitimate influence on the company strategy and have their rights and obligations respected. Stakeholder satisfaction has a significant impact on the company's success and conflict resolution. Despite the debate surrounding the stakeholder aspect, this theory was eventually enacted in law in many countries.658 Nevertheless, efficient application of the stakeholder theory in the Saudi situation experience some difficulties. Due to the fact that this corporate governance notion remains partly undeveloped and recognised in Saudi Arabia.

Stewardship theory operates in the sense that managers (stewards) are motivated to act in the shareholders' best interests and show cooperation with each other to advance their performance.[658] The stewardship theory presumes that it would be probable to attain an improved financial performance by trusting the directors as well as given them greater powers. Thus, A healthy and personal relationship with the directors is necessary for stewards and builds trust and advances commitment. However, it is apparent that, from a critical viewpoint, corporate governance practicein Saudi Arabia differs markedly from the presuppositions of stewardship theory.

The nexus of contracts theory reveals that managers accept corporate contracts by choosing a state with suitable corporate standards for incorporation, which becomes the companies default rules.[659] The logical result of this theoretical and contractual approach is that corporate insiders are efficiently capable of balancing their roles much better than the state because they have insider information of the company dynamic and can form contracts at lower costs. Freedom of contracts enables all parties to form a relationship and to achieve the free market principle. However, asserting elimination of all compulsory regulations from the state would indeed generate the possibility of a considerably greater degree of fraud, than is the case at the present time.

While The resource dependence theory assumes that internal corporate governance methods; for instance, boards of directors are valuable resources, may have an improved impact on company performance. The resource dependence theory adds

[658] Hill and Jones (n105)
[659] Davis and Schoorman (n119)

that the boards of directors are essential as they connect the company with every resource that it requires to function effectively. The resource dependency theory enables a board whose links with the external environment to facilitate and enhance access to useful resources, thereby enhancing corporate governance practices.[660] Consequently, it is particularly significant to appoint board members who represent diverse independent organisations.[661] From the Saudi context, appointing board members, as well as the composition of the board appear to contrast the resource dependency theory presuppositions.

Chapter three was focused on the ownership structure that is prevalent in Saudi Arabia to examine the shareholders' role and accountability; it also examined the shareholder protection mechanism and investigated whether minority shareholders are protected against abusive action. Corporations with too many shareholders make it impossible to have the shareholder manage the firm directly, which calls for management and ownership to be separated. The separation of control from ownership generates an agency problem and affects the company's performance. Countries that have the best quality of investor protection, such as those with origins in the common-law tradition, tend to have less concentration. This is opposite to the civil-law tradition, where ownership concentration is exceptionally high due to the wealthy protection that concentrated shareholders enjoy.[662] The ownership in Saudi Arabia is characterized by concentrated ownership (government and families) with low institutional ownership.

More than 70% of the whole shares in the Saudi capital market have concentrated ownership, whether by families, state, or other groups.[663] The high proportion is due to less liquidity in the hands of the Saudi citizens to invest in a large scale of the kingdom capital market. Family firms also have a significant influence on the Saudi Arabian stock market. 95% of corporations in the Kingdom, both listed and unlisted,are owned by families.[664] These families own approximately 75% of the stock market in the Kingdom.[665] These concentrated ownerships are prone to; increased risk of minority expropriation.

The setbacks associated with family business include; family's resistance to structure their firms in a formal way, there is no separation between family relationships and

[660] Davis and Cobb (n130)
[661] Abdullah and Valentine (n131)
[662] Diamond (n138)
[663] Alajlan (n153)
[664] ibid
[665] ibid

business relationships, absence of diversity at the management level, agency problems as managers are prone to promoting a nepotistic culture that leads to minority ownership expropriation. In addition, Family business in Saudi Arabia is specifically affected by lack of proper succession plans, lack of formal principles and regulations, generational envy, non-merit based compensation, and rivalry among siblings. It's therefore essential to develop general policies which introduce a code of conduct to handle sibling conflict, determine salaries and promotions and appointing siblings in separate positions in the company.

In Saudi Arabia, though the government has transferred a considerable amount of its shareholders to the general public, it still has massive, influential investment in corporate enterprises. Currently, the Saudi government and its agencies own a high percentage of shares in the Saudi stock market. However, the government is still unwilling to sell shares to private sector. Privatization process in the Saudi Arabia is still slow. Thus, there is a heavy burden on the Kingdom's budget to continue meeting these conditions; therefore, it must transfer key sectors to the private business to operate in a competitive, efficient and profitable manner.[666] In addition, Saudi government-owned firms are exposed to great political interference and need to be separated from this intervention. Political officials in Saudi Arabia remain heavily involved in the day-to-day management of state-owned companies. Though not qualified to do so, these officials frequently interfere in companies' decisions, thereby making other managers think more politically rather than commercially.

The Saudi Arabian Kingdom has passed several laws to fulfil its commitment to enhancing foreign ownership. In pursuit of encouraging companies to attract foreign investment, the Capital Market Authority (CMA) released a code that opened the equities market to foreign ownership for the first time. The Saudi Kingdom has not yet been placed on international indexes such as MSCI emerging Market Index which prevents it from attracting foreign investors. Membership in the above index would bring the Saudi equities market up to international standard. In addition, existing settlement disputes in Saudi Arabia is uncertain to foreign investors. Most foreigners, especially those who are not Arabs, lack an understanding Sharia law, which is still unwritten in modern codification. This uncertainty is discouraging foreign investors from engaging with Saudi corporations.

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[666] Ramady (n204)

Shareholders must have full capacity to actively practice their right to influence management decisions and enhance company performance. There are a variety of ways to practice this activism, most importantly during the general meeting. additionally, their activism covers a wide range of activities, including writing letters to management, calling for meeting with boards and other managers and making proposal. Institutions have greater motivation to take on this role, as they can afford the essential costs of monitoring and proposal submission.[667] Also, Institutions possess specialized expertise and are equipped with influential power to involve themselves actively and collectively in this process. However, Unfortunately, current Saudi Arabian institutional investors in the equity market tend to be passive, and rarely coordinate with each other. This situation contrasts sharply with US and UK companies, where coordination between institutions occurs jointly in order to intensifytheir influence in disciplining managers and introducing tight scrutiny.[668]

Misappropriation of minority owners frequently occurs in Saudi Arabia. Expropriation of minority shareholders in Saudi firms is caused by weak enforcement, low disclosure and high concentration, all of which contribute to affect them severely. Thus, Unfortunately, minority shareholders in Saudi firms do not enjoy a strong position;they feel exposed by majority shareholders, often due to the shareholder concentration structure that exists in the region. This is opposite to the corporate environment in developed countries such as the UK and US, whose shares are divided and owned by minorities defined as dispersed shareholders. Furthermore, another form of minority shareholder expropriation is nepotism, which is a disadvantage especially in Saudi family firms, where owners usually nominee one of the family instead of appointing a qualified candidate from the valuable labour market. Minority shareholders, by contrast, cannot do anything to stop these ineffective nominations.

The fourth chapter analysed the accountability of the directors in Saudi Arabia corporate governance. The chapter was focused on determining whether the board members' tasks and responsibilities are clearly defined and whether the board of governors' regulations ensures fairness for all shareholders. The responsibilities and power given to directors in Saudi Arabia are mostly analogous to those in UK and US firms; in terms of the codification of director's responsibilities, and the clarification of the board's rights. However, the Saudi approach is still imperfect and experiences some ambiguity and

[667] Gillan and Starks (n234)
[668] Black and Coffee (n243)

omission of needed procedures to facilitate board performance. This view of directors as agents of the shareholders has led to great powers and wide responsibilities being delegated to the board members beyond challenging of shareholders at the company level.

Saudi Corporate Governance Codes state that the board must act honestly with due conscientiousness when carrying out corporate affairs.[669] The director must act with reasonable care and necessary skill when making business decisions.[670] However, the Saudi law does not specify criteria for this level of care, which gives room for carelessness and negligent directors to hide behind the ambiguity of this measure. This situation hinders the effective implementation of the duty of care.

The SCGC categorize board members as executive, non-executive, and independent directors. The SCGR (Article 24) suggests that most directors ought to be non- executive, whereas one-third of them should be independent.[671] The advantages of having independent non-executive directors as board members are supported by the literature, and would be an appropriate solution to improve corporate governance in the Saudi kingdom. This could solve current defects that have resulted from the concentration of family and governmental ownership in the region. Independent directors bring diverse experience, knowledge and skills to the boardroom and adding value to the firm's performance. However, due to the voluntary nature of the mentioned prevision, it is worthy of mention that the proportion of independent directors in the Saudi kingdom remains small, especially in family- and government- owned corporations.

Despite the importance of frequency of board meeting, unfortunately, in the Saudi kingdom, the Saudi Companies Act does not provide regulatory requirements on how often the board should convene each year. Another issue is that Saudi company law does not indicate ideal board size and has left it to the firm's articles of association to specify the number of members on the board. In addition, the representation of women on boards is a significant problem for Saudi Arabian legislators as a result of the continual absence of women in positions of management.

It has gained global recognition that establishing subcommittees enhances the performance of a board. The significance of board committees in the governance

[669] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 29
[670] ibid
[671] Ibid Article 24

process lies in the fact that they facilitate the enhancement of board accountability and ensure that board activities are independently monitored. SCGC indorses that boards delegate some of their authority to various subcommittees, namely the audit, remuneration, and nomination committees.[672]

Based on the SCGR, the audit committee should have three members at a minimum who are independent, qualified, and possess the skills and expertise needed and should not have any business interest linked to the firm.[673] However, despite the recent reform and adoption of a suitable set of rules to facilitate the formulation of an audit committee, the existing roles of the audit committee in the Saudi firms revealed that there is ambiguity concerning the roles and responsibilities of an audit committee, and that committee members were not always conversant with their full objectives.

The nomination committee carries the same provision as the remuneration committee in the SCGR; it would, therefore, be favorable if the Saudi regulators separate these two committees from each other in the Corporate Governance Regulations and standardize their roles separately. In addition, in spite of SCGR's attempt to regulate the remuneration committee, regulation failed to specify important elements such as setting a minimum number of members, limiting the maximum executive salary level and clarifying how remuneration committee members should be compensated.

Corporate governance within Islam provides further benefits to the prevailing governance framework. To enhance trustworthiness and to meet the ethical expectations of consumers, most Islamic financial organizations have established systems of control that are comprised of in-house religious experts, frequently labelled as the Shariah Committee.[674] Members of the Shariah Committee are professional jurists in the field of Islamic commercial jurisprudence and specialize inthe area of Sharia financial organisations. However, the findings imply that problems surround the various requirements and qualifications of Shariah Committees. In addition, for an extended period, various Sharia experts have taken advantage of the right to be a member of multiple Committees with no form of limitation. Consequently, this leads to the Shariah Committees being perceived negatively due to the fact that issues surrounding confidentiality and conflicts of interest are emerging. Taking into account the diverse nature of practices of Islamic finance in various jurisdictions, the potential for conflicting

[672] Ibid Article 60
[673] Corporate Governance Regulations in the Kingdom of Saudi Arabia 2017, Article 54
[674] Gambling and Jones (n429)

fatwas or Sharia edicts is comparatively high.

Chapter five evaluates the existing disclosure and transparency applications within the Saudi system of corporate governance. The rationale of this chapter is to determine potential ways to improve disclosure legislation. The chapter revealed that disclosure and transparency is a very critical matter in Saudi corporate governance. Disclosure and transparency are considered vital elements of corporate governance, according to the Organization for Economic Cooperation and Development (OECD). Disclosure and transparency help to reinforce the relationship network among all actors in firms which increase the level of reliability within the firm.

The amount and quality of disclosure by corporate governance is influenced by the ownership framework. Several scholars have suggested that firms in which numerous shares are owned by institutional investors have a greater likelihood of disclosing such information appropriately. This is because these investors are able to oversee management effectively and can decrease any agency problems. In a widely-owned firm, institutional investors can compel managers to provide them with additional corporate information so that they can assess the company with respect to its performance. However, Institutional ownership in Saudi Arabia has historically been low though the CMA has attempted to encourage a higher number of shares held by Institutions to improve transparency CG standards in Saudi companies.[675]

A low level of disclosure has been attributed to family ownership. there is less likelihood of family corporations to disclose than there was of non-family corporations.Numerous studies have analyzed the link between the disclosure of family firms and the ratio of family members who are directors. They demonstrated a notable negative link between the disclosure of corporate governance and the percentage of family members on the board.

It is acknowledged that language have a considerable impact on corporate governance disclosure in the Saudi Context. as a result of different languages, the degree of transparency that exists in Saudi financial markets is constrained by information that normally only published in the English language. Thus, it could be challenging for certain shareholders to understand the disclosed information as a result of language differences. Therefore, this could negatively affect the degree of transparency that

[675] [675] Abdallah and Ismail (n165)

exists within Saudi financial markets.

The CMA is mandated to investigate and take appropriate enforcement actions in the event that disclosure provisions are violated. For instance, in 2006, a total of 83 cases were referred to the CMA reports.[676] Despite these attempts to enforce the transparency provisions, the majority of firms in Saudi Arabia fail to satisfy the requirements regarding the disclosure of information. This kind of conduct is widespread in the country due to the weakness of the CMA supervision and the structure of concentrated ownership. These conditions have motivated key speculatorsto implement market manipulation, disseminate rumors, and conduct fake transactions.

Moreover, the degree of compliance with the specifications of non-financial disclosure has been defined as poor. In general, Saudi firms reveal information associated with non-financial matters, but the volume of data disclosed is low in comparison to similar firms in developed countries. This could be explained by the fact that there is a general lack of comprehension of the significance of the advantages of corporate non-financial disclosure and the lack of compulsion to reveal this type of data.

When making decisions in regard to the type of information disclosed by firms, management must consider both the advantages and costs of these actions, and subsequently determine the amount and the kind of information that will be suitable for release. Information disseminated should have worth for investors and is specifically selected for market participants. Optimal transparency should have a particularly positive effect on information users' decision-makers. Optimal transparency can be attained by increasing the availability of the information provided, respecting all information users' common interests and ensuring the disclosure of the high-balanced information.

Chapter six focused on the accountability of Saudi external corporation governance legal system. The rationale of this chapter was to reveal the problems surrounding the enforcement of current legislation that affects publicly held companies. The chapter concentrated on external institutions, specifically the legal bodies responsible for enacting corporate regulation and for supervising the implementation of the corporate governance code. The legislative process is a very crucial aspect in the setting of corporate governance; it is, therefore, necessary to evaluate the principle factors of associated authorities that influence Saudi corporate governance regulations.

[676] World Bank (n481)

The CMA had become the most critical external corporate governance reform in the country. The CMA corporate governance is responsible for; laying down regulations of the corporate governance that apply to publicly traded companies, increasing the protection of stock market from fraud and illegal practices, increasing the efficiency of transparency in the capital market, and preventing the market risks by developing suitable measures to detect any potential drawback in some transactions. The CMA has both executive and legislative empowerment to organize the security market and to pass any necessary regulations to accomplish its responsibilities and sustain its reliability.

However, despite the fact that CMA has clear missions and objectives and despite the establishment of corporate market framework which seek to strengthen the stock market, the depth of this regulation compared to the developed world is low and still needs some reforms to enhance its roles in guiding the stock market. The CMA is impeded by excessive governmental interferences mostly from the CMA board members who were nominated by the government and work to care about the state interest instead of focusing on the market interests. This conflict of interest affects the ability of the CMA to supervise and regulate the corporate sectors efficiently.[677] Another challenge facing effective performance of the Saudi CMA is the overlap ofroles between CMA and Ministry of Commerce and Industry causing some contradictions between their frameworks of corporate regulations. Since some of the corporate governance rules are combined between them, so it is sometimes uncertain who should monitor and track the companies' obedience.

Saudi Stock Exchange is considered one of the main entities to deal with corporate sectors. The role of the Saudi stock exchange (SSE) in corporate governance regulations is to ensure efficiency and fairness in market activities, provide education and awareness to investors and develop the capability and competency of the stock market. In 2004, the Capital Market Authority published the Saudi Listing Rules which comprise 52 articles split into nine sections. The Listing Rules control the admission, and supply a portrayal of the information which is required to be disclosed prior to adding the securities to the official list.[678] However, the main drawback regarding the Saudi Stock Exchange roles is the overlapping with the roles of the CMA to monitor the company's statement announced on the Stock Exchange Website.

[677] Al-Matari and Al-Swidi (n592)
[678] The Listing rules 2004, Article (52)

The efficiency of the accounting profession in the Saudi Kingdom are important in facilitating a suitable environment for accountability and governance practices. For this regard, the roles of the Saudi Organization of Certified Public Accountants (SOCPA) in corporate governance regulation include; monitoring the performance of public accountants and evaluates their compliance, enforcing disclosure requirements, and overseeing the disclosure standards in listed companies. Nonetheless, despite the recent achievement that has been recognized in the Saudi accounting sector, insufficient accounting standards and unsatisfactory monitoring mechanisms have been seen as causative factors responsible for weakening the Saudi stock market. Unfortunately, the Saudi accounting organization does not involve strong legal clauses to support some of issues of auditing professions. In addition, the accounting line of work in the Saudi Kingdom still suffers from serious problems, such as the failure to reduce the audit fees and the apparent monopoly of accounting services. These problematic issues impair the quality of accountancy in the country. In addition, auditing committees that are required by Corporate Governance regulations are still absent in many listed companies. This shows the lack of seriousness from the SOCPA toenforce and monitor its regulations.

The judicial bodies would add more importance to ensure that efficient corporate governance is applied and enforced in Saudi Arabia. Within the field of corporate governance, the function of courts and power of applying punishments and enforcing laws are crucial aspects. The Saudi commercial courts deal with security disputes and also play a significant role in corporate governance regulations. However, succeeding in effectively implementing the recent Saudi judicial reform agenda to its full extent is a more difficult process than it might appear. This is because of the fact that introduction of the Commercial Court Regulation has partly been opposed by theSharia courts judges. Thus, it cannot be guaranteed that shareholders' rights in companies conflicting with Islamic law will be imposed.

Another concerning issue is that the Saudi commercial judicial system process is very slow and continues to endure disappointing achievement rates of litigations and lengthy durations of time required for proceedings which in some ways directly influences corporate governance enforcement negatively. Furthermore, judges are notprovided with the necessary levels of education and training in order to handle more complicated corporate legal matters. It is a common that Saudi Arabian judges receive training in Islamic law without undertaking the study of modern legal subjects, including civil procedure and statutory law.

Another corporate court forms within the Saudi judicial system are the Committee for the Resolution of Securities Disputes (CRSD) and the Securities Conflict Appeal Committee which consider as quasi-judicial financial commissions and undertaken crucial functions in enforcing corporate governance in Saudi Arabia. However, there is a debate regarding the extent to which judicial courts truly are independent due to the fact that some courts undertake simultaneously the roles of prosecution and the lawsuit and enforcement. The Committee for the Resolution of Securities Disputes is regarded as an entity that independent of the CMA. However, in practice, its members are appointed by the CMA. This means that realistically the Committee membersfunction in a similar way to employees administrated by the CMA.

7.2 Thesis Recommendations

Some recommendations emerge from the research, which relates to enhancement of the accountability and transparency of corporate governance in Saudi Arabia.

7.2.1 Recommendations to Enhance Shareholders Accountability in the Saudi Firms.

Since ownership framework may have an impact on the effectiveness of other governance mechanisms in the capital market in Saudi Arabia, policymakers could benefit from developed markets where policymakers have been developing suitable policies in order to enhance effectiveness of the shareholders to engage accountably in the implementation of corporate governance rules. It is not sufficient to hold only executives and shareholders accountable for violations of fiduciary responsibilities while ignoring the role that controlling shareholders play.

In particular, forming guidelines can positively affect family company performance. The interior family governance framework must be formally rewritten with more flexibility, as families with tremendously rigid boundaries find it difficult to persist. Establishing clear guideline for recruiting family members along with promotion criteria based on the accumulation of accomplishments are essential to the sustainability of family enterprises. In addition, Due to the increasing number of family firms in the Kingdom, the importance of having robust family succession planning is more widely required. Moreover, allowing women to have access to the company, either by involving them in management or giving them a say in family meetings, will lead them to remain in the firm instead of feeling isolated and thus consider exitingthe business.

Going public and listing the family company on the stock exchange is also recommended. It would also force companies to adopt and impose proper governance policies. Additionally, offering a small family company, the opportunity to have an alternative investment market (AIM), as in that of the UK Market, which was designed for smaller and growing companies,[679] is advantageous to the Saudi family who wants to join the exchange market but chose not to do because of the rigidity of its corporate governance policies. AIM would allow such firms to join an alternative exchange market that has more flexible corporate governance regulations than that of the main market exchange.

Giving more autonomy to the management of state-owned enterprises would result in fruitful performance that follows the market principle. Many regulators in the Kingdom are calling for giving boards of directors more autonomy, freeing them from political pressure. In addition, An essential role of reform is that Saudi government should sell its majority shares to private sector in order to offer autonomy to the management, while at the same time retaining considerable minority shares in order to have a say in board meetings and prevent abusive dealings that would affect the national wealth distribution.

A golden shares provision would be useful if adapted and implemented in Saudi Arabia to ensure the stability of public service-providing companies. These rights include veto power to prevent changes to the corporation charter, the right to issue prior approval of any new owners who want to acquire shares beyond a set of limited shares or upon making strategic decisions such as dissolution, and the right to block takeover, especially when the government wants to prevent the sale of essential corporations overseas or to competitors who engage in anticompetitive behaviour. The goldenshare approach remains useful for protecting national security and employment interests; and would be more acceptable if it were narrowed and defined more clearly. Consequently, the provision of golden shares must be limited to a pre-determined period of time such as five or ten years.

It is advantageous for the Saudi stock market to raise the allowance of a single foreign investor to own up to 20% of a Saudi company' shares instead of owning only 10% of a single listed company, which is consider too low. In addition, the rule of the Saudi CMA allows overall foreign ownership of single company to not exceed 49% of the equity-

[679] Power (n194)

listed company is making Foreigners as a minority ownership with weak protection. Thus, it is beneficial to enable foreigner investors to possess majority shares in a company, specifically in companies that do not provide essential services to Saudi citizens. Moreover, there is a need for more the Qualified Foreign Investors Institutions to facilitate the entrance and the involvement of foreign investors in the Saudi stock market. Thus, it is advisable that the CMA should make new adjustments to relax the rigid restriction on the criteria of the QFI eligibility by reducing the minimum amount of assets that the QFI organization must possess to a reasonable amount in order to increase those institutions' participation.

Furthermore, it should be recommended by the Saudi Stock Exchange that firms who aim to appeal to foreign investors should stipulate within their bylaws that the resolution of disagreements that occur among shareholders and the corporation or among minority shareholders and controlling shareholders will be achieved via arbitration. This would advance flexibility and offer both parties the opportunity to choose between laws, and to choose arbitrators that they have confidence in and who possess commercial knowledge. In addition, it is recommended that the government of Saudi Arabia should provide companies with the ability to cross-list in international stock markets in order to attract foreigner ownership. This can be beneficial for firms as it can enhance their corporate governance as they willingly choose to embrace the more robust regulatory standards necessitated by the foreign exchange.

It is recommended that companies can benefit from new technologies to enhance the attendance of individual shareholders at general meetings. introducing an electronic voting system would serve investors who are geographically remote, whether inside the country or overseas. Article 13 of SCL 2015, indicates that shareholders have the right to vote by their presence or by proxy and have the right to use modern technology to vote;[680] however, in practice, the usability of modern technology when distributing the notice of the meeting and when delivering votes is not common because this provision is voluntary and thus not enforceable. Thus, revising this provision by making it mandatory would solve the common problem of having an increased number of shareholders absent at the general meeting due to the fact that shareholders are distributed widely across the country, as the kingdom's geographical area is quite large.

[680] Saudi Company Law 2015, Article

Moreover, shareholders cannot call the meeting without board consent. Therefore, this provision makes it difficult for shareholders to exceed board wishes and prevents these bodies from exercising their rights; for this reason, and in order to fill the gaps in the statutory, SCL 2015 should provide clear guidelines regarding the convening of the meeting to allow a neutral body such as CMA to convene the meeting, especially when the board of directors refuses to respond. In addition, clear criteria should be introduced regarding what questions are considered harmful to the company in order to hold directors responsible for responding to appropriate inquiries.

Saudi Arabia needs to establish a meaningful legal instrument that supports minority investors in the capital market. It is therefore recommended that the term 'the wrongful act' should be defined by the Saudi regulator under the CL to eliminate any potential ambiguity, as this may limit the right of minority shareholders to initiate litigation against board members. The condition indicated in Article 78 of SCL is abroad; the term 'wrongdoing' covers a wide range of claims and can lead to multiple lawsuits, which cause disruption to and instability in the company. Thus, the Saudi regulator could utilise UK measure that determine the 'the wrongful act' and to alter the right of minority shareholders to initiate litigation against board members. The UK Companies Act states that claims can be presented before the court in matters relatingto negligence, omission, default, and a breach of duty or trust by board members or other relevant persons.[681] Thus, according to the Act, negligence, omission and a breach of duty or trust are considered wrongful acts.

7.2.2 Recommendations to Enhance the Accountability of Saudi Board of Directors.

Saudi regulators should reform the concept of the duty of care to eliminate the current ambiguity and avoid careless behavior on the board level. They should consider adopting the subjective standard of business judgment defense, thus, if a director's action or inaction can be classified as a business judgment, the director is assumed not to be liable for what has been done or not done. Besides, Specification of the skills and level of experience that directors must have should be clearly defined.

It can be discussed that without adequate identification of the duty of loyalty in the Saudi kingdom, companies will not be protected adequately. Indeed, the duty of loyalty provision should be regulated in a restricted manner like that of the UK, which has the

[681] The UK Companies Act 2006, S 260

best practice in terms of clear definition and boundary of loyalty duty. The UK Companies Act indicates that directors must not engage in any direct or indirect interest that may conflict with interests of the firm, whether these exploitations were of property, opportunity or inside information.[682] Thus, if this provision is adapted in Saudi context it would motivates directors to avoid business that does not favour the company and preventing possible indirect conflict.

There are still several drawbacks in the rules regarding director independence which need to be reformed with constructive restrictions and amendments. The responsibility of an independent director to actively participate in and contribute to strategic policy should be included in the regulation and should be stated clearly as the best practice of the UK Combined Code (2006), which stipulates that non-executive directors are responsible for determining crucial subjects such as the company's future direction specifically in terms of remuneration and appointment and removal of the board.[683] Additionally, there should be a new provision that emphasizes appointing and dismissing the independent members of the board by a separate legal body suchas the nomination committee, so that these members do not become ineffective. Apart from their appointment and dismissal, these directors should be also independent of any sort of business or other association which may substantiallyhinder the application of their independent judgment. Another useful reform that should be introduced in Saudi law is the percentage of the independent directors in some board functions, such as the nomination, remuneration and audit committees.

In addition, to improve independent directors' performance, Saudi law should impose mandatory clauses to separate the chairman position from the CEO position. lastly, the part-time nature of non-executive directors in Saudi corporations is problematic in that it makes it infeasible for these directors to exercise their role over management when required. The time commitment is crucial in determining directors' contribution to the firm's accomplishments.[684] Thus, imposing time and membership limitations for independent directors is necessary to ensure that they perform with due consideration.

[682] The UK Companies Act 2006, S 175
[683] The UK Companies Act 2006, S 171
[684] Armour (n386)

The provision of SCGR requiring at least one member to have expertise in accounting or the financial profession should be amended to require all three members of the committee to have professional accounting experience in order to be selected for committee seats. Complex accounting deals require highly qualified professionals with sufficient understanding of the issues. Sarbanes-Oxley Act in US further specifies several elements of financial expertise audit committee members must have, namely understanding general principles of accounting, understanding audit committee functionality and having sufficient experience in auditing and evaluating financial reports and complex accounting affairs. When adopting this prevision, Saudi corporate regulations would enhance the qualification of audit committee members by placing highly qualified professionals on the audit committee. In addition, it is useful to impose a provision insisting on the audit committee reviewing financial statements regularly, as with the Blue Ribbon committee in the US, which requires the audit committee to review and discuss the company's financial statement not only annually but quarterly,[685] While the UK's Cadbury committee recommends the audit committee review the financial report every six months before submission to the board.[686]

It could be acknowledged that the nomination committee carries the same provision as the remuneration committee in the SCGR. Therefore, it would be favorable if the Saudi regulators separate these two committees from each other and standardize their roles separately. Moreover, Nominations should be made on merit by objective criteria and with due consideration for the benefits of diversity on the board, consequently, board composition must be addressed from a legalistic viewpoint to obliges companies to have a certain level of diversity representations on the board of directors. Moreover, it is advantageous to reform this clause in accordance with the Greenburg recommendation, which indicates that the remuneration committee should have at least three independent members or should otherwise state the reason why the committee employs fewer than three members.[687]

Continuing to neglect board meeting frequency in the Saudi kingdom will result in potential management manipulation and corruption. Therefore, it is best to specify the minimum of number of board meetings in the SCGR as a mandatory clause. Additionally, Saudi Company Law does not indicate ideal board size, and has left it to the company's

[685] Blue Ribbon Committee (n359)
[686] Cadbury Committee (n53)
[687] Greenbury (n403)

articles of association to specify the number of board members. This lack of limitations should change. Saudi regulators should indicate the minimum and maximum number of board members needed. Boards should be sufficiently large to incorporate the various different proficiencies required to fulfil its responsibilities but with adequate balance.

Nevertheless, In Saudi Arabia, less advancement has been made in regard to females reaching positions of leadership in companies. The lack of female directors on a board has negative implications for the firm. Consequently, board composition must be addressed from a legalistic viewpoint similar to the UK Code, which obliges companies to have a certain level of female representation on the board of directors. Although the UK Code has yet to establish quotas for women, it necessitates and emphasises gender diversity in corporate boards in various sections, such as: "appointments made on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender"[688], Hence, this process of reforming boards could augment the effectiveness of the boards by enabling the introduction of various different viewpoints into the board process.

It is also recommended that a legal provision must be established that clearly restricts individuals from serving on multiple Shariah Committees concurrently. This policy would ensure that the Shariah Committee member is fully available to provide effective guidance and monitoring to the IFI. Furthermore, it is recommended that a specialist in the area of Shariah with a fundamental understanding of finance should be recruited to performthe Shariah Committees functions. This recommendation provides a practical solution for resolving the problem of shortages in this area.

7.2.3 Recommendations to Enhance the Transparency Framework in Saudi Arabia

In terms of content, the disclosure statements' objective must focus on quality rather than quantity. This suggests that policymakers should generate optimal transparency in financial markets a, as well as consider costs and advantages prior to requesting information from firms in financial markets. The particular dimensions for the quality of the disclosed information are inclusive of applicability, understandability, confidentiality and balance.

The IASB Exposure Draft on an improved Conceptual Framework for Financial Reporting (2008) describes understandability as the quality of information that enables the

[688]UK Corporate Governance Code 2018, Principle J

meaning to be understood.[689] It is advantageous for Saudi corporate governance regulations to adapt the mentioned IASB recommendation in this regard. It is evident that directors' annual reports should be both logical and understandable because the majority of stakeholders are unfamiliar with legal and financial terminology, thus, making it comprehensible to understand is essential.

Accessibility to such information has a detrimental impact on companies' competitive status. Therefore, transparency should be restricted only for companies' secrecy and confidentiality. Article 26 of The IASB (2010) permits disclosure requirements to be relinquished, when the issuer believes that the disclosure would be harmful to him/her, and such omission would be unlikely to mislead investors' evaluation of the securities.[690] Such a measure may be required, particularly in the case of highly- competitive companies which sustain industrial secrets. Thus, this prevision could certainly be suitable to Saudi firms to apply the information disclosure that has a significant effect on public interest and in the same time sustaining confidentiality.

It is necessary to apply an enhanced mechanism in order to enforce listed companies to achieve the requirements of transparency and disclosure. One such mechanism, which can be of assistance is that the CMA should create the Continuous Disclosure Department in order to review company reports every year in order to observe any weaknesses and find way to promote them. Consequently, establishing a compliance and enforcement committee within the CMA to oversee the levels of compliance among trading companies on an ongoing basis could be an important first step in this regard.

It is anticipated that the disclosure level will decrease when the ratio of family members of the board increases. Therefore, regulators and policymakers should take in consideration that it is important to establish and to define the number of family members who will become directors of listed family firms.

Institutional investors should be active and should regularly add more pressure on firms to disclose information that is of better quality. It is recommended that the Saudi CG code puts pressure on institutional investors to encourage corporations to increase and implement strong corporate governance disclosure. Indeed, It is advantageous to Saudi context if the regulators adopt similar prevision that being advocated in the UK Combined Code which stipulates that institutional investors should implement the

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689 IASB, Exposure Draft on an improved Conceptual Framework for Financial Reporting (2008)
690 IASB, The conceptual framework for financial reporting (2010), Article 26

following actions: 1. Engage in discussion in firms. It is essential that Institutional shareholders commence discussion with firms according to the mutual understanding of their goals. 2. It is necessary for institutional shareholders to evaluate accurately all elements informed to them when assessing firm's governance statement.

The Saudi regulatory method should reform its standards to appoint qualified audit committee members in the company with the purpose of guaranteeing a suitable transparency standard. It is therefore important to recommend that Saudi Arabia could find the adoption of the conditions on audit committees produced by the FRC (2012) which recognizes the audit committee's function concerning account reporting as, at the request of the directors, the audit committee should review the yearly accounts and reports and also give guidance to the board as to whether it is generally equitable, objective, and understandable, and also supplies the required information for shareholders to evaluate the performance of the firm, and also its business paradigm and strategy.[691]

The accessibility criteria of the transparency in disclosed information is crucial mechanism. Therefore, Numerous Saudi companies have commenced utilizing modern communication methods like the Internet, with the purpose of facilitating shareholders and other interested individuals in obtaining the information that they need in order to reach investment decisions.[692] Nevertheless, in Saudi Arabia, being a developing nation, use of the Internet is less common than it is in developed nations. Therefore, lawmakers in Saudi Arabia should make it a compulsory requirement for companies to enhance electronic storage and distribution.

Lastly, to enhance overall levels of transparency in Saudi Arabia, it is important to assess the non-mandatory disclosure levels. The regulations and laws do not usually supply investors with the mandatory disclosure they need, often they are simply given the minimum information required to assist in the making of decisions. This explains the need for non-mandatory information disclosure, which is understood as plugging the gap left by compulsory disclosure.

7.2.4 Recommendations to Enhance the Accountability of Saudi External Corporate Governance Mechanism

The Saudi Capital Market Authority should be financially and managerially independent

[691] FRC, Guidance on Audit Committees (2012) Financial reporting Council
[692] Habbash (n563)

of political intervention. This authority should not be influenced by any external factors. Thus, it is recommended Saudi Arabia follow the UK Financial ConductAuthority (FCA) structure in this regard because the FCA is approved to be run independent of the government and is therefore not influenced by any political agendadue to the fact that It is funded entirely by the business sector not by the UK government.[693] In addition, the Saudi Capital Market Authority should preserve sufficient monetary reserves to guarantee financial autonomy and stability over the long term and rely on business funds instead of on the Saudi government fund.

In addition, the CMA board is considered the starting point for the rule-making of corporate governance, so performing due diligence before members are nominated should be a priority to guarantee qualified members are placed on the CMA board. Hence, Saudi state should give the CMA the freedom to nominate qualified members to its board without any interference and if necessary, consult the government agencies for their nomination and ask for their approval. In addition, Specific topics are better dealt with through mandatory legislation. Those subjects are, among others, the protection of minority shareholders, the liability of directors, the characterization of independent directors, and the designation of director rights and duties.

Commerce and Industry Ministry and CMA should coordinate with each other to ensure that contradictions in their regulations is minimized to avoid any overlap between them. Indeed, the corporate governance framework should undoubtedly articulate the division of duties among different supervisory and regulatory authorities in Saudi Kingdom. Certainly, this situation has to be changed, and it is recommended the CMA revise its monitoring role and tighten its criteria to preserve the rights of investors and to enhance its supervisory role. As US Securities and Exchange Commissioner has stated, the Corporate Market Authority has to enforce the compliance by engaging in the investigation of illegal behaviors, such as insider trading and market manipulation.[694] Additionally, the CMA should enforce its fraud detection techniques and impose tight risk detection examinations of companies' financial matters.

A further significant aspect that could enhance corporations' best practice is the autonomy of the judicial body. However, the Capital Market Authority interference on the dispute resolution committee independence is evident. Enhancing these

[693] <http://www.fca.org.uk/about> Accessed 21 May 2021

[694] SEC, 'Strategic Plan for Fiscal Year 2010-2015', US Securities and Exchange Commission 4

committees by converting them into authentic courts is an alternative route to resolve the negative impacts of the judicial dilemma created by semi-judicial committees in the Kingdom of Saudi Arabia. Such committees would need to be recognised as part of the judicial authority by the Saudi legal system as courts with all the associated independence, powers, and authority they entail. As such, the nature of the decisions made, along with the appointment of members, their tenures, and work locations, must be broadly equivalent to those in the judicial authority. Additionally, judges who have a connection to security market disputes should receive adequate training regarding corporate matters.

7.3 Future Research Recommendations

More research is needed to assist regulators in their efforts to promote a regulatory framework and identify additional alternative solutions to enhance a sustainable corporation climate in Saudi Arabia. Future research on corporate governance in Saudi Arabia can evaluate non-listed companies' level of compliance to corporate governance principles. While most existing studies are conducted on listed companies, a study investigative non-listed companies may be an innovative prospective to be undertaken. In addition, Researchers can also inspect ways minority shareholders can exercise their rights within the Saudi corporate governance framework and the mediating factors that enhance the achievement of this concept. Ways to incorporate an Islamic perspective of corporate governance inside conventional institutions is also a crucial area of research. Also, based on the discussed recommendation, researchers can investigate measures to encourage and enhance the implementation of the corporate social responsibility criteria in the Saudi market. Moreover, the connection between the appropriateness of the disclosure and of independent non-executive directors has been analyzed. Nevertheless, conducting additional research on the variable framework of board in the Saudi context and assessing its role in facilitating qualified transparency might be important to be undertaken.

7.4 Contribution to Knowledge

Since the literature on corporate governance in Saudi Arabia is minimal and ineffectively researched, this thesis bridges the gap in this legal field. It also contributes to reforming the regulatory shortcomings of the relevant Saudi corporate governance regulations by proposing additional alternative measures in order to enhance an accountable corporation climate in Saudi Arabia. Significantly, this thesis recommends comparative solutions through which Saudi policymakers could improve the current governance structure, promote market transparency and accountability, and enhance directors' implementation of their duties and independence. Such solutions also offer unambiguous protection to minority shareholders and facilitate participation and activism among shareholders and corporations, as well as improve clear fiduciary duty standards among shareholders. Furthermore, this study contributes to emphasising the power of institutional investors in reducing agency issues in highly concentrated ownership in the kingdom. Finally, it is essential to regard the impact of Islam when analysing corporate governance in Saudi Arabia. For this purpose, and in order to advance Sharia-compliant companies, this study recommends several reforms to the Sharia supervisory board (SSB).

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