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**The Board of Directors in Listed Companies under the
Corporate Governance System in Saudi Law as Compared to
English Law and Global Standards**

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Abstract

Saudi Arabia has a unique environment in terms of its political, economic, legal and judicial aspects which have some anomalous characteristics that create challenges for corporate governance. Further challenges are presented by the current structure of listed companies and by Saudi Arabia's Vision for 2030.¹ This environment significantly influences the role of the board of directors in listed companies and increases its role in safeguarding the interests of different shareholders and stakeholders. This thesis reviews the new legislation relating to corporate governance in Saudi Arabia in relation to the board of directors in listed companies and the extent to which such legislation affects its relationships with the main parties in the company. It defines the major features of the new Saudi Law of Companies, issued in 2015, and the new Corporate Governance Regulation, issued in 2017. The thesis deals with all of the relevant changes in the new law and regulations. It also clarifies the extent of the improvement in corporate governance resulting from the new legislation and those aspects related to the thesis that require further reform by suggesting more details, flexibility or enforcement to meet the standards of corporate governance. It uses a comparative study with both English law and global standards and assesses the compatibility of Saudi legislation with them in this respect in a manner that suits the particularities of the legal and economic environment in Saudi Arabia.

The thesis explores the main theories and the most prominent models of corporate governance that affect the role of the board of directors. It discusses the composition of the board of directors, including the diversity of board membership, structure and models as well as the provisions for shadow directors. It also covers the relationship of the board of directors with the AGM, board meetings, company committees, company auditors, stakeholders and - in particular - employees.

¹ See the official website of Saudi Arabia's Vision for 2030, at 45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016.

Declaration

I confirm that this thesis is my own work. It has not been submitted in support of an application for another degree or qualification for any university or institute of learning. All quotations have been recognised and the sources of identification specifically acknowledged.

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Chapter One

Introduction

1.1 Preamble

The past two decades have seen some major corporations (Enron, World Telecom, etc.) fall into insolvency, and the current financial crises in many parts of the world have placed the issue of corporate governance as a priority in the agenda of meetings of world leaders, business people and international financial institutions. Analysts have attributed the main reason for the failure of such companies to a lack of proper rules for management, the easy manipulation of accounts, fraud, taking flawed/bad decisions and the lack of supervision and follow-up by shareholders and stakeholders.² Such failures have led international financial institutions to lay down a list of rules and criteria that guarantee good performance and provide strong control under the title “corporate governance”. The mechanisms of corporate governance provide a better way to manage corporations in a manner that protects the money of investors and creditors and safeguards the rights of all stakeholders, thus providing promising opportunities for corporations to be successful.³

Saudi Arabia, where the export and manufacture of oil products dominate the economy, is considered to have one of the strongest economies in the world. This enables it to be a member of the Group of Twenty (G-20) which comprises the 20 major economies.⁴ However, Saudi Arabia has sought to diversify its income sources as well as build and attract investments simultaneously with developing its laws and legal environment to create an atmosphere of confidence and stability for investors, shareholders and stakeholders.

A comprehensive review should be made of the legislation relating to corporate governance in Saudi Arabia. This may significantly enhance the effectiveness of internal control systems in a manner that matches the particularity, nature and size of Saudi listed companies. Furthermore, assisting the external oversight entities and raising awareness of investors and shareholders as to the necessity of playing an active role in enforcement of internal control systems should be considered as well. This research seeks to deal with a part of these needs that relates to the board of directors in

² Lückers-Rovers, M. and Bos, A. (2011), Code of Conduct for Non-Executive and Supervisory Directors, *Journal of Business Ethics*, 100, at 465.

³ Tricker, B. (2015). *Corporate governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 4.

⁴ See the official G-20 website. available at <http://www.g20.org/English>, accessed on 20/3/2016.

listed firms, improve the relevant legislation and find some solutions for their problems. Thus, in achieving the research aims, it will use a comparative study with English law to try to measure to what extent Saudi legislation is compatible with global standards in this respect.

It is hoped that corporate governance concepts, rules and culture, when successfully applied at a public corporate level, can contribute to spreading concepts and the culture of participation, transparency and accountability in all spheres of Saudi society, thus playing an important role in developing the private and public sector in Saudi Arabia, particularly given that many corporations and important institutions are run by the Government.

1.2 The Importance of the Research

Corporate governance is in its infancy in many developing countries, including Saudi Arabia. As a result, it suffers from inadequate legislative, judicial, investment and supervisory regimes. Moreover, there is a lack of independent media, strategies for combating corruption, civil institutions and democratic principles that successful corporate governance depends on. All of these factors give the internal entities of corporate governance a pivotal role in the Saudi context and point to the importance of the board of directors in order to safeguard the interests of different shareholders and stakeholders.

The new trend in the Saudi Vision for 2030 issued in 2016⁵ is another factor that refers to the importance of studying the role of the board of directors in corporate governance in the Saudi context. The Saudi Vision for 2030 can be considered a major turning point that could have a substantial impact on the diversification of the economy, the culture of work and corporate governance practices. It aims to maximise the role of the private sector, increase economic liberalisation and create a comprehensive privatisation programme.⁶ Such trend need to be considered in light of the essential characteristics of the current economy and corporate sector to deal with challenges that may arise from this trend.

It should be noted that on the 4th of December 2015, when this thesis was well underway, the new Company Law was published in Saudi Arabia and superseded the previous law issued in 1965.⁷ This new law is designed to meet the contemporary needs of the company sector and create a motivating environment for them to increase their contribution to the national economy. It also tackles the shortcomings of the obsolete law and the dispersed decrees that tried to amend it. This thesis seeks to be one of the earliest studies to review the relevant Saudi rules in the new law that are related to the board of directors in the light of those in England and global standards of corporate governance.

⁵ See the official website of Saudi Arabia's Vision for 2030, at 45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016.

⁶ Ibid.

⁷ Article 226 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

Moreover, on the 13th of February 2017, when this thesis was in its final stages, a new version of the Corporate Governance Regulation (CGR) was introduced in Saudi Arabia. The new regulation has 56 pages with 98 articles, as opposed to the massively lower figure of 19 pages with 19 articles in the previous one. The new regulation has changed many provisions, and has impacted on numerous points that had been discussed by this thesis. Several rules had been criticised and some amendments and solutions had been suggested in this thesis which were subsequently tackled by the new CGR. However, the thesis deals with all relevant changes and the shortcomings addressed by the new regulation. It also clarifies the extent of the improvement in corporate governance that could result from the new regulation and those aspects related to the thesis that require further reform.

In response to these important factors, this research will provide options for reforming Saudi legislation in order to balance and fill the gap between the deficiency of democratic principles and the need to enhance the pivotal role of boards of directors in this kind of environment. This will be achieved by discussing the corporate governance theories and models, and the preferable composition of the board of directors. Moreover, the legal rules that regulate the relationship and role of the board of directors with main actors will be considered. Taking all of these points together may assist Saudi practice to achieve the objectives of corporate governance.

1.3 Objectives and Questions of the Research

The main question of this research is: **"To what extent is it possible to reform the legislation related to the board of directors in listed companies in Saudi Arabia in the light of English law and global standards, taking into account the local political, economic and legal environments which significantly impact the board of directors?"**.

The research seeks to study the Saudi law related to the board of directors of listed⁸ companies and its role and relationships under corporate governance, while comparing the same with the prevailing laws in England and global standards. This research intends to critique Saudi laws and see whether they are capable of achieving the objectives of corporate governance (i.e. whether they are mandatory, adequate, clear and applicable), and in so doing whether they protect the interests of shareholders and other stakeholders.

The objective of this research is to identify loopholes and flaws in Saudi law in this regard. Then, the intention is to make recommendations and suggest some solutions that would contribute to enriching the respective laws by providing more detail, flexibility or enforceability, thus reforming and developing them.

To deal with the main question, the research aims to answer the sub-questions below:

- What are the concepts and principles of corporate governance that affect the board of directors? What are the theories and models that explain the relationship between the board of directors and the company? To what extent are these theories and models compatible with those in Saudi Arabia and able to achieve the objectives of corporate governance in the Saudi context?
- To what extent are Saudi political, legal and economic environments compatible with the requirements that affect the role of boards of directors in discharging their

⁸ It is worth noting that this thesis will deal with only listed companies which have shares that can be publicly traded on a stock exchange. All listed companies will necessarily be joint stock companies but the reverse is not true as the shares of public company can be traded between its members. Also, many companies which de-list from a stock exchange continue to be public limited companies. However, in Saudi context, the expression of "public companies" to refer to joint stock companies is unusual.

duties and the success of corporate governance in light of English law and global standards?

- To what extent are the composition of the board of directors in Saudi Arabia and its types of membership compatible with English law and global standards of corporate governance? Which international experiences in this regard are more appropriate to the Saudi context and capable of achieving the objectives of corporate governance in it?
- How can Saudi law be reformed in terms of the roles and relationships of the board of directors with the main actors in light of corporate governance in English law and global standards?

It should be noted here that it is impossible for this research to cover all aspects of the board of directors and its role and relationships. Therefore, it will focus on the main responsibilities and roles of the board of directors that are linked with the main question of this research and will not discuss the detailed duties of the board of directors.⁹ Hence, the research will discuss the vital aspects that can be found in English law and global standards which may influence the board of directors in the Saudi context and assist in achieving the goals of corporate governance in such an environment.

⁹ The research, for example, will not discuss the relationship of the board of directors with the CEO and the relationship with profitable and non-profitable entities, supporting institutions and international observing bodies of corporate governance. As well as, measures that ensure the quality of law enforcement and provisions related to breaches of corporate governance rules, negligence and abuse.

1.4 Methodology of this Research and its Scope

In answering the research questions, the study uses doctrinal, comparative and critical analytical methods to deal with legislation relating to the board of directors of listed companies under corporate governance in Saudi Arabia. The research will compare said legislation to similar legislation in England and global standards. Materials will be collected through primary sources such as pieces of legislation and case law and through secondary sources such as government papers and academic publications. An analysis and an evaluation of these materials are indispensable for the interpretations, applications and reforms of the current laws. This will illuminate the similarities and differences between the ways comparable problems are resolved by different nations using different legislation.

This research adopts a limited method of comparative study which concentrates on reforming Saudi law. Its aim, therefore, is to use comparative law to discuss and evaluate rules in Saudi law which are not appropriate for the Saudi context. Likewise, it tries also to find some solutions to domestic problems from English law and global standards which are appropriate to the Saudi circumstances. Hence, the research will not seek to critique English law or provide any suggestions for reform, except in the case of evaluating the validity of specific ideas to be used in Saudi Arabia.

My university in Saudi Arabia granted me a scholarship to do a comparative study with English law because it has a prestigious and respectable reputation in my country. Moreover, England is one of the foremost countries that has issued rules that organise operations of firms and serve to develop corporate governance. The UK generally has shown a great deal of stability in the face of the financial crisis of 2008. The Companies Act 2006 emerged as a result of a long term cumulative experience. It regulates the company sector, codifies directors' duties and clarifies shareholders' rights and the administrative procedures required.¹⁰ Furthermore, the corporate governance model in Saudi Arabia is much closer to the Anglo-Saxon model in the UK as they both adopted the unitary board of directors and do not support the bank-oriented system or any form of employee representation. Therefore, using such a law comparatively will help attempts to reform company law in the Saudi context. However, this will not prevent

¹⁰ See the description of the UK Companies Act 2006, the National Archives of the UK government, available at <http://www.legislation.gov.uk/ukpga/2006/46/notes>), accessed on 10/3/2015.

me from mining global standards and useful practices in other countries when they appear more suitable for Saudi needs.

1.5 Comparative Law and Legal Transplantation

This research is concerned with corporate governance in listed companies in Saudi Arabia.¹¹ This stock market, like other markets across the world, aims to maximise its value and receive more liquidity by encouraging foreign investors to invest in it. Therefore, looking at the worldwide successful experiences and measuring the compatibility between Saudi legislation and good global standards in this regard will highly affect in both developing corporate governance and improving the Saudi stock market.

Understanding the nature of law and knowing the ways and the sources of legal development are the prime merits of comparative law. This provides a valuable opportunity to get a fuller insight into the variety of facts that shape the legal rules along with improving academic and practical fields in this context, which can be very useful in legal reform.¹²

In our uninsulated world, it is important for everyone, whether an advocate or a resistor of state legal change through international and transnational law, to recognise the factors and implications that enhance or impede these induced legal changes. It is important to consider the dynamic interaction between transnational law and its opportunities, limits and impacts in light of their particular contexts and local institutions and national law.¹³

Through comparative law, those people concerned with legal reform would be able to see their tasks more clearly. They would be eligible to decide when and how to borrow from other systems as well as evaluating the authenticity and validity of foreign solutions and to what extent the modification is required.¹⁴ However, to obtain genuine advantages from comparative law, the people concerned with law reform should have the capability to distinguish and isolate the major factors that caused the success in a

¹¹ For further information about the Saudi stock market, see chapter three, section entitled “The Public Joint Stock Companies in Saudi Arabia”.

¹² Watson, A. (1974). *Legal transplants: An Approach to Comparative Law* (1st ed.) Edinburgh: Scottish Academic Press, at 16,17.

¹³ Gregory, S. (2012). Transnational Legal Process and State Change. *Law and Social Inquiry: Journal of the American Bar Foundation*, 37, at 45. Available at SSRN: <http://ssrn.com/abstract=1901952>, accessed on 20/3/2016.

¹⁴ Watson, A. (1974). *Legal transplants: An Approach to Comparative Law* (1st ed.). Edinburgh: Scottish Academic Press, at 16.

particular society. They should also be aware of the circumstances which support or hamper legal development in both compared societies.¹⁵

1.5.1 The Concept of "Legal Transplantation"

Legal transfers have been common since the earliest recorded history and brought about the development of legal systems around the world.¹⁶ The term 'legal transplant' was created in the 1970s by Alan Watson who defined it as "the moving of a rule or a system of law from one country to another, or from one people to another".¹⁷

Watson argues that legal transplantation of limited or large parts of legislation is the most fertile source of their development from early times to the present day and it is responsible for most legal changes. He also argues that legislation represents the fruit of human experience like useful technology which can be created in a certain region and then become widespread depending on its value and the needs of other nations.¹⁸ Thus, countries that are less advanced materially or culturally are more likely to receive foreign legal rules. This claim is borne out by a great deal of historical evidence, such as Germany in the fifth century and the Wild West.¹⁹

Legal transplantation is a useful way for the domestic legal model to develop its society and enact new legislation. Moreover, it can deliver advanced solutions to their problems that may not be available in their original legal framework. However, this can only be done as long as the process of legal transplant takes into account ambitions and interests of the local society and its initial conditions and domestic legal practice.²⁰

Transnational legal rules can assist legislators to perceive, weigh up and shape both the appropriate enactments and institutional arrangements which guarantee good

¹⁵ Ibid.

¹⁶ Gillespie, J. (2006). *Transplanting Commercial Law Reform: Developing a 'rule of Law' in Vietnam*. Aldershot: Ashgate Publishing, Ltd., at 3.

¹⁷ Watson, A. (1974). *Legal transplants: An Approach to Comparative Law* (1st ed.). Edinburgh: Scottish Academic Press, at 21.

¹⁸ Ibid, at 95,100.

¹⁹ Ibid, at 99.

²⁰ Berkowitz, D., Pistor, K., and Richard, J. (2003). Economic Development, Legality, and the Transplant Effect. *European Economic Review*, 47(1), at 174.

application and enforcement of law. Comparative law and legal transplantation, therefore, makes it possible to take advantage of legal norms, processes, institutional organisation and practices within states.²¹

1.5.2 Forms and Causes of Legal Transplantation

Valderrama gives the main qualities that qualify laws for legal transplant: "(i) authority, (ii) prestige and imposition, (iii) chance and necessity, (iv) expected efficacy of the law, and (v) political, economic and reputational incentives from the countries and third parties".²² Regardless the reasons that legal transplantation takes place, there have been numerous forms of law transplantation and institutional structures over time and location whether through geopolitical or cultural borders. These different shapes significantly affect the acceptance of the transplant process and the extent of its success.²³ Legal transplant forms can be divided, in general, into two major styles; externally imposed and internal voluntary.²⁴

The first are compulsory legal transplants which come about due to colonisation and military expansion. This form was the fundamental way to legally transplant through superpower hegemony into many host developing countries.²⁵ It should be noted that this compulsory transplantation did not end with the end of the colonial era. Legal transplant continued to play a role as a weapon in the 'Cold War' between the USSR and the United States when they were competing for political and military supremacy.²⁶ Beyond that, it can be said that imposed legal transfers still exist in the soft form of some globalisation agreements and international legal harmonisation projects which

²¹ Gregory, S. (2012). Transnational Legal Process and State Change. *Law and Social Inquiry: Journal of the American Bar Foundation*, 37, at 15. Available at SSRN: <http://ssrn.com/abstract=1901952>, accessed on 20/3/2016.

²² Valderrama, I. (2004). Legal Transplants and Comparative Law. *International Law Journal*, 1(2), at 265. Available at SSRN: <http://ssrn.com/abstract=2017940>, accessed on 20/3/2016.

²³ Berkowitz, D., Pistor, K., and Richard, J. (2003). Economic Development, Legality, and the Transplant Effect. *European Economic Review*, 47(1), at 174.

²⁴ Ibid.

²⁵ Gillespie, J. (2006). *Transplanting Commercial Law Reform: Developing a 'rule of Law' in Vietnam*. Aldershot: Ashgate Publishing, Ltd., at 3.

²⁶ Ibid, at 4.

serve and are governed by large trading nations according to Western culture and its liberal democracy.²⁷

The second are voluntary legal transplants which can be seen as a positive legal transfer. This form is common today and it is responsible for most legal transfers as a result of internationalisation and globalisation. This situation is a logical consequence, particularly in the commercial and economic sectors where there is an increasing demand for communication technologies and international trade and investment,²⁸ as well as global economic integration and the standardisation of global models.²⁹

Globalisation, however, takes place in this form also; it is the pivotal factor in increasing the demand for comparative law and spreading legal transplantation.³⁰ At the legal level, as with other interactive spheres, there is a search for new solutions for unsolved problems regardless of geographical borders.

Conveying legal norms can be voluntary done through several concerned people and institutions such as public officials, business actors and representatives, independent activists, civil society and professionals.³¹ Moreover, they may receive further support from transnational organisations and networks, as well as international treaties and global, multilateral, regional and bilateral norms that are approved by their country.³²

1.5.3 Some Important Standards for Legal Borrowing

It is important to bear in mind that legal transplant is not a simple copy-paste act. Hence, a legal rule cannot be separated from its cultural, political, social and economic contexts and may not serve the same extent as elsewhere. Careful consideration is in fact

²⁷ Ibid.

²⁸ Ibid, at 13.

²⁹ Spamann, H. (2009). Contemporary Legal Transplants: Legal Families and the Diffusion of (Corporate) Law. *Brigham Young University Law Review*, (6), at 1876. Available at SSRN: <http://ssrn.com/abstract=1411704>, accessed on 20/3/2016.

³⁰ Valderrama, I. (2004). Legal Transplants and Comparative Law. *International Law Journal*, 1(2), at 264. Available at SSRN: <http://ssrn.com/abstract=2017940>, accessed on 20/3/2016.

³¹ Gregory, S. (2012). Transnational Legal Process and State Change. *Law and Social Inquiry: Journal of the American Bar Foundation*, 37, at 11. Available at SSRN: <http://ssrn.com/abstract=1901952>, accessed on 20/3/2016.

³² Ibid.

required on the extent to which foreign legal rules are appropriate for the final consumers and the domestic demand for the new law. Starting from this objective, legislators should increase their familiarity with legal borrowing and ensure that new rules are eligible to be used in practice in relation to the local legal culture and conditions. These rules should also be applicable by law enforcers and show promise as far as fostering development is concerned.³³

Moreover, the legal environment in a recipient country needs to be taken into account. Owing to the fact that "the transplantation process may vary based on social, legal economic, fiscal, financial and technical circumstances prevailing in each country's "legal culture" and legal system".³⁴ Along similar lines, before the borrowing process begins, the environment in the country of origin should also be understood. The different regional circumstances of such legal rules may result in transplantation having a negative influence and the opposite consequences.³⁵

Watson draws attention to the important role of authority in terms of whether legal transplants and law as a whole. He argues that: "Transplants in fact offer an insight into the overwhelming importance of the part played by authority in law".³⁶ However, the way of enforcing the borrowed rules is another issue that needs to be taken into account. There are several legal mediators and configurations of power who are involved in enforcing the process of the law such as judges, lawyers, legal academics and corporate legal officers. The enforceability of foreign legal rules relies on the cooperation of these legal actors and their capability to work side by side toward improving the quality of their national law regardless of the agenda or interests of certain groups.³⁷ Moreover,

³³ Berkowitz, D., Pistor, K., and Richard, J. (2003). Economic Development, Legality, and the Transplant Effect. *European Economic Review*, 47(1), at 192.

³⁴ Valderrama, I. (2004). Legal transplants and Comparative Law. *International Law Journal*, 1(2), at 274. Available at SSRN: <http://ssrn.com/abstract=2017940>, accessed on 20/3/2016.

³⁵ *Ibid*, at 272- 273.

³⁶ Watson, A. (1974). *Legal transplants: An Approach to Comparative Law* (1st ed.). Edinburgh: Scottish Academic Press, at 99.

³⁷ Berkowitz, D., Pistor, K., and Richard, J. (2003). Economic Development, Legality, and the Transplant Effect. *European Economic Review*, 47(1), at 167.

national legal norms and institutions should be resilient and play a mediating role with them.³⁸

The vital role of globalisation in legal transplants was mentioned above as it enhances the transmission of legislation and legal knowledge. Nevertheless, it can also be one of the serious challenges to successful legal transplants when it uses double standards and serves a select group of developed nations at the expense of developing ones. Hence, global economic integration should be more clear, transparent and beneficial for all parties as all have a similar authority to protect and lead their economies.³⁹

1.5.4 Legal Transplants in Saudi Arabia

Within its current borders, Saudi Arabia has never been occupied by any other country with a different culture or religion. Moreover, no foreign laws have ever been imposed upon it. Furthermore, it has unique legislations based on Islamic law in different spheres especially in the area of personal status law and the civil judicial system.⁴⁰ In addition, Saudi Arabia is a young country which has been growing fast and it has built strong connections with leading countries and international organisations. This situation has pushed law-makers in Saudi Arabia towards further openness in borrowing and transferring some beneficial legislation from either similar regional countries or worldwide. In order to harmonise their laws to address people's needs and developmental demands, Saudi Arabia has voluntarily adopted several transnational legal rules, particularly in commercial, banking, economic and company laws.

An example of this situation can be found in the explanatory note of the initial Saudi Law of Companies issued in 1965. It mentioned that the rapid growth of large trade projects increased the number of companies dramatically, while there were insufficient regulations to deal with the variety of needs and the complicated issues they faced. This

³⁸ Gregory, S. (2012). Transnational Legal Process and State Change. *Law and Social Inquiry: Journal of the American Bar Foundation*, 43, at 11. Available at SSRN: <http://ssrn.com/abstract=1901952>, accessed on 20/3/2016.

³⁹ Tamanaha, B. (2008). Understanding Legal Pluralism: Past to Present, Local to Global. *Sydney Law Review*, 30(3), at pp 386-388.

⁴⁰ Further details can be seen in chapter three in this research.

drove those firms to borrow a number of rules that had already been applied in other countries, which made their affairs even more complicated and the task state supervision more difficult.⁴¹ Another example comes from the Saudi Commercial Law issued in 1931 and which was extracted from the Ottoman Trade Act, which was also derived from the French commercial code.⁴²

The challenge in this research is how to distinguish between, on one hand, the particularities of the local Saudi setting and the nature of the current economy which need to be considered and, on the other hand, negative aspects of the local setting that need to be changed by repealing some obsolete rules and borrowing some beneficial rules from other legal systems to respond the demands of business development.

These factors need to be considered when enacting laws and cannot be served by cloning the experiences of other nations, as this may create additional obstacles for the corporate sector. There is a need to benefit from the relevant useful experiences of the different legislative frameworks and to enact more legislations that could suit developed countries.

1.6 Conclusion

The internal corporate structure of a company, including its board of directors, is one of the central aspects that needs to be considered when reviewing the corporate governance system in the Saudi context. The board of directors is the most important internal corporate institution for representing shareholders and coordinating the interactions within company boundaries, for regulating the relationships between the different constituencies and for enacting bylaws and corporate policies. Therefore, it is of utmost importance to consider the composition, roles and key relationships of the board of directors carefully when reviewing corporate governance legislation.

⁴¹ See the official website of the Bureau of Experts at the Council of Ministers, the explanatory note of the law of companies is available at: <https://www.boe.gov.sa/printsystem.aspx?lang=1&systemid=236&versionid=48>, accessed on 18/10/2015.

⁴² Al-Jabre, M. (1996). *The Saudi Commercial Law (5th ed.)*. Riyadh: King Fahd National Library, at 22.

This research aims to review the legislation relating to the board of directors in listed companies under the corporate governance system in Saudi Arabia and the extent to which such legislation affects its composition and relationships with the main parties in the company. In seeking to achieve the stated research aims, this thesis uses a comparative study of both English law and global standards. This is to assess their compatibility with Saudi legislation in this respect and to suggest some reforms to it. This will be conducted in a manner that matches the particularity of the legal and economic environment and the nature of listed companies in Saudi Arabia.

Looking at the successful global experiences and measuring the compatibility between Saudi legislation and good global standards in this regard will greatly affect the development of corporate governance. However, the nature of law and knowing the ways and the sources of legal development should be considered. This should enable people concerned with legal reform to see their tasks more clearly in deciding when and how to borrow from other systems as well as to evaluate the authenticity and validity of foreign solutions and to what extent the modification is required.

In the next chapter, the research will try to discuss the key concepts and principles of corporate governance and the major corporate governance theories and models. This is important to understand the particular nature of a joint stock company and to clarify the most significant duties and roles of the board of directors and the boundaries of the relationships between various groups in a firm, as well as the importance of finding a comprehensive balance between liability, control and ownership. Understanding the overlapping factors in this regard may positively affect the legal reform of corporate governance in the Saudi context.

Chapter Two

The Concept of Corporate Governance, its Theories and Systems and How They Relate to the Board of Directors

2.1 The Definition of Corporate Governance and its Importance

2.1.1 The Definition of Corporate Governance

Effective corporate governance is an ideal way to protect the rights of shareholders and other stakeholders as well as to maximise company profits. Due to this, many countries have sought to raise standards of corporate governance and improve the corporate governance system through their legislation. This has especially been the case in the last decade during which many countries across the world have been beset by financial crises. Essentially, all entities need governance regardless of type or the sector they belong to, whether profit-oriented or non-profit organisations, public or private companies. This is to ensure that they are run well and their managers are responsible and accountable.⁴³

In general, corporate governance concerns itself with ‘the appropriate board structures, processes and values to cope with the rapidly changing demands of both shareholders and stakeholders in and around their enterprises’.⁴⁴ Irrespective of the particular definition used, corporate governance is based on two types of mechanisms: the first one is internal to the company which seeks to give shareholders some way of influencing the board of directors; the second one is external to the company, it exists in the regulatory environment and it depends on state agencies for the detection of corruption.⁴⁵

Originally, the term ‘governance’ comes from the Greek word “kubernetes” which means the steersman who guides the ship safely.⁴⁶ It found its way into English from Latin via Old French to express effective values such as accountability, probity and transparency of the governing context.⁴⁷ It should be noted that there is no word in Arabic with the same meaning without qualifying it with an explanation. As such, this

⁴³ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 4.

⁴⁴ Garratt, B. (2003). *Thin on Top Why Corporate Governance Matters and how to Measure and Improve Board Performance* (1st ed.). London: Nicholas Brealey Publishing, at 12.

⁴⁵ Pettet, B., Lowry, J., and Reisberg, A. (2009). *Pettet's Company Law; Company and Capital Markets Law* (3rd ed.). New York: Pearson Longman, at 137.

⁴⁶ Garratt, B. (2003). *Thin on Top Why Corporate Governance Matters and how to Measure and Improve Board Performance* (1st ed.). London: Nicholas Brealey Publishing, at 33.

⁴⁷ Ibid.

issue has been the subject of considerable debate among Arabic language scholars and institutions as they strive to find an equivalent phrase for corporate governance. Some scholars have agreed on the phrase “Hawkamah” or “Hawkamat Asharikat” to express the term, and this is now in regular use.⁴⁸ Nevertheless, the meaning of this translated phrase is still unclear to non-specialists. This has, therefore, necessitated adding a clear definition or explanation of the meaning of corporate governance in Saudi regulations, as in the UK code, that deal with this phrase. The absence of a proper definition of corporate governance has been remedied in the new Saudi CGR issued on 13th February 2017, which provides a comprehensive description that covers its meaning, targets and the principal parties involved.⁴⁹

It is difficult to accurately define the phrase ‘corporate governance’ as there are many different definitions. Therefore, looking at multiple definitions is helpful to understand the boundaries, levels and processes of corporate governance.⁵⁰ In this regard, it is helpful to explore some short definitions as given below:

- A "system of legal or other mechanisms which ensures that the interests of the managers of the company are aligned with those of the shareholders".⁵¹
- A "set of mechanisms through which outside investors protect themselves against expropriation by the insiders".⁵²
- A "system of laws, rules and factors that control operations at a company".⁵³

Some researchers have adopted the broader definitions of what constitutes corporate governance which cover multiple governance mechanisms and their interactions. This may be more suitable for corporate governance research development.⁵⁴ Cornelius and

⁴⁸ See Academy of the Arabic Language in Cairo statement in 20/5/2005, as reported in Alrezin, A. (2012), 'حوكمة الشركات المساهمة', *Imam Muhammad Ibn Saud Islamic University, SABIC Research Chair* (23-01), at 3.

⁴⁹ Articles 1 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁵⁰ Tricker, B. (2015). *Corporate governance principles, policies and practices* (3rd ed). Oxford: Oxford University Press, at 30.

⁵¹ Pettet, B., Lowry, J., and Reisberg, A. (2009). *Pettet's Company Law; Company and Capital Markets Law* (3rd ed.). New York: Pearson Longman, at 137.

⁵² Porta, R., Lopez-de-Silanes, F., Shleifer, A., and Vishny, R. (2000). Investor protection and corporate governance. *Journal of Financial Economics*, 58(1), at 4.

⁵³ Gillan, S. (2006). Recent Developments in Corporate Governance: An Overview. *Journal of Corporate Finance*, 12(3), at 382.

⁵⁴ *Ibid*, at 395.

Kogut, for example, favour one of these broader definitions. They see corporate governance as a system that consists of:

"Those formal and informal institutions, laws, values, and rules that generate the menu of legal and organisational forms available in a country and which in turn determine the distribution of power; how ownership is assigned, managerial decisions are made and monitored, information is audited and released, and profits and benefits allocated and distributed".⁵⁵

Whilst the above definition emphasises the role of laws, rules and institutions, some researchers look at corporate governance from the inverse angle. They define it as:

"The ability of organisations in the private, public and non-profit sectors to achieve their purpose in the most efficacious manner while minimising the need for laws, regulations, regulators, courts or codes of so called "best practices" to protect and further the interests of their stakeholders and society".⁵⁶

This definition is potentially more suitable for developing countries where the roles of laws, regulations, regulators and courts do not guarantee good practices of corporate governance.

2.1.2 Cadbury Definition

The UK Code⁵⁷ still uses the classic definition of corporate governance that was produced in 1992 by the Cadbury Committee. It stipulates that:

"Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship.

⁵⁵ Cornelius, P., and Kogut, B. (2003). *Corporate Governance and Capital Flows in a Global Economy* (Global outlook series). New York: Oxford University Press, at 2.

⁵⁶ Boubaker, S., Nguyen, B., and Nguyen, D. (2012). *Corporate Governance [electronic resource]: Recent Developments and New Trends*. Berlin, Heidelberg: Springer Berlin Heidelberg: Imprint: Springer, at 347.

⁵⁷ See the UK Corporate Governance Code 2016, para. 2, at 1.

The board's actions are subject to laws, regulations and the shareholders in general meeting".⁵⁸

Despite the fact that the Cadbury definition was the starting point for most other reviews of governance, over the passage of time some shortcomings have become apparent. For example, the Cadbury report gives the directors a pivotal position and ignores several activities which have a substantial impact on the success of the business and managing a company.⁵⁹ Some researchers have noted other shortcomings. They argue that the Cadbury definition limits the interplay of corporate governance between only three groups of actors; directors, shareholders and auditors. In addition, the definition limits the roles of shareholders on setting up board structures without referring to continuing oversight or how governance should be developed. This makes the Cadbury definition more suited to business corporations acting for profit than public sector organisations.⁶⁰

Bloomfield states that the definition of corporate governance should contain a specific reference to four forms of governance: procedural, behavioural, structural and systemic. Moreover, it should consider the differences between private and public sectors in the materials and context of governance. He provides two alternative definitions of corporate governance.⁶¹ The first definition is for the private sector:

"Corporate governance is the governing structure and processes in an organisation that exist to oversee the means by which limited resources are efficiently directed to competing purposes for the use of the organisation and its stakeholders; including the maintenance of the organisation and its long-run sustainability, set and measured against a framework of ethics and backed by regulation and laws".⁶²

The second definition is for the public and non-profit sector:

"A series of principles, which are usually embodied in formal controls, in agencies which seek to redress market imperfections by acting for, on behalf of and with the express approval of the State, through all or some of the activities of policy-making, management, and regulation; mostly using resources without the intention of generating a profit and providing more or less appropriately-transparent information about the means of arriving at the allocation of

⁵⁸ Cadbury, A. (1992). Report of the Committee on the Financial Aspect of Corporate Governance. *Gee (a division of Professional Publishing Ltd)*, para. 2.5.

⁵⁹ Committee on Corporate Governance. (1998). *Final report*. London: Gee, para. 1.15

⁶⁰ Bloomfield, S. (2013). *Theory and Practice of Corporate Governance: An International Approach*. Cambridge: Cambridge University Press, at 7-9.

⁶¹ *Ibid*, at 17-19.

⁶² *Ibid*, at 19.

resources in the absence of a set of rational economic methods of achieving those ends".⁶³

In conclusion, the debate above indicates that there is no definition of corporate governance that can cover all its different aspects. However, whatever the definition used it should contain some specific reference to a number of important factors such as legal, regulatory and institutional environment. Moreover, it should include some substantial concepts such as business ethics and societal interests which have an impact on a firm's reputation and its long-term success.⁶⁴

In this regard, Tricker⁶⁵ argues that there are **five** different perspectives on definitions of corporate governance. The first is an operational perspective which is based on the interactions between the shareholders, the board and the management as they are the basis for much work on corporate governance. Second, a relationship perspective which focuses on various participants including the board, managers, shareholders and other stakeholders such as employees. Such a perspective tends to distribute rights, responsibilities and different activities among the different participants in decision-making and to determine the direction and performance of corporations. The corporate charter, formal policy and rule of law should regulate this relationship.

Third, a stakeholder perspective which takes a wider view of how those groups are involved in and affected by corporate governance. It is more of a response to the rights and wishes of stakeholders. Fourth, a financial economics perspective which sees corporate governance from a different angle of the suppliers and creditors. They seek to get an abundant return from their investment and worry about the legal protection available to them, especially over ownership concentration in corporate governance systems.

Finally, the perspective that tends to see corporate governance through the eyes of non-contractual stakeholders including local, national and international entities. The interests of this kind of stakeholders outside the firm may be affected by inside

⁶³ Ibid.

⁶⁴ Organisation for Economic Co-operation and Development. (2004). *OECD Principles of Corporate Governance*, OECD Publications Service, at 12.

⁶⁵ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 30.

corporate behaviour. This social responsibility sets corporate governance at a high level of abstraction.⁶⁶

2.1.3 Emergence and Development of the Concept of Corporate Governance

Although the phrase ‘corporate governance’ emerged as a theoretical subject in the 1980s, corporate governance practices have been used for much longer. These practices have been improved according to current needs, especially by companies set up by trading empires and when limited liability companies were first invented in the early 19th century.⁶⁷

Moreover, the principles of corporate governance have been greatly assisted by the wave of corporate consolidation at the turn of the 20th century and its financial requirements which have been partly achieved through public offerings of shares. Consequently, ownership structures of firms became dispersed among a wide range of investors which necessarily led to developing the idea of governance.⁶⁸

By the beginning of the 20th century, firms in developing countries had become larger and more complex with numerous worldwide shareholders. Geographically widespread ownership inspired Berle and Means to innovate an important idea in corporate governance which was termed the ‘separation of ownership and control’.⁶⁹ However, although Berle and Means described this idea in 1932, it was not put into practice until much later in England. By 1951 a clear separation could be seen between control and ownership in England which resulted in a managerial revolution taking place, particularly in large companies. The idea became very common by the 1980s.⁷⁰

⁶⁶ For these five perspectives in details, see Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 30-32.

⁶⁷ Ibid, at 4-5.

⁶⁸ Cheffins, B. (2001). History and the Global Corporate Governance Revolution: The UK Perspective. *Business History*, 43(4), at 88. available online at: <http://dx.doi.org/10.1080/713999243>, accessed on 12/3/2015.

⁶⁹ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 7-8.

⁷⁰ Cheffins, B. (2001). History and the Global Corporate Governance Revolution: The UK Perspective. *Business History*, 43(4), at 89-90. available online at: <http://dx.doi.org/10.1080/713999243>, accessed on 12/3/2015.

Some considerable improvements occurred in corporate governance in the 1970s. Listed companies became required to form audit committees on their boards comprising independent outside directors. The adoption of two-tier boards was encouraged in several countries. The duties of boards of directors towards stakeholders, companies' responsibilities have been widely debated to improve. The annual public report which follows accounting standards became a requirement for all listed companies.⁷¹

There was a reconsideration of a number of significant issues in the 1980s such as excessive remuneration for directors and standards of transparency. Moreover, a number of reports emerged such as the Cadbury Report in 1992 as well as the corporate governance codes.⁷²

The importance of corporate governance has been recognised and its practices have improved around the world since the beginning of the century. There are abundant references to corporate governance and its best practices. Most countries have published corporate governance codes for all listed firms to comply with or explain why they have not done so. However, this advanced level of corporate governance did not prevent the global financial crisis in 2008, and it has not been enough to disclose unreported indebtedness or dubious attitudes among executive directors. This draws attention to the importance of constant review of the principles, practices and processes of corporate governance according to the real needs, environment and culture in each country. It should be noted that "raising standards of corporate governance cannot be achieved by structures and rules alone. They are important because they provide a framework which will encourage and support good governance, but what counts is the way in which they are put to use".⁷³

⁷¹ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 9-10.

⁷² Bloomfield, S. (2013). *Theory and Practice of Corporate Governance: An International Approach*. Cambridge: Cambridge University Press, at 127.

⁷³ Cadbury, A. (1992). Report of the Committee on the Financial Aspect of Corporate Governance. *Gee (a division of Professional Publishing Ltd)*, para. 3.13.

2.1.4 Objectives of Corporate Governance and its Fundamental Principles

According to the Cadbury report, the main issue of corporate governance is to support the role of shareholders in the accountability of board of directors.⁷⁴ The UK Code widens this purpose to ensure the sustainable success of a firm over the longer term by focusing on facilitating effective, entrepreneurial and prudent management. It stipulates that this purpose can be achieved through significant principles such as accountability, transparency and probity.⁷⁵

Most principles and business values of good corporate governance either in public or private firms have been built on **three** fundamental values.⁷⁶ Those supreme values are accountability, transparency and probity which, in fact, represent some of the essential concepts of a democratic system. They already form part of the UK Code. A return to those great values will pay considerable dividends in terms of both social justice and financial returns for the company.⁷⁷

The OECD Principles of Corporate Governance published in 1999 are still considered the international benchmark on the subject. They cover **six** aspects that impact the relationship not only between the managers and shareholders of firms but also other stakeholders such as employees and creditors. The Organisation for Economic Co-operation and Development (OECD) is an international organisation of 34 countries. It concerns itself with financial market integrity and economic efficiency, and seeks to stimulate and compare practices and ideas as well as review progress in trade and financial markets. Those principles target policymakers and regulators market to promote the legal and regulatory frameworks that support corporate governance, particularly in listed firms.⁷⁸

The OECD Principles of Corporate Governance are:⁷⁹

⁷⁴ Ibid, para. 6.1.

⁷⁵ See the UK Corporate Governance Code 2016, para. 1.4, at 1.

⁷⁶ Garratt, B. (2003). *Thin on Top Why Corporate Governance Matters and how to Measure and Improve Board Performance* (1st ed.). London: Nicholas Brealey Publishing, at 3.

⁷⁷ Ibid, at 11.

⁷⁸ Organisation for Economic Co-operation and Development. (2004). *OECD Principles of Corporate Governance*, OECD Publications Service, at 2-5.

⁷⁹ For further details and the subsections of these principles see *ibid*, at 17-24.

1. Ensuring the basis for an effective corporate governance framework: ... promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
2. The rights of shareholders and key ownership functions: ... protect and facilitate the exercise of shareholders' rights.
3. The equitable treatment of shareholders: ... All shareholders should have the opportunity to obtain effective redress for violation of their rights, including minority and foreign shareholders.
4. The role of stakeholders in corporate governance: ... by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
5. Disclosure and transparency: ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
6. The responsibilities of the board: ... ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

These principles were subject to a second review conducted in 2014/15 under the responsibility of the OECD Corporate Governance Committee. The review received significant contributions from relevant international organisations, business advisory committees and experts in several countries. The 2015 version maintained the core principles of the 2004 version and strengthened them to ensure that the high quality would continue. The new principles were adopted by the OECD Council and the G20 Leaders in 2015 and named "G20/OECD Principles of Corporate Governance".⁸⁰

Siems argues that a global model of corporate governance is not a perfect solution, with many differences in social, cultural and economic levels. The model that applies to the leading OECD countries may be incompatible with many developing countries, where the economy, including the corporate sector, is dominated by ineffective formal

⁸⁰ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, at 2.

institutions.⁸¹ He suggests that the OECD Principles may be more useful when they are considered as a "common frame of reference" for the debate about reforming corporate governance in academia and practice rather than being a universal benchmark that should be translated into rules of codified company law.⁸²

⁸¹ Siems, M. and Alvarez-Macotela, O. (2017). The G20/OECD Principles of Corporate Governance 2015: A Critical Assessment of their Operation and Impact. *Journal of Business Law*, 4, at 315-318.

⁸² *Ibid*, at 328.

2.2 The Major Corporate Governance Theories Affecting the Board of Directors

2.2.1 Introduction

This research aims to discuss joint stock companies, which have dispersed ownership and generally have large capital and labour inputs, as well as a wide impact on different external parties and sectors.

There are a number of significant issues that need to be clarified in these kinds of companies. The first is, who owns a joint stock company, in light of the fact that the firm is legally considered as both a legal person and citizen who has independent rights and responsibilities.

Secondly, who is the principal in a joint stock company? Is it shareholders, or the company itself as a legal person who has rights and interests which may conflict with both shareholders and leaders?

Thirdly, what are the boundaries governing shareholders in terms of ownership, leadership and the right to dispose of the company assets? The liability and disposition of shareholders should be considered in the light of the complicated assets of a firm such as intellectual rights, secrets, moral rights and employees' experiences and its power and role in a society, which may impact the local environment, the quality of life and surrounding industries. We should consider also the particular nature of the joint stock company and the importance of comprehensive balance between boundaries of liability, control and individual ownership in the context of shareholders. This particular nature of shareholder ownership may influence the limitation of their power and the priority of interests.

Fourthly, how many categories of shareholders with diverse kinds of interests are there in a firm? Do they all have the same rights? There are speculators who are concerned with movements in the daily price of shares; investors who concentrate on the annual earnings of shares; and senior investors who have a different long-term priority which is to improve the company, expand its productions and compete successfully.

This research will deal with many of the above issues, particularly those relevant to the role of the board of directors. Studying the theoretical aspect of corporate governance and discussing the main corporate governance theories is essential to understand concepts and principles of corporate governance and the nature of a joint stock company as well as the boundaries of relationships between various groups in a firm.

There are numerous corporate governance theories which arise from different theoretical perspectives, whether they be political, ethical, social, institutional and economic. Some of them seek to serve particular aspects of corporate governance while others may be formed as a result of a reaction to and the tackling of some problems, circumstances, needs and weaknesses which emerged.

2.2.2 Agency Theory

In the corporate governance context, agency theory relates to the scenario when principals delegate their duties and decision-making authority to agents who work on their behalf.⁸³ This relation is mostly represented by the managers as the agents and the shareholders as the principals. Nevertheless, this does not prevent the agency perspective from recognising rights of other company parties such as creditors and employees.⁸⁴

The separation of ownership and control has contributed greatly to the prominence of agency theory which, in general terms, provides a simple nexus between only two participants: shareholders and managers who are supposed to act in the interests of the former.⁸⁵ Despite agents being controlled by principals' rules which aim to maximise shareholder value,⁸⁶ the interests of principals and agents do not always converge. From this arises the concept of agency costs, which describes the resources spent on

⁸³ Hill, C., and Jones, T. (1992). Stakeholder- Agency Theory. *Journal of Management Studies*, 29(2), at 132.

⁸⁴ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 16.

⁸⁵ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, Issue 4, at 89, 90. available at <http://www.eurojournals.com/MEFE.htm>, accessed on 12/3/2015.

⁸⁶ *Ibid*, at 89.

monitoring by the principal and the incentives of agents.⁸⁷ These costly mechanisms may guarantee good conduct in the principals' interests and reduce opportunistic actions by agents as well as impacting on the firm's returns at the same time.⁸⁸

In spite of the devices and mechanisms that reduce agency cost, it is difficult to deny that some divergence between the principal's interests and the agent's actions will occur.⁸⁹ This includes misuse of the agent's power for pecuniary gain or the taking of risks in pursuit of their own interests. Moreover, the difference in the level of information between the agent and principal serves the former and puts the latter at a disadvantage.⁹⁰

Some researchers differentiate between "owning capital" and "owning the firm". This, therefore, means that there are not enough justifications to claim that shareholders own the company, and this does not enable them to control the firm on their own.⁹¹ This is particularly the case when taking into account that shareholders are surely able in general to sell their shares at any time or simply for a profit.⁹²

It is difficult to deny that shareholders bear risks as providers of capital which is certainly affected by management decisions. However, there are other groups that may suffer more than them with less opportunities for survival. These groups include managers and employees who have a stronger correlation with a firm and there is no straightforward justification for giving them less preferential treatment than investors.⁹³

A company is not merely physical and financial assets, it is composed also of its human capital who own the portable knowledge productions. The modern company relies on multiple factors of production which are dependent on each other, such as money, time, skills, ideas and experiences that deserve to be appreciated equally. This leads to a comprehensive view of the different actors who own a firm including capital,

⁸⁷ Hill, C., and Jones, T. (1992). Stakeholder- Agency Theory. *Journal of Management Studies*, 29(2), at 132.

⁸⁸ Ibid.

⁸⁹ Ibid.

⁹⁰ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 16.

⁹¹ Fontrodona, J., and Sison, A. (2006). The Nature of the Firm, Agency Theory and Shareholder Theory: A Critique from Philosophical Anthropology. *Journal of Business Ethics*, 66(1), at 35.

⁹² Ibid, at 36.

⁹³ Ibid.

management and labour at the least, and who are all entitled to a rent in exchange for bearing risks.⁹⁴

To overcome the potential mischief that results from conflicts and divergences between agents and principals, Lan and Heracleous draw attention to the need to critically review and reformulate agency theory in order to successfully deal with the complexities of real-world organisations and open up new directions for legal theorization and empirical research. In particular, they suggest revising **three** underlying doctrines of agency theory which have had a large impact on corporate governance.⁹⁵

First, the principal in the principal-agent relationship should be redefined to be more aligned with legal doctrine and the corporation's societal function. This could be done by classifying the firm itself as a principal instead of shareholders. Hence, the corporation can be defined "as a legal entity acting as the nexus for contracting among several parties/stakeholders contributing to team production".⁹⁶

Second, it should be noted that the board of directors is not merely a first-order agent to shareholders or any other parties exclusively. Rather, it is an autonomous fiduciary body with sufficient power that enable them to do the right actions away from any interferences from any kind of beneficiaries.

Third, the role of the board of directors should focus on the intermediary instead of the traditional role of the board of monitoring managers' actions which is supposed to serve principals' interests. Intermediary hierarchy function works with all groups as a team and balances the competing interests of different parties that impact on the production, assets, strategic decisions and performance of the firm. This rethinking of agency theory makes it more consistent with both the principles of stakeholder theory and the assumptions of stewardship theory,⁹⁷ which will be discussed later.

Fontrudona and Sison propose that a company should be seen as a body of agents and a node of competencies with coordinated activities seeking to achieve a common goal,

⁹⁴ Ibid, at 36-37.

⁹⁵ Lan, L., and Heracleous, L. (2010). Rethinking Agency Theory: The View from Law. *Academy of Management Review*, 35(2), at 294-295.

⁹⁶ Ibid at 305.

⁹⁷ Ibid.

not a mere aggregation of individual skills. They believe that the goal will be achievable by rehabilitating agency theory through a human perspective.⁹⁸

2.2.3 Stakeholder Theory

Stakeholder theory expands the group of constituents to cover “any group or individual who can affect or is affected by the achievement of the organisation’s objectives”.⁹⁹ This applies to any kind of stockholder, including creditors, managers, employees, customers, suppliers, business partners, local communities and the general public as well as any types of relationships that require to be appreciated by managers. According to stakeholder theory, those parties deserve to obtain benefits and they can also affect the decision-making of the firm in both processes and outcomes.¹⁰⁰ They all represent a part of a firm’s capital, infrastructure and human capital commitments as well as provide a different level of services to it. In exchange, they also expect to gain appropriate benefits and avoid risks from their firms.¹⁰¹ Therefore, stakeholder theory assumes two levels of a board’s duties: a contractual duty to the shareholders’ interests and at the same time a moral duty to take other stakeholders into consideration.¹⁰²

Despite the fact that shareholders have an asset specificity, this alone does not qualify them to acquire special consideration over all other stakeholders who may be more involved and affected by the firm's risks. Nevertheless, shareholders are more capable of withdrawing themselves from the company via the stock market.¹⁰³ Therefore, the stakeholder approach depends on the idea that seeking to satisfy all groups who have a stake or a legitimate claim in the business relies on reformulating implementations and

⁹⁸ Fontrodona, J., and Sison, A. (2006). The Nature of the Firm, Agency Theory and Shareholder Theory: A Critique from Philosophical Anthropology. *Journal of Business Ethics*, 66(1), at 40-41.

⁹⁹ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, Issue 4, at 91, available at <http://www.eurojournals.com/MEFE.htm>, accessed on 12/3/2015.

¹⁰⁰ Ibid.

¹⁰¹ Hill, C., and Jones, T. (1992). Stakeholder- Agency Theory. *Journal of Management Studies*, 29(2), at 133.

¹⁰² Freeman, E., and McVea, J. (2001). A Stakeholder Approach to Strategic Management. *Darden Business School Working Paper*, No. 01-02, at 19, Can be downloaded from the Social Science Research Network Electronic Paper Collection at: http://papers.ssrn.com/paper.taf?abstract_id=263511, accessed on 12/3/2015.

¹⁰³ Ibid, at 18.

processes to be able to run and integrate stakeholders' relationships and interests for the long-term success of the company, as well as to ensure that management, the business environment, relationships and the shared interests are active and promoted.¹⁰⁴

On the other hand, dealing with a variety of unmeasurable interests at different levels of stakeholder groups may give managers a chance to exploit this complicated climate to be unaccountable for their actions.¹⁰⁵ There is also the possibility in some environments to favour particular stakeholder groups at the expense of others.¹⁰⁶ However, in today's fast changing business environment it is difficult to cover the myriad of groups who have a stake or interest in a firm. Therefore, attention should be drawn to the key stakeholder's interests and to creating integrated and coherent relationships as well as the key purpose of the firm.¹⁰⁷

Freeman and McVea argue that the stakeholder theory can offer a comprehensive framework to improve and combine the many other theories, such as agency theory, human relationships, transaction costs, contract theory, and even ethics and the environment into a coherent whole.¹⁰⁸ However, they also highlight some characteristics and issues that need to be developed in the stakeholder approach. These are summarised below:¹⁰⁹

1- The stakeholder approach provides a flexible framework that is able to deal with environmental shifts to manage strategically the mutual influence between the firm and the environment.

2- The survival of the firm is the greatest priority of the stakeholder approach. Hence, the firm should try to achieve its key objectives and understand stakeholder relationships in this context. This does not mean focusing on maximising a single

¹⁰⁴ Ibid, at 10.

¹⁰⁵ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 20.

¹⁰⁶ Freeman, E., and McVea, J. (2001). A Stakeholder Approach to Strategic Management. *Darden Business School Working Paper*, No. 01-02, at 11, Can be downloaded from the Social Science Research Network Electronic Paper Collection at: http://papers.ssrn.com/paper.taf?abstract_id=263511, accessed on 12/3/2015.

¹⁰⁷ Ibid, at 11.

¹⁰⁸ Ibid, at 19.

¹⁰⁹ Ibid, at 11-13.

objective but instead governing, balancing and integrating relationships and multiple objectives.

3- Unlike other theories that adopt the individualism approach in the protection of interests, there is a critical role for values in the stakeholder theory in the areas of business ethics and business and society. It supposes that ensuring long-term success requires stakeholders to share a set of core values whatever their differences. This is particularly in the case of boundaries blurred between firms, industries and public and private lives.

However, there are a series of shortcomings surrounding stakeholder theory which revolve around two major points. First, the term stakeholder is relatively vague and the definition of its object remains controversial. Furthermore, its objective to create value for all stakeholders with multiple targets is impossible to achieve. Similarly, it is unable to tackle the shortcomings of capitalist theories. This undefined management objective leads to confusion, conflict, inefficiencies and even a weakening of the corporation.¹¹⁰

Second, stakeholder theory is merely an ideological product based upon socialisation and moral behaviour. It does not have a sufficient scientific thoroughness to deal with the financial and economic objectives of companies. Moreover, it does not provide a clear description of a company's behaviours and its links with internal and external actors as well as how to tackle the challenges and the internal and external variables and how to manage conflicting interests.¹¹¹

2.2.4 Stewardship Theory

Although stewardship theory sees itself as an alternative approach to agency theory, both theories draw on the same assumptions. However, stewardship theory empowers

¹¹⁰ Mainardes, E., Alves, H., and Raposo, M. (2011). Stakeholder Theory: Issues to Resolve. *Management Decision*, 49(2), at 242-244.

¹¹¹ Ibid. For further information about evaluation of stakeholder theory, see Keay, A. (2010). Stakeholder theory in Corporate Law: Has it Got what it Takes? *Richmond Journal of Global Law and Business*, 9(3), 249-300.

managers to take autonomous executive action rather than placing them under the excessive control of the firm's owners.¹¹²

In contrast to the individualism perspective of agency theory, the stewardship theory derives from psychology and sociology perspectives. It assumes that maximising shareholder returns is based on firm performance and the capability of top management to integrate their targets as part of the organisation as they are also keen to protect their reputations. Moreover, it recognises that organisational success needs vital structures which place confidence in the stewards, empower and offer them maximum autonomy, as well as reduce the monitoring of their behaviours. Furthermore, in order to minimise agency costs further, stewardship theory looks to unite the role of the CEO and the chairman.¹¹³

Based on the fact that there are different shareholders with multiple objectives and a number of competing stakeholders, a firm cannot build its decisions on individualistic or self-serving behaviour. This situation motivates fostering the interests of the group and pro-organisational behaviour.¹¹⁴ Stewardship theory assumes that all interests of managers, the company and its owners are able to be aligned through the collective behaviour of stewards¹¹⁵ as long as those stewards are supported by a long-term correlation based on trust, autonomy and stability even when there is no individual utility or extra financial incentive.¹¹⁶

Most groups in a firm may be satisfied when they seek to achieve objectives of the firm at large and try to redirect their interests to accomplishments, performance and success of the organisation as a whole. This is a logical consequence that has resulted from the

¹¹² Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 20.

¹¹³ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, Issue 4, at 90, available at <http://www.eurojournals.com/MEFE.htm>, accessed on 12/3/2015.

¹¹⁴ Davis, J., Schoorman, F., and Donaldson, L. (1997). Toward a Stewardship Theory of Management. *The Academy of Management Review*, 22(1), at 24-25.

¹¹⁵ Ibid.

¹¹⁶ Ron, K., and John, T. (2011). An Exploration of Stewardship Theory in a Not-for-Profit Organisation. *Accounting Forum*, 35(4), at 227.

fact that increasing organisational wealth generally influences all aspects of the firm, such as sales growth, profits on dividends and share prices etc.¹¹⁷

2.2.5 Resource Dependence Theory

Resource dependence theory draws attention to a different but equally important aspect that focuses on providing access to a firm's resources via the board of directors. It considers the board of directors as crucial in meeting a firm's demands for resources.¹¹⁸

There are two major roles of the board of directors: firstly, they represent shareholders in monitoring managers, which is asserted by agency theorists; secondly, they support a firm in provisioning of resources, which is the dominant one according to resource dependence theorists.¹¹⁹ Those demanded resources include advisory services, information, skills, legitimacy and networks of relationships as well as obtaining support from external entities.¹²⁰

Resource dependence theory concentrates on the external role and linkages of each member of the board of directors who came from diverse independent organisations and is supposed to play a vital function in securing essential resources for a firm. Therefore, appointing representatives of independent organisations as members of the board of directors is of critical importance in this context.¹²¹

According to Abdullah and Valentine, the desired resources which promote the opportunities of organisations in both levels of performance and survival can be classified into four categories:¹²² first, the executive experiences in general strategy, law and finance which could be provided by the insiders' directors; second, the business experiences in decision making and problem solving which relies on engaging the

¹¹⁷ Davis, J., Schoorman, F., and Donaldson, L. (1997). Toward a Stewardship Theory of Management. *The Academy of Management Review*, 22(1), at 24-25.

¹¹⁸ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 21.

¹¹⁹ Hillman, A., and Dalziel, T. (2003). Boards of Directors and Firm Performance: Integrating Agency and Resource Dependence Perspectives. *The Academy of Management Review*, 28(3), at 383-385.

¹²⁰ Ibid, at 386.

¹²¹ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, Issue 4, at 92. available at <http://www.eurojournals.com/MEFE.htm>, accessed on 12/3/2015.

¹²² Ibid.

senior business experts from large companies to work on the board of directors; third, the support specialists in several substantial specialised fields such as legal advice, banking, insurance and public relations; and fourth, the society influence, which could be obtained via appointing some political leaders, university professors and members of leaders of community organisations.

2.2.6 Nexus Theory

The contractual or nexus-of-contracts theory satisfies the major claims of stakeholder theory. It is based on participation in the firm's governance structures by all stakeholders as contractors to protect the interests of each group of constituencies through efficient bargaining between them.¹²³ According to this theory, there are two conditions that should be met: fair bargaining among all groups and ensuring that there are no unjust consequences inflicted on third parties.¹²⁴

The goals of this theory will be achieved through selecting satisfactory means from other parties to work side by side to maximise return on the assets, which impact on the firm's production and make a balance between internal and external costs. Further support might also come from government regulation, a tort liability system and contract law.¹²⁵

2.2.7 Complexity Theory

Complexity theory emerged from the idea that it is extremely inadequate to look at only the relationship between the board and the shareholders or merely focus on a particular aspect such as compliance or the legal setting. Instead, it seeks to take into account the whole picture of dynamics that influences corporate governance.¹²⁶

¹²³ Boatright, J. (2002). Contractors as Stakeholders: Reconciling Stakeholder Theory With the Nexus-of-contracts Firm. *Journal of Banking and Finance*, 26(9), at 1843.

¹²⁴ Ibid, at 1849.

¹²⁵ Ibid, at 1849-1850.

¹²⁶ Goergen, M. (2010). *Corporate Governance and Complexity Theory [electronic resource]*. Cheltenham, UK: Edward Elgar, at 4-5.

This theory offers another interpretation of corporate governance which focuses on all actors of a social system and responds to a variety of dimensions that interact and influence each other, such as cultural, political, physical, technical and economic. It assumes that actors, including regulators; institutional investors; listed companies and their employees, customers and suppliers; the financial press and analysts are able to co-evolve and to adapt to changing circumstances. In addition, actors are also able to facilitate good corporate governance through creating new rules, regulations and frameworks, which resulted from feedback processes whether positive or negative.¹²⁷ This theory is highly effective when it is supported by an enabling environment, a capability of adaptation, a flexibility and the ability of co-evolve with broader external environment.¹²⁸

2.2.8 Other Corporate Governance Theories

There are numerous other corporate governance theories which are based on or serve different theoretical perspectives. **Transaction cost theory**, for example, seeks to combine people with different views of law, economics and organisations in interdisciplinary alliance to build a large firm that is capable of playing the role of the market in determining and allocating resources.¹²⁹ The transaction cost economics theory takes into consideration the firm's internal efficiencies rather than external contracting of firms. This makes required transactions cheaper or more efficient as a firm has its own internal capital market.¹³⁰

Whilst the **political theory** is interested in the issues that under the governments' concerns of the corporate governance context, such as their allocating and determining of corporate power, structures, profits and privileges,¹³¹ the **business ethics theory**

¹²⁷ Ibid.

¹²⁸ Ibid, at 5.

¹²⁹ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, Issue 4, at 92. available at <http://www.eurojournals.com/MEFE.htm>, accessed on 12/3/2015.

¹³⁰ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 19.

¹³¹ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, Issue 4, at 93. available at <http://www.eurojournals.com/MEFE.htm>, accessed on 12/3/2015.

focuses on honesty, justice, fairness and the “rights and wrongs” in business, setting these values as their ultimate goal. This helps companies to build a healthy social relationship which is a positive influence on their actions and the levels of interactions.¹³²

Managerial hegemony and class hegemony theories focus on the gap between expected and actual actions of the board of directors and how to deal with these in the light of behavioural theory. Moreover, their focus is on the extent of the impact of potential asymmetry of information and elite networks that may be exploited by managers away from the board’s monitoring.¹³³

Path dependency theory assumes that "the path used by each country will necessarily influence the outcome. This means that the evolution of corporate governance will be progressive and different according to each country. At the same time the model towards which each country will converge will depend on its starting point, and the result will differ according to whether the initial model at the beginning was stakeholder or shareholder".¹³⁴

Some theorists have tried to review and improve upon the existing theories. One of these attempts is **director primacy** which developed the societal role of agency theory by drawing an alternative conception of the principal and of the role and status of the board of directors as autonomous fiduciaries. In this context, there is an alignment between this model of director primacy and both stewardship and stakeholder theories.¹³⁵

Keay argues that there is no need to modify the dominant theories. Instead, he advocates another approach, namely **the entity maximisation and sustainability theory**, which sees the company as a separate legal entity. This theory focusses on maximising the wealth of the company as an entity in a manner that can guarantee its survival and sustainability. According to this theory, the broad range of investors in the company

¹³² Ibid, at 93-94.

¹³³ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 21.

¹³⁴ Jeffers, E. (2005). Corporate Governance: Toward Converging Models?. *Global Finance Journal*, 16(2), at 232.

¹³⁵ Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), at 234.

should be valued and receive benefit from their investment depending on what is the best for the company as an entity. The board of directors should, therefore, seek to maximise the overall long-run market value of the firm as a whole. However, the investment made by different people and groups should be taken into account.¹³⁶

2.2.9 Conclusion

Theories and models of corporate governance are constantly evolving as a result of overlapping influences and a variety of concerns.¹³⁷ These continual changes are driven directly and indirectly by two other significant dynamics; first, the internal environment which focuses on shareholders' relationships and the maximising of profits; and second, on the external environment which tries to deal perfectly with some pivotal issues such as financial funding, human resource development, business collaborations, communication and information technology.¹³⁸

The differences between countries in terms of cultural values, political, historical and social circumstances and economic contexts is another factor that influences the theoretical perspective of corporate governance of an individual country.¹³⁹ However, the equilibrium between exogenous and endogenous changes will not be achieved by a single theory of corporate governance. Hence, careful consideration of the various theories is the best way to build an effective governance practice.¹⁴⁰ This is confirmed by Abdullah and Valentine who state that: "Literature has proven that even with strict regulations, there have been infringements in corporate governance. Hence it is crucial that a holistic realisation be driven across the corporate world that would bring about a different perspective towards corporate governance ... Therefore, it is important to re-visit corporate governance in the light of the convergence of these theories."¹⁴¹

¹³⁶ Keay, A. (2011). *The Corporate Objective* (Corporations, Globalisation and the Law). Cheltenham: Edward Elgar, at 230.

¹³⁷ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, Issue 4, at 88-89. available at <http://www.eurojournals.com/MEFE.htm>, accessed on 12/3/2015.

¹³⁸ Ibid, at 94.

¹³⁹ Ibid.

¹⁴⁰ Ibid, at 88.

¹⁴¹ Ibid, at 94.

In a case-based approach, all theories of corporate governance have relative merits and, therefore, no single theory offers an integral explanation of corporate governance.¹⁴² All the theories, including agency, stewardship and resource dependence, have some feasible elements that can be applied in different environments and circumstances and can contribute to governance improvement.¹⁴³

Some researchers support the trend that looks at corporate governance as not just knowledge, but rather as an art that is based on human activities, which are highly affected by interacting variables and subject to a high number of changes. The concepts of increasing market value, profit maximisation and economic efficiency and rationality cannot operate in isolation from the social process and non-economic factors, including legislation, institutional contexts and social correlations. Thus, it will be impossible to measure through only scientific precision or to be identified by any single model or structure of corporate governance for all organisations at all times.¹⁴⁴ Quite to the contrary, corporate governance needs to be workable, adaptable, flexible and innovative. Introducing value creation for all parties broadens capabilities and cooperative value in the management framework as well as enhances internal control mechanisms and avoids the probability of any kind of conflict.¹⁴⁵

It is difficult for board of directors to deal with interests of different parties and diversity of firm's priorities as a zero-sum game. For example, maximising shares values does not necessarily entail the same result for the corporation at large.¹⁴⁶ Therefore, "The position here seems to be that a director can take into account group interests when carrying out his role as a director of a group member, but not to the point of subordinating the interests of his company to the interests of the group as a whole".¹⁴⁷

¹⁴² Kiel, G., and Nicholson, G. (2003). Board Composition and Corporate Performance: How the Australian experience informs contrasting theories of corporate governance. *Corporate Governance: An International Review*, 11(3), at 201.

¹⁴³ Ibid.

¹⁴⁴ Beleya, P., Raman, G., Ramendren, C., and Nodeson, S. (2012). Independent Directors and Stakeholders Protection: A Case of Sime Darby. *International Journal of Academic Research in Business and Social Sciences*, 02(04), at 428.

¹⁴⁵ Ibid, at 429.

¹⁴⁶ Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), at 235.

¹⁴⁷ Milman, D. (2013). *Governance of Distressed Firms [electronic resource]*. Cheltenham: Edward Elgar Publishing, at 42.

The traditional perspective that sees shareholders as principals and directors as their agents is not supported by legal systems such as that of England. Instead, they deem the firm as principal and the board of directors as autonomous fiduciaries and mediating hierarchs who act on behalf of the interests of the whole corporation. The legal systems also recognise various stakeholders as team members who have claims and they need a fair balance in competing on the firm's resources.¹⁴⁸

The Companies Act 2006 has mentioned this broad view of principals and it provides a clearer and stronger formulation than its predecessor of 2002.¹⁴⁹ Section 172(1) of the Companies Act 2006 stipulates “**Duty to promote the success of the company:**

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to: (a) the likely consequences of any decision in the long term, (b) the interests of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.”¹⁵⁰

Similarly, the Saudi law clearly mentions that one of the main functions of the board is to regulate the relationship with stakeholders with a view to protecting their respective rights and maintaining good relationships with them as well as regulating the company's social contributions.¹⁵¹ This issue has received further attention from the new Saudi CGR of 2017, as will be discussed in chapter five of this thesis.

¹⁴⁸ Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), at 230.

¹⁴⁹ Dignam, A. (2007). Capturing Corporate Governance: The End of the UK Self-regulating System. *International Journal of Disclosure and Governance*, 4(1), at 32.

¹⁵⁰ See section 172 of the Companies Act 2006.

¹⁵¹ Articles 83- 85 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

2.3 The Most Prominent Models of Corporate Governance Used Worldwide

2.3.1 Introduction

The successive financial crises that have affected many countries around the world in the last few decades has increased the need to search for and adopt a strong corporate governance method and legislation. Moreover, some other factors give good corporate governance practices further importance and drive improvements in corporate governance mechanisms, such as the development of capital markets, increasing investor confidence and the need to reduce barriers between worldwide capital markets, as well as the tendency for companies to expand through privatisations of state-owned enterprises, acquisitions and mergers.¹⁵² The legal environment and local circumstances are highly effective in determining the corporate governance system and its appropriate practices.

Given the internationalisation of cross-border portfolios and international markets' interactions through technological advances, it can be said that there is global consensus about the importance of many core principles of corporate governance. One of the most famous sets of principles are the Organisation for Economic Co-operation and Development (OECD) Principles. However, there are several systems of corporate governance that have been formed in different legal and economic environments. These have also been subjected to various cultural and political contexts. Corporate governance models can therefore be said to depend on the legal and economic systems, capital market development and the ownership structure adopted by each country.¹⁵³ Moreover, many of the differences in "corporate governance systems around the world stem from the differences in the nature of legal obligations that managers have to the financiers, as well as in the differences in how courts interpret and enforce these

¹⁵² Dignam, A. (2007). Capturing Corporate Governance: The End of the UK Self-regulating System. *International Journal of Disclosure and Governance*, 4(1), at 25.

¹⁵³ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 22,27.

obligations".¹⁵⁴ Such factors have a significant role in both forming models and the practice of corporate governance.

This chapter will discuss some of the most prominent and most successful models of corporate governance which have the essential elements of a good governance system, such as in the United States, the United Kingdom and Germany.¹⁵⁵

2.3.2 The Anglo-Saxon Model; the US System

The Anglo-Saxon model of corporate governance in both the USA and the UK has been built on a common law system that tends to focus on shareholders and gives their interests and rights wide protection. Furthermore, these countries often have a more dispersed shareholder ownership structure from a large number of outside investors. This contrasts with countries that have civil law where a concentrated share ownership structure is popular.¹⁵⁶ This Anglo-Saxon model of corporate governance has three leading features. It is: market-oriented, outsider-dominated and shareholder-focused.¹⁵⁷

Generally, the Anglo-Saxon model adopts the outsider system with regard to institutional investor ownership and control structures which rely on the market.¹⁵⁸ This system assumes that there is no conflict between the separation of ownership and control and minority shareholders' protection due to the legal infrastructure and advanced capital markets.¹⁵⁹

The Anglo-Saxon model could also be termed capital-related, which assumes that the concepts of market capitalism and self-regulation are capable of creating a balance

¹⁵⁴ Shleifer, A., and Vishny, R. (1997). A Survey of Corporate Governance, *Journal of Finance*, 52(2), at 750. Available at: <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.1997.tb04820.x/full>, accessed on 12/3/2015.

¹⁵⁵ *Ibid*, at 737.

¹⁵⁶ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 22, 227.

¹⁵⁷ Weil, G., and Manges, L. (2002). *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States*, European Commission, Final report and Annexes, Weil, Gotshal and Manges, at 32. See also Jürgens, U., and Rupp, J. (2002). Working Paper - The German system of corporate governance: characteristics and changes. *Social Science Research Center Berlin (WZB)*, No. FS II 02-203, at 2. available at: <http://hdl.handle.net/10419/50757>, accessed on 12/3/2015.

¹⁵⁸ Dignam, A. and Galanis, M. (2004). Australia Inside-Out: The Corporate Governance System of the Australian Listed Market. *Melbourne University Law Review*, 28, at 625.

¹⁵⁹ Cernat, L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or Still the Century of Diversity?. *Journal of European Public Policy*, 11(1), at 151.

between the functions of self-interest and decentralised markets. As long as they can provide a well-functioning stock market, this gives shareholders an ability to sell their shares safely. Moreover, these markets should have strict regulations that ensure the integrity of information disclosure and insider trading, with institutional settings that are based on a fiduciary relationship between shareholders and managers and promote profit-oriented conduct.¹⁶⁰ The structure of corporate ownership is the most salient feature that distinguishes this system. In the US, for example, more than 50% of outstanding shares are owned by individual shareholders.¹⁶¹

It could, therefore, be said that the system of corporate governance in the US gives shareholders the dominant position in relation to other stakeholders, such as creditors, employees, suppliers and the wider community. The companies that belong to this system of corporate governance are seeking to maximise the profits for their investors.

2.3.3 The Anglo- Saxon Model; the UK System

Despite the fact that corporate governance in the UK belongs to the Anglo-Saxon system and so shares most of the above characteristics, there are a number of remarkable differences between the system in the UK and that in the US, particularly in terms of stakeholder protection. Some of these divergences have arisen from the UK's relationship with countries in Continental Europe as it is part of the EU. These have diverse models of corporate governance and some particular regulations that adjust their corporate sectors toward European integration.¹⁶²

Mullineux broadly debates some of the different aspects of the corporate governance models in the USA and the UK. These can be summarised in the **six** points below:¹⁶³

¹⁶⁰ Ibid at 149-151.

¹⁶¹ Ibid, at 151.

¹⁶² Armour, J., Deakin, S., and Konzelmann, S. (2003). Shareholder Primacy and the Trajectory of UK Corporate Governance. *British Journal of Industrial Relations*, 41(3), at pp 50- 51.

¹⁶³ Mullineux, A. (2010). Is There an Anglo-American Corporate Governance Model?. *International Economics and Economic Policy*, 7(4), at 437- 443. See also Bush, T. (2005). Divided by a Common Language Where Economics Meets Law: US Vs Non-US Financial Reporting Models, *Dialogue in Corporate Governance: Beyond the Myth of Anglo-American Corporate Governance; Institute of Chartered Accountants in England and Wales (ICAEW)*, June 2005 at 18-23.

- The US system is widely based on rules and litigation whereas the UK has a principles-orientated system that relies on the concept of 'comply or explain' of codes. These codes give shareholders a pivotal role in appointing directors and replacing CEOs and Chairmen as well as influencing their remuneration. However, the concept of 'comply or explain' gives a listed company a chance to avoid complying with some rules of the UK Corporate Governance Code if it can explain the circumstances and reasons that drive it to do so.
- The system in the UK concentrates more on protecting outside shareholders "ex ante" and facilitates their role of monitoring by providing financial reporting. In contrast, the US system focuses on the primacy of share traders' protection "ex post" and on providing accurate market pricing for them. It could be said that the most divergent point between the US and the UK systems is that the US system focuses on an efficient capital market (equity) through guaranteeing legal price 'right' of the share.
- The UK system has more concentrated share-ownership in the hands of institutional investors than the US system. This situation makes institutional investors eligible to play vastly greater roles and have a prominent position in corporate governance in the UK in contrast to the case in the US.
- Unlike the case in the UK, the CEOs in the US have a considerable level of power and there is no need for them to be isolated from any elevated liability, including to be chairman of the board of directors. Moreover, they are eligible to sit on or chair any committees such as remuneration and internal audit committees.
- There are also a number of other divergences such as the financial reporting model and its requirements, the system of auditor accountability and the firm's efficiency running compared with its capital resources which have been addressed by the UK model through different methods than those in the US context. This may make the UK legislations related to corporate governance much closer to continental Europe than the US.

2.3.4 The Continental European Model; the German System

Continental European countries who have built their corporate governance system on civil law often adopt a concentrated share ownership structure which prioritises protection at the expense of minority shareholders.¹⁶⁴ Moreover, these countries tend to focus on certain stakeholder groups through giving their interests and rights wide legal protection rather than to shareholders.¹⁶⁵ In other words, the stakeholder theory is the underlying principle that distinguishes the Continental corporate governance system.¹⁶⁶

Many Continental European countries, especially Germany, have adopted the insider system in terms of institutional investor ownership and control structures.¹⁶⁷ Moreover, in contrast to the Anglo-Saxon model, these countries have a two-tier board: the executive board of directors and the supervisory board: "The supervisory board is formed according to different procedures across Europe but in many cases employees have the right to appoint or recommend several members to the supervisory board".¹⁶⁸

This model has **three** main features: it is bank-oriented, meaning that it gives banks the dominant role in a complex system of cross-shareholding and company financing; it is insider-dominated, i.e. a production-oriented, company-centred management system; and finally, it is stakeholder-focused.¹⁶⁹ Therefore, in this system, banks and other dominant ownerships, including governments in some countries, might be able to place their representatives on the supervisory board, thus exercising some control.¹⁷⁰

In Germany, banks and insurance companies have owned more than 50% of all shares and have strong relationships, business interdependencies and long-term commitment involvement. Similarly, in Austria large shareholders occupy 54% of the companies

¹⁶⁴ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 227.

¹⁶⁵ Ibid, at 22.

¹⁶⁶ Cernat, L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or Still the Century of Diversity?. *Journal of European Public Policy*, 11(1), at 153.

¹⁶⁷ Dignam, A. and Galanis, M. (2009). *The Globalisation of Corporate Governance*. Farnham: Ashgate publishing limited, at 7.

¹⁶⁸ Cernat, L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or still the century of diversity?. *Journal of European Public Policy*, 11(1), at 153.

¹⁶⁹ Weil, G., and Manges, L. (2002). *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States*, European Commission, Final report and Annexes, Weil, Gotshal and Manges, at 32. See also Jürgens, U., and Rupp, J. (2002). Working Paper - The German system of corporate governance: characteristics and changes. *Social Science Research Center Berlin (WZB)*, No. FS II 02-203, at 2. available at: <http://hdl.handle.net/10419/50757>, accessed on 12/3/2015.

¹⁷⁰ Dignam, A., and Galanis, M. (2008). Corporate Governance and the Importance of Macroeconomic Context. *Oxford Journal of Legal Studies*, 28(2), at 202.

and control between 50 and 75 per cent of the voting rights.¹⁷¹ Thus, the value orientation that targets maximisation of shareholder return and the value-based conduct of trading stocks play a minor role in this system.¹⁷²

In the continental literature on corporate governance, good practice for firms does not necessarily mean what is good for shareholders as corporations have independent volition.¹⁷³ Nevertheless, the continental tradition highlights the labour-related aspects and employee involvement schemes and participatory management, and gives them a right to participate in strategic management decisions. For example, in Austria, Denmark, Germany, Luxembourg and Sweden, employees of companies of a certain size have the right to elect some members of the supervisory body or directors. This is also the case to some extent in Finland and France.¹⁷⁴ Consequently, the influence of the labour sector is much greater in the European model when compared with the limited role of trade unions in the Anglo-Saxon model.¹⁷⁵

Mallin argues that: "It is likely that, over time, the remaining influence of banks in terms of direct influence in a company will reduce, and it will be the distinction between ownership and control that helps drive and shape corporate governance reform".¹⁷⁶ Furthermore, some noteworthy changes have happened recently in the German system, such as stock-based remuneration packages and the introduction of the principle of shareholder value, as well as further regulatory initiatives in increasing transparency and accountability. The adoption of international accounting standards and improvement in stock market regulations have maximised initial public offerings and created some degree of convergence between the German and Anglo-Saxon models. However, these changes have not dissipated the above pivotal divergences which are

¹⁷¹ Cernat, L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or still the century of diversity?. *Journal of European Public Policy*, 11(1), at 150.

¹⁷² Jürgens, U., and Rupp, J. (2002). Working Paper - The German system of corporate governance: characteristics and changes. *Social Science Research Center Berlin (WZB)*, No. FS II 02-203, at 4. available at: <http://hdl.handle.net/10419/50757>, accessed on 12/3/2015.

¹⁷³ Cernat, L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or still the century of diversity?. *Journal of European Public Policy*, 11(1), at 149.

¹⁷⁴ Weil, G., and Manges, L. (2002). *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States*, European Commission, Final report and Annexes, Weil, Gotshal and Manges, at 32.

¹⁷⁵ Cernat, L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or Still the Century of Diversity?. *Journal of European Public Policy*, 11(1), at 150, 152.

¹⁷⁶ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 228.

based on a host of institutional, legal and cultural barriers firmly rooted in those two doctrines.¹⁷⁷

¹⁷⁷ Goergen, M., Manjon, M., and Renneboog, C. (2008). Is the German System of Corporate Governance Converging Towards the Anglo-American Model?. *Journal of Management and Governance*, 12(1), at 65- 66.

2.4 The Theory and Model of Corporate Governance in Saudi Arabia

It is clear that Saudi legislation seeks to adopt rules and standards that regulate the management of joint stock companies listed on the stock market to ensure their compliance with the best governance practices. This is in order to guarantee the protection of shareholders' rights as well as the rights of stakeholders.¹⁷⁸

The corporate governance theory and the adopted model in Saudi Arabia seems to be much closer to the Anglo-Saxon model and more in harmony with its general theory which aims to generate a fair return for shareholders. Saudi legislation and the corporate governance regulations adopt the unitary board of directors and do not provide an option to approve a two-tier model.¹⁷⁹ The Saudi system does not support the trend of a bank-oriented or any other long-term dominant ownership. Furthermore, Saudi corporations are not subject to any legal enforcement or compliance that gives employees a right to participate in strategic management decisions or to have any representative form.

On the other hand, the Saudi legal system, including its corporate governance regime, is based on civil law as is the case in Germany and France.¹⁸⁰ It also contains many rules that protect and regulate rights and interests of stakeholders' groups and minority shareholders as well as providing some limitations to CEO power. For example, Saudi law prevents the position of the chairman of the board of directors from being merged with any other executive position in the company.¹⁸¹ Unlike the Anglo-Saxon model, the government in Saudi Arabia dominates most labour, financial, services and business sectors, and recently it has tended to privatise some of them under its supervision.¹⁸² Moreover, the ownership structure of many large joint stock companies has been occupied by state-concentrated ownership. This environment to some extent boosts the state's role and control over the corporate sector.

¹⁷⁸ Article 2/a of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

¹⁷⁹ The research will discuss this issue in depth in chapter four.

¹⁸⁰ Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 746.

¹⁸¹ Article 81/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

¹⁸² These points will be discussed in depth in chapter three.

Regardless of the extent of compatibility that the Saudi system has with either model or theory, no system of corporate governance can operate in isolation from the effect of companies' actions on the wider groups of various stakeholders.¹⁸³ Therefore, reviewing the Continental European system of corporate governance in depth will be helpful in reforming and developing corporate governance in Saudi Arabia. One of the useful concepts of the Continental European system of corporate governance is that of engaging employees in governance issues without diluting shareholder influence. This would be particularly useful as, unlike Anglo-Saxon countries, there are no civil institutions or labour unions that might provide further protection for employees.¹⁸⁴

In conclusion, there is no need to search for the best system to imitate blindly. Instead, the principal practical question when designing a corporate governance system is how to introduce significant legal protection for investors and other stakeholders as well as how to achieve the firm's goals successfully.¹⁸⁵ Corporate governance systems and legal protection of investors in most countries including developed or developing need to be continuously improved.¹⁸⁶

Moreover, the theories and models of corporate governance should be viewed in light of the local legal system, the ownership structure and the capital market characteristics.¹⁸⁷ In addition, the challenges and negative impacts that come from the local setting should also be considered.¹⁸⁸

2.5 Conclusion

This chapter discussed the importance, concepts and major principles of corporate governance. Moreover, it explored the major corporate governance theories and models

¹⁸³ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 22.

¹⁸⁴ These points will be discussed in depth in chapter five.

¹⁸⁵ Shleifer, A., and Vishny, R. (1997). A Survey of Corporate Governance, *Journal of Finance*, 52(2), at 739. Available at: <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.1997.tb04820.x/full>, accessed on 12/3/2015.

¹⁸⁶ Ibid.

¹⁸⁷ Mallin, C. (2013). *Corporate Governance* (4th ed.). Oxford: Oxford University Press, at 22.

¹⁸⁸ Shleifer, A., and Vishny, R. (1997). A Survey of Corporate Governance, *Journal of Finance*, 52(2), at 739. Available at: <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.1997.tb04820.x/full>, accessed on 12/3/2015.

which arise from different theoretical perspectives. Some of these theories seek to serve particular aspects of corporate governance while others may be formed as a result of a reaction to and the tackling of some problems and needs in corporate governance. Each of the theories has its relative merits and some have feasible elements that can be applied to contribute to governance improvements in different environments and circumstances.¹⁸⁹ Therefore, studying the main theories is essential to understand the role of the board of directors and the boundaries of the relationships between various groups in a firm and the importance of finding a comprehensive balance between liability, control and ownership.

The board of directors and the firm have a unique relationship which can never be described as an agent-principal relationship between the board and shareholders exclusively.¹⁹⁰ Hence, both English and Saudi legislation deem the firm (not its shareholders) to be the principal and the board of directors as autonomous fiduciaries and mediating hierarchs who act on behalf of the interests of the whole corporation. They also recognise various stakeholders as team members who have claims, needs and rights.¹⁹¹

The chapter also highlighted the most prominent models of corporate governance used worldwide that affect the role of the board of directors and described the main characteristics of each of them. Furthermore, this chapter attempted to point out to what extent these models are compatible with those in Saudi Arabia.

The model adopted in Saudi Arabia is much closer to the Anglo-Saxon model and more in harmony with its general theory as it aims to generate a fair return for shareholders. Like this model, Saudi legislators adopted the unitary board of directors and have not supported the bank-oriented system which creates long-term dominant ownership. Furthermore, there are no regulations that support any form of employee representation or participation in decision-making. However, the legal and economic environments in Saudi Arabia to some extent boost the state's role, ownership and control over the

¹⁸⁹ Kiel, G., and Nicholson, G. (2003). Board Composition and Corporate Performance: How the Australian experience informs contrasting theories of corporate governance. *Corporate Governance: An International Review*, 11(3), at 201.

¹⁹⁰ Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), at 231.

¹⁹¹ Section 172 of the Companies Act 2006. And see articles 83- 85 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

corporate sector. The government also dominates most labour and financial services as well as business sectors. Therefore, some of the principles of the Continental European model may be useful in developing corporate governance in the Saudi context. Moreover, there is a real need to introduce significant legal protection for investors and achieve the firm's goals successfully.

The chapter clarified the theories and models which impact on the corporate governance system in each country. This, however, necessitates clarification of the legal environment, judicial system, local circumstances, economic system and political context in Saudi Arabia. These will all be discussed in the next chapter alongside the prominent characteristics of the capital market and the relations between the government and corporate sector which impact on the board of directors. Moreover, the discussion will try to cover Saudi Arabia's new vision for 2030 which includes economic projects that promise dramatic changes that will expand the role of the corporate sector at the expense of the current governmental dominance.

Chapter Three

The Legal and Economic Environments Affecting the Board of Directors in Saudi Arabia as Compared to English Law and Global Standards

3.1 Introduction

The preceding chapter mentioned that the legal environment, local circumstances, economic system, cultural values and political context are highly significant in determining the corporate governance system and its theory in each country.

In this chapter, the discussion will focus on the legal and judicial systems and the political and cultural environments in Saudi Arabia, as well as the prominent characteristics of the capital market and the relations between the government and corporate sector which impact on the board of directors. Moreover, the discussion will try to cover Saudi Arabia's future economic projects that have been announced recently. These promise dramatic changes that will expand the role of the corporate sector at the expense of the current governmental dominance. However, in order to achieve the desired results, those economic objectives need to meet the legal, political and economic requirements that are compatible with the principles of corporate governance and global standards.

3.2 State Authorities and Legal Environment in Saudi Arabia

3.2.1 State authorities

Saudi Arabia was founded in 1932 as a fully sovereign Arab Islamic state¹⁹² based on a monarchical system.¹⁹³ This is limited to the sons and grandsons of the Founder King Abdul Aziz Al Saud.¹⁹⁴ Like most countries, the state authority, in general, consists of judicial, executive and regulatory authorities but conversely there is no separation between these three authorities.¹⁹⁵ In other words, the King has the final authority over all these bodies.¹⁹⁶

The executive authority of internal and foreign affairs of the state in Saudi Arabia is assigned to the Council of Ministers.¹⁹⁷ It has full power over all executive and administrative affairs and the final authority to draw up the internal, external, financial, economic, educational and defense policies, and over other government agencies. Moreover, it supervises and monitors all ministries and government agencies in terms of the implementation of policies, laws, regulations and resolutions.¹⁹⁸ It is presided over by the King who supervises and directs the general policy of the state and monitors the implementation of laws. He also works to safeguard coordination and cooperation among the various governmental agencies.¹⁹⁹ Moreover, each member of ministers of the Council of Ministers are appointed by the King and he has full authority to remove them; he may also dissolve the Council of Ministers and reconstitute it as a whole.²⁰⁰ According to Saudi law, the King is the supreme commander of all armed forces and has the right to appoint and terminate the services of their officers.²⁰¹

Legislative authority (or regulatory authority as it is called to avoid confusing it with the legislative role of Shari'ah) in Saudi Arabia has the task of formulating laws and

¹⁹² Article 1 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

¹⁹³ Ibid, article 5.

¹⁹⁴ Ibid, article 5/b.

¹⁹⁵ Ibid, article 44.

¹⁹⁶ Ibid.

¹⁹⁷ Ibid, article 56.

¹⁹⁸ Articles 19, 24 of Law of the Council of Ministers 1993 in the Kingdom of Saudi Arabia.

¹⁹⁹ Ibid, article 29.

²⁰⁰ Article 57 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

²⁰¹ Ibid, article 60.

rules of state affairs in accordance with the principles of Islamic Shari'ah.²⁰² In the Saudi system, the function of enacting and amending laws and regulations, approving international treaties and agreements and concessions have been assigned to the Council of Ministers (the executive authority), not to an independent entity like a Parliament.²⁰³ The Council of Ministers reviews the drafts of such legislation and votes on them article by article and then as a whole; after that they will be issued by Royal Decree.²⁰⁴

Saudi law stipulates that "the Judiciary shall be an independent authority. There shall be no power over judges in their judicial function other than the power of the Islamic Shari'ah."²⁰⁵ However, it also stipulates that "appointment and termination of judges shall be by Royal Order, at the recommendation of the Supreme Judicial Council".²⁰⁶ It should be noted here that this Supreme Judicial Council is currently presided over by the minister of justice who is a member of the Council of Ministers (the executive authority).

Saudi Arabia also has the Shura Council²⁰⁷ which can, to some extent, undertake the role of Parliament or in more accurate phrase the "consultant council". This Council consists of a hundred and twenty members, excluding the chairman, composed of scholars, experts and specialists who have all been chosen and can be relieved by the King.²⁰⁸ He also defines their grades, rights, duties and all their affairs through Royal Orders;²⁰⁹ he may also dissolve and reconstitute the Shura Council.²¹⁰

The function of this council is to review and study laws, policies and regulations²¹¹ of the state that are referred to it by the President of the Council of Ministers and provide

²⁰² Ibid, article 67.

²⁰³ Ibid, article 70.

²⁰⁴ Article 21 of Law of the Council of Ministers 1993 in the Kingdom of Saudi Arabia. And Article 70 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia

²⁰⁵ Article 46 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

²⁰⁶ Ibid, article 52.

²⁰⁷ The term "Shura" can be defined as the process of asking specialists to give their opinions and have a dialogue with each other to support decision-maker to reach the right decision. See, Aljamili. M. (2012). *Role of the Shura Council in the Kingdom of Saudi Arabia in Drawing and Overseeing the Internal and External Policies in the Kingdom, the Fact and Aspirations*, Riyadh: Naif Arab University for Security Sciences, PhD Thesis, at 11. (Arabic).

²⁰⁸ Article 3 of Law of the Shura Council 1992 in the Kingdom of Saudi Arabia.

²⁰⁹ Ibid, article 10.

²¹⁰ Article 68 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

²¹¹ Article 20 of Law of the Council of Ministers 1993 in the Kingdom of Saudi Arabia.

opinions and suggestions on them.²¹² Moreover, they discuss annual reports of ministries and governmental agencies and give appropriate suggestions.²¹³ However, all these suggestions and resolutions will be reviewed by the Council of Ministers.²¹⁴ Furthermore, Saudi law gives each minister the right to propose a new draft law or an amendment to an active law²¹⁵ whereas it should be proposed by a group of ten members of the Shura Council to submit the proposal to the King.²¹⁶

It should be noted that there are no political parties in Saudi Arabia and there is no direct representation or proxy representation. Nor are there any elected officials in at level of the state apparatus. Moreover, there are no trade unions or civilian institutions for overseeing the state. This context should, therefore, be considered in any attempt to reform laws or transplant rules or principles from different contexts.

3.2.2 The Role of Shari'ah

There are numerous articles in different laws that emphasise the pivotal role of Islamic Shari'ah in Saudi Arabia. These articles express that Shari'ah is the final reference for all legislation, which must be formulated in accordance with the principles and the sources of Shari'ah; all development regulations needed must not be departed from either.²¹⁷ The first article of the Basic Law of Governance stipulates that "The Kingdom of Saudi Arabia is a fully sovereign Arab Islamic State. Its religion shall be Islam and its constitution shall be the Book of God and the Sunnah (Traditions) of His Messenger..."²¹⁸ This act also states that governance "derives its authority from the Book of God Most High and the Sunnah of his Messenger, both of which govern this

²¹² Article 15 of Law of the Shura Council 1992 in the Kingdom of Saudi Arabia.

²¹³ Ibid.

²¹⁴ Article 19 of Law of the Council of Ministers 1993 in the Kingdom of Saudi Arabia.

²¹⁵ Article 22 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

²¹⁶ Article 23 of Law of the Shura Council 1992 in the Kingdom of Saudi Arabia. For further details about the limited power and influences of Shura Council in Saudi Arabia, see Aljamili, M. (2012). *Role of the Shura Council in the Kingdom of Saudi Arabia in Drawing and Overseeing the Internal and External Policies in the Kingdom, the Fact and Aspirations*, Riyadh: Naif Arab University for Security Sciences, PhD Thesis. (Arabic). See also, Aljuhani, G. (2006). *Role of Shura Council in Preparing Legislation in Saudi Arabia, A Comparative Study*, Riyadh: Naif Arab University for Security Sciences, Master's degree dissertation. (Arabic).

²¹⁷ Article 46 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia. And Article 2 of Law of the Shura Council 1992 in the Kingdom of Saudi Arabia.

²¹⁸ Article 1 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

Law and all the laws of the State".²¹⁹ The King is responsible for running state affairs according to the dictates of Islamic Shari'ah.²²⁰ He also supervises the ministers' implementation of Shari'ah laws and the state's general policies as they are collectively responsible before the King.²²¹ Moreover, the courts ought to apply the provisions of Islamic Shari'ah and the other promulgated laws that are not in conflict with them.²²²

Despite all the rules that emphasise the role of Shari'ah in Saudi main legislation, there are in fact a number of rules that conflict with Shari'ah teachings, especially in the banking sector for example. This also applies to other rules that have been imposed by the needs of civil society in the modern state which have been simply borrowed from transnational law without any serious attempt to investigate local solutions or to consider the divergence in environment.²²³ The process of enacting laws and their codification are controversial issues in Saudi Arabia and the subject of long-term disagreements between politicians and scholars of Shari'ah. This dispute has affected even the usage of the term "law"²²⁴ in Saudi Arabia, with legislators preferring to avoid the term altogether and use "system" instead. Cultural controversy can also arise with many steps being taken by the government towards civil society modernisation.²²⁵

To understand this situation, it should be recognised that Shari'ah is not only a body of laws but also a religion with provisions that cover all aspects of people's lives including worship, business activities and relationships. Islamic doctrine is a part of Saudi culture; it is owned by all Saudi people²²⁶ and affects the majority of them who respect its

²¹⁹ Article 46 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

²²⁰ Ibid, article 55.

²²¹ Ibid, article 57.

²²² Ibid, article 48.

²²³ Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 734-737.

²²⁴ Ibid, at 734.

²²⁵ for more information about this confliction between those two parties, see Layish, A. (1987). Saudi Arabian Legal Reform as a Mechanism to Moderate Wahhābī Doctrine. *Journal of the American Oriental Society*, 107(2). And Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 732-734.

²²⁶ 100% of Saudi citizens are Muslim. See the report of percentage of Muslims in each country, The World Factbook, which can be found at: <https://www.cia.gov/library/publications/the-world-factbook/fields/2122.html> , accessed on 2/5/2016. See also Oxford Islamic Studies Online, available at http://www.oxfordislamicstudies.com/article/opr/t125/e2114?_hi=0&_pos=2 . accessed on 2/5/2016.

provisions, seek to follow them and are keen to protect their beliefs. This claim can be proved by emphasising the above rules in Saudi law and the cultural controversy that will be explained later. Therefore, it is extremely important to clarify the concept of Shari'ah and to distinguish its genuine principles from peoples' interpretations.

To understand the confusing relationship between Shari'ah and law, this research divides the provisions attributed to Shari'ah into **four** categories:

The first consists of absolute provisions that are based on the text of the holy book of the "Quran" or the correct text of the "Hadiths" of the Prophet Muhammed which are recognised by all or the majority of Islamic scholars. These provisions may include either rules or general principles such as provisions on inheritance, divorce settlements, the wearing of headscarves ("Hijab") and the Islamic penalties for specific crimes. Moreover, Shari'ah prohibits drinking alcohol and usury, whether in the form of paying or receiving interest.

Second, there are several principles and general rules that regulate whether something is permissible "Halal" or prohibited "Haram" in the Shari'ah context – this can be derived from the Islamic texts, provisions and instructions. For example, the principle of justice, the protection of human rights and their funds, the principle of preventing damage, harm and risk taking and so on. A further one is the general principle that activities are permissible as long as they do not conflict with Shari'ah goals. Such principles can be considered guidance for judging the regulations, evaluating new needs and innovating solutions for events and problems that did not happen during the time of the Prophet Muhammed.

There is an entire field of Islamic literature devoted to the study of this kind of knowledge with subtopics such as principles of Islamic jurisprudence "Asol Alfiqh", the objectives of Shari'ah "Maqasid AlShari'ah" and the policies of the Islamic government "Siyasah Shar'iyah". In addition, there is the importance of taking "custom" into consideration as a vital source in law-making.²²⁷ These focus on how to use the

²²⁷ In English, see for example, Kamali, M. (1991). *Principles of Islamic jurisprudence* (Rev. ed.). Cambridge: Islamic Texts Society.

limited texts of Islamic sources to regulate novel events. This makes Shari'ah creative and innovative and enables it to be flexible to accept good global experiences.

Accordingly, it can be said that Shari'ah admits every new rule that does not conflict with the general framework of Islamic objectives, teachings and human rights and people interests according to Shari'ah principles wherever the rules originate from.²²⁸ This appears to confirm Shari'ah's recognition of the role of social and human experiences in improving legislation; something which is not monopolised by any one nation. Historically, through this open and flexible perspective, Islamic civilization has played a pivotal role in regulating people's affairs and creating proactive solutions for many existing or perceived problems. It has also benefited and improved the experiences of people and civilisations that it has been in contact with.²²⁹ The current dilemma in Islamic legislation is not about the capability of Shari'ah but rather the capabilities of Islamic scholars, politicians, and people concerned with cultural improvement.

There is no denying that the development of law is an integral part of the development of culture, civilisation, social relationships, industry and economics. Hence, the advanced nations in these aspects have been more able to introduce, direct and control the law and its progression. Consequently, in the last two centuries, the role of Islamic scholars has switched from producing rules to harmonising legal products of Western civilisation with Shari'ah. It should be noted here that there is a strong relation between law and culture. Therefore, many legal rules of Western commerce and finance, for instance, are built on capitalist principles which focus, in general, on maximising profits. In contrast, religious teachings including Shari'ah support justice and social welfare. This situation makes Islamic scholars tend to be reluctant and resistant, particularly when some of those legal rules diverge from Shari'ah in either their principles or goals.

Thirdly, there are the debatable provisions that have not obtained the consensus of all or the majority of Islamic scholars who may see the case from different perspectives

²²⁸ Ibid, at 246- 250.

²²⁹ For example, the efforts of Islamic scholars in interpreting the knowledges of Greek and the considerable efforts of Ibn Rushd and Ibn Khaldun in philosophy and sociology.

and, therefore, give a variety of opinions or conflicting judgments on it. It will be recalled that this kind of provision represents the majority of "Fiqh" Islamic jurisprudence that has been recorded²³⁰ and there are several schools that deal with those debatable issues with their specific methods. There are four schools: Hanafi, Maliki, Shafi'i and Hanbali that have become most famous and each has influence on specific regions in the Islamic world. Consequently, it is difficult for this kind of provision to be attributed to Shari'ah as conclusive provisions because it is impossible to take both contradictory opinions or select one of the scholarly opinions at the expense of another. In addition, this situation has not prevented ongoing debates among Islamic scholars inside each school. However, at the individual level, anyone can follow whichever opinion he or she is convinced by. This situation for individuals can be applied by groups of people or indeed a country, such as Saudi Arabia which adopted Hanbali doctrine.²³¹

Along similar lines, there are other debatable issues such as the ongoing debate among Islamic scholars about company issues such as "legal person" and "limited liability company".²³² Conflicting opinions on this have emerged from Islamic scholars. Thus, it is difficult to claim that Shari'ah offers a conclusive judgment or there is necessarily a negative attitude towards them from Shari'ah.

The fourth category features the provisions incorrectly attributed to Shari'ah. These misunderstandings of Shari'ah arise unscientifically in political, social and cultural contexts. In other words, these provisions may be used as tools in the political and cultural conflicts in Islamic states, and this has been occurring since the collapse of the Ottoman Empire.

²³⁰ Apart from the essential Islamic provisions and the prime principles of Shari'ah, the unanimous issues are exceedingly limited in Islamic jurisprudence. See for example the book named "Consensus" who tried to collect all unanimous matters, Ibn Almonther. (2009). *Consensus* (ed 2), Beirut: dar- al-kotob al-ilmiah.

²³¹ See the Royal Decree in 1927 and The Judicial Board declaration, which can be found at the official website of the Judicial Board <https://www.scj.gov.sa/about>, accessed on 18/8/2016.

²³² Habib, A. (2012). Islamic Law, Investors' Rights and Corporate Finance. *Journal of Corporate Law Studies*, 12(2), at 385- 386.

In the last few centuries, Islamic civilisation, including the provisions that can be derived from Shari'ah, has been retreating in the face of the domination of Western civilisation in many aspects including militarily, commercially, economically and industrially. Colonialism by European states that occurred in several Muslim countries widened the gap between these two cultures, particularly when they imposed their laws over the countries they occupied. Moreover, the situation worsened when some dictatorial Muslim leaders imposed a Western lifestyle over Muslim societies and legislated strongly against Shari'ah and many Islamic features like the Hijab. Moreover, a number of them adopted the Socialist system which is directly opposed to Islamic teachings.²³³

Taking all of the above factors together, an atmosphere of distrust arose against Western civilisation and its culture and generated resistance among Sharia scholars towards foreign legislation and any modernising projects proposed by their countries' leaders as well.²³⁴ This information can be used to understand the Saudi context as it contains the most holy sites of Muslims; its population and other Muslims also consider Saudi Arabia as the ideal Islamic country. Therefore, the usage of Shari'ah provisions in the conflicts between politicians and Islamic scholars is most visible in Saudi context. As a result of this confliction, some strange provisions have emerged, which have never belonged to Shari'ah or are consistent with its principles, for example, the prohibition on the usage of the term "law", forbidding benefiting from Western laws at all even when their rules are compatible with Shari'ah,²³⁵ as well as banning women from driving. This resistance comes from people who think that these provisions will protect the supremacy of Shari'ah and protect women from the bad decision to remove Hijabs, for instance, which has already happened elsewhere. Such provisions are not fair and should not be attributed to Shari'ah.

²³³ For example, the Socialist system which had adopted by Syria and Libya dictators, and the sufferance that women wearing Hijab were facing in Turkey.

²³⁴ Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 733.

²³⁵ See for example, Almubred, M. (2015). *The Faculties of Law and the Judgment in Other Than What Allah Revealed*. (Arabic) available online at <http://saaid.net/book/open.php?cat=&book=14183>, accessed on 18/8/2016. This book has praised by two of the senior of Islamic scholars in Saudi Arabia.

In conclusion, this relationship between Shari'ah and law has very heavily impacted on both the legislative and judicial systems in Saudi Arabia. This includes the development of the company sector at both levels of the legislative and judiciary, which will be discussed in the upcoming sections.

3.2.3 The Saudi Judicial System

Saudi law, in general, assigns judicial authority to two branches: the General Courts "Sharia Courts" and the Administrative Judicial Body "Board of Grievances", which has been allocated for disputes where the government is a party. This dual model is a tradition in countries that belong to the French legal family where civil law has been adopted. Likewise, many Middle East countries including Egypt, Lebanon and Tunisia have copied this system.²³⁶ Both of these judicial bodies have an independent Supreme Judicial Council which has a supervisory role over courts and judges and oversees administrative aspects of the judiciary. As well as a huge court, courts of appeals and other courts that related to their jurisdiction.²³⁷

Despite Saudi law restricting judicial authority to those two judicial bodies, there are, in fact, several administrative committees that have a judicial jurisdiction. The Saudi legal system does not recognise these committees as part of the judicial authority but does grant them full jurisdiction to adjudicate some civil, commercial and administrative cases in accordance with the judicial jurisdiction assigned to each committee by its constituted decree.²³⁸ Such administrative committees can be found in a variety fields, such as Committee for Resolution of Securities Disputes, the Tax Committees, the Committees for Penalizing Traffic Violations, the Mining Disputes Committee, the Banking Disputes Settlement Committee, the Copyright Committee,

²³⁶ Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 746.

²³⁷ Articles 4, 8 of Law of the Board of Grievances 2007 in the Kingdom of Saudi Arabia. See also articles 5, 9 of Law of the Judiciary 2007 in the Kingdom of Saudi Arabia.

²³⁸ Ansary, A. (2008). A Brief Overview of the Saudi Arabian Legal System, *Hauser Global Law School Program, New York University School of Law*, available online at http://www.nyulawglobal.org/globalex/saudi_arabia.htm#a, accessed on 18/8/2016. And see Al-Jarbou, A. (2004). Judicial Independence: Case Study of Saudi Arabia. *Arab Law Quarterly*, 19(1/4), at 30.

Customs Committee, the Labor Disputes Settlement Committee, the Committees for Press and Publication Violations and so on.

Al-Jarbou discussed the possible reasons for creating these kinds of semi-judicial committees. One reason is that the situation is a response to the requirement of the comprehensive development that has occurred in Saudi Arabia at all levels and the current courts do not have sufficient experience to deal with it. Other interpretations tend to justify their establishment to ease the caseload before courts or to cope with disputes arising from applying the decrees or regulations due to the privacy of those issues.²³⁹

Codification is one of the most important justifications for the creation of these unusual judicial bodies in the Saudi context. More accurately, those committees are following the particular provisions that have been codified in each field and then been adjudicating thereunder.²⁴⁰ This idea of codifying Shari'ah rules has received strong opposition from Shari'ah scholars who control the judicial authority. This resistance to codifying Shari'ah rules into a single civil code comes from the fact that this idea has led some countries to dispossess Shari'ah from its pivotal role in the judicial authority.²⁴¹ It should be noted that the number of those committees is reducing over time through the development of the Saudi judicial system and some of their liabilities have been transferred to the appropriate courts.²⁴²

Starting from the fact that Shari'ah is the master authority for Saudi courts, it therefore also plays another role in appointing judges and their rehabilitation. Saudi laws require a candidate to "hold a degree of one of the Sharia colleges in the Kingdom or any equivalent degree, provided that, in the latter case, he shall pass a special examination to be prepared by the Supreme Judicial Council".²⁴³ Gaining a postgraduate degree

²³⁹ Al-Jarbou, A. (2004). Judicial Independence: Case Study of Saudi Arabia. *Arab Law Quarterly*, 19(1/4), at 30.

²⁴⁰ Almarzogy, M. (2004). *The Regulatory Authority in Saudi Arabia* (1st ed.). Riyadh: Obeikan Bookstore, at 174. (Arabic)

²⁴¹ Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 732-733.

²⁴² See the royal decree number M/78 in 1.10.2007. See also Section 8 of the Operational Mechanism of Judicial law, available at the official website of Supreme Judicial Council: <https://iservices.scj.gov.sa:9113/home/pdflist>), accessed on 18/8/2016.

²⁴³ Article 31/d of Law of the Judiciary 2007 in the Kingdom of Saudi Arabia.

further enables judges to be promoted through the ranks of the judiciary. However, judges working in criminal, labour and commercial courts are required to "undergo at least two months of training in the Commercial, Labour and Criminal Procedure laws and other relevant regulations".²⁴⁴

3.2.4 The Judicial Authorities Related to the Company Sector

The structure of judicial authority related to the company sector has also been affected by the dispute between Shari'ah scholars and the Saudi policy-makers. This disagreement has pushed the Shari'ah courts to refuse to introduce and implement the Commercial Law (Law of the Commercial Court) issued in 1931 as the first prime commercial legislation in Saudi Arabia. In contrast, this drove the authorities to exclude commercial and company cases from the judicial authority and create alternative ways to fill the gap in the judicial system as a logical consequence of that situation.²⁴⁵

The first commercial tribunal entity in Saudi Arabia was established in 1926 and was named the 'traders council'. It comprised seven members who had been appointed by the king. In 1931, the Commercial Law (Law of the Commercial Court) was issued, including the regulations that arranged the jurisdiction, procedure and composition of a commercial council or 'commercial tribunal', which covered the jurisdiction of company disputes. One year before the Company Law was published in 1965, the Saudi Legislature Authority assigned the settlement of commercial and companies disputes to two separate entities. Then, in 1967 those two authorities merged under the name of 'The Settlement of Commercial Disputes Authority' with full judicial powers under the umbrella of the Ministry of Commerce.²⁴⁶

Decree number (402) of the Council of Ministers issued in 1987 abolished 'The Settlement of Commercial Disputes Authority' and transferred its jurisdiction to the

²⁴⁴ Ansary, A. (2008). A Brief Overview of the Saudi Arabian Legal System, *Hauser Global Law School Program, New York University School of Law*, available online at http://www.nyulawglobal.org/globalex/saudi_arabia.htm#a, accessed on 18/8/2016.

²⁴⁵ Sfeir, G. (1988). The Saudi Approach to Law Reform. *The American Journal of Comparative Law*, 36(4), at 746.

²⁴⁶ Al-Drib, S. (1999). *The Judicial Organizing in Saudi Arabia in the Light of Islamic Law and the Judiciary System*. Riyadh: Al-Imam Muhammad Ibn Saud Islamic University, at 450- 452. (Arabic)

specialised commercial divisions in the Board of Grievances with two levels of courts/litigations, first instance and appellate. With this decree, commercial and company cases finally came under judicial authority. This excludes certain issues such as banking disputes and cases involving the stock market which are still assigned to administrative committees.

In 2007, a significant reform happened in the Saudi judicial authority. A new law was published for both the General Courts "Sharia Courts" and the Board of Grievances which have also expanded their authorities.²⁴⁷ This law stipulates creating the commercial courts under the General Courts framework, which can be considered as the first commercial court as there has never been one in the previous Saudi judicial structures. The Royal Decree of this new law included also an operational mechanism that discussed the needs of those courts and regulated the stages for creating bodies or legislation needed and the ways of transferring the tasks between the judicial systems. It also includes a timetable about collecting the authorities of commercial judiciary under the commercial court, which lead to abolish several current administrative judicial committees gradually.²⁴⁸ Accordingly, the commercial courts was to run under the Board of Grievances until 2 October 2016 as that had been agreed and indicated in the documents signed by Saudi Arabia's two judicial parties.²⁴⁹ With this kind of court, the Saudi commercial environment will become more harmonised with global development and respond to the economic needs and commercial international agreements; it will also be able to engage more with foreign investors in its market.²⁵⁰

In contrast, while all companies are monitored by the Ministry of Commerce and are subject to the jurisdiction of commercial courts, the Capital Market Authority is the authorised body which has the jurisdiction over listed companies in Saudi Arabia.

²⁴⁷ See the royal decree number M/78 in 1.10.2007

²⁴⁸ Section 8 of the Operational Mechanism of Judicial law, available at the official website of Supreme Judicial Council: <https://iservices.scj.gov.sa:9113/home/pdflist> , accessed on 18/8/2016.

²⁴⁹ See documents number 37/19/2104 and 37/19/2105 in 21.3.2016. See also, the website of Ministry of Justice at https://www.moj.gov.sa/ar/Pages/News_Details.aspx?NewsID=68, accessed on 18/8/2016. And see the declaration of spokesman of Supreme Judicial Council which available at <http://www.alriyadh.com/1140580>, accessed on 18/8/2016.

²⁵⁰ Altwijry, S. (2011). *Commercial Courts in the Saudi Judicial System*. Riyadh: Naif Arab University for Security Sciences (NAUSS), at 98. (Arabic)

3.2.4.1 The Capital Market Authority

The nature of the administrative and judicial bodies that have authority over the board of directors significantly impacts on the performance of the board of directors and the roles and relationships with its members, shareholders, stakeholders and the company as a whole. Listed joint stock companies in Saudi Arabia come under the supervision of the Capital Market Authority (CMA) and are subject to its jurisdiction, not to the Ministry of Commerce or commercial courts. The members of the board of the CMA are appointed by Royal Order; this also determines the salaries and benefits of the board members.²⁵¹ The CMA has corporate personality and financial and administrative independence. It also reports directly to the president of the Council of Ministers (the king).²⁵² The CMA has a particular law that determines the scope of its authority, its jurisdiction and its power in enacting regulations and enforcing the provisions of the Capital Market Law and other relevant regulations and rules. In order to fulfil this function, the CMA has the power to inspect records, and gather evidence and documents required to tackle any violations or prevent them in the first place.²⁵³

The CMA establishes the Committee for the Resolution of Securities Disputes (CRSD), whose members shall be appointed by the board of the CMA for a renewable three-year term. Such a committee has the full jurisdiction to decide complaints or lawsuits and to issue decisions over all relevant disputes in both public and private rights, as well as to consider the grievances against actions and decisions taken by the CMA.²⁵⁴ The law also empowers the Committee to punish anyone violating the law with fines, imprisonment, suspension of trade, seizure of property, travel bans and so on according to set conditions.²⁵⁵ Moreover, it has the powers required to investigate these disputes, including subpoenaing witnesses and ordering the production of any necessary evidence and documents.²⁵⁶ Disputes and issues that are not mentioned by the Capital Market Law and the regulations issued by the CMA are essentially subject to the jurisdiction of commercial courts.²⁵⁷

²⁵¹ Articles 7/a, 59 of Capital Market Law 2003 in the Kingdom of Saudi Arabia.

²⁵² Ibid, article 4/a.

²⁵³ Ibid, article 5/a, c.

²⁵⁴ Ibid, article 25/a, c.

²⁵⁵ Ibid, articles 57/c, 59.

²⁵⁶ Ibid, article 25/a.

²⁵⁷ See the decision number 5/L/D1/2005 in 2006 of the Committee for the Resolution of Securities Disputes about the prosecution of a shareholder who claim that the company sold his shares without his

The CMA can also file a lawsuit before the CRSD against certain violations. It has the power to determine these violations as well as the authority to issue regulations and rules related to them.²⁵⁸ For example, article 57 of the Capital Market Law empowers the CMA to file a lawsuit against those violating articles 49 and 50 which determine matters relating to fraud and insider trading. These two articles give the CMA the power to set rules determining acts and practices constituting violations of such matters, as well as specifying and defining related terms.²⁵⁹ This means that the CMA in some cases plays the roles of legislator, claimant, inspector, jury and judge at the same time.

According to Saudi law, the Council of Ministers shall issue a resolution to form an appeals panel for a renewable three-year term to receive appeals against the decisions of the CRSD and to issue final decisions for the complaints or lawsuits considered. The appeals panel comprises three members representing the Ministry of Commerce and Industry, the Ministry of Finance, and the Bureau of Experts at the Council of Ministers.²⁶⁰ In practice, the data show that the CMA Board and the Committees for the Resolution of Securities Disputes issued 241 sanction decisions; 102 of which were issued and enforced against listed companies/senior executives. On the other hand, there were 36 final judgments issued in favour of the CMA in cases brought by or against it, compared with three final judgments which were issued against the CMA in cases brought by or against it. These data come from the latest report of the CMA in Saudi Arabia.²⁶¹

It should be noted that despite the fact that the CRSD and the appeals panel are carrying out judicial functions and they have the full authority to do so, the Saudi law does not deem the members of these committees as judges and it considers their decisions as administrative decisions not judicial verdicts.²⁶² Moreover, the CRSD and the appeals panel are exercising their judicial duties away from the courts which, unlike them, have

permission, the committee decided that this case is outside its jurisdiction. See also Dahish, S. (2014). *The Jurisdiction of Saudi Commercial Courts and their Litigation Procedures*. Riyadh: Naif Arab University for Security Sciences (NAUSS), at 88. (Arabic)

²⁵⁸ Article 5/a of Capital Market Law 2003 in the Kingdom of Saudi Arabia.

²⁵⁹ Ibid, article 25/c, 49, 50.

²⁶⁰ Ibid, article 25/ f, g.

²⁶¹ See the Capital Market Authority in Saudi Arabia, Annual Report 2016, at p. 105, 107.

²⁶² Article 25/ b, c of Capital Market Law 2003 in the Kingdom of Saudi Arabia.

the supreme principles of justice, judicial independence and objective procedures. The members of the CRSD and the appeals panel have been appointed from legal consultants specialising in the jurisprudence of transactions, who have expertise in commercial and financial affairs, securities and financial markets. The law prevents them from having any financial or commercial interest even indirectly or having a kinship relationship with parties to lawsuits up to the fourth degree of relatives.²⁶³ However, this does not mean that they have sufficient legal qualifications and independence, which the members of the judicial authority have.

Another important point in this context is that the Capital Market Law uses fines and financial penalties imposed on violators of the provisions of the law as financial resources of the CMA.²⁶⁴ The law requires the CMA to deduct from its total income all current capital expenses, any expenses needed and double the total of its expenditures as a general reserve, and then it shall remit the surplus revenues collected to the Ministry of Finance.²⁶⁵

The above influential factors may create an atmosphere of uncertainty about the credibility of the litigation in Saudi capital market. These may cause serious negative effects not only on Saudi companies and the relationships with their board members but also on attracting foreign investors. Such a situation goes against the current strong trend towards privatisation and maximising the role of the corporate sector in Saudi Arabia, which needs to improve regulations, the judicial system, the environment of the market economy and measures of protection for the rights of all parties.

The recent final resolution issued on 9 February 2017 against Mohammad Al Mojil Group Company has created a big debate in the Saudi capital market and may disclose the extent of concerns in this regard, when strict sanctions including fines of billions and many years of imprisonment can be issued by a mere administrative authority. This resolution gave 5 years' imprisonment for each of the chairmen of this company and the deputy, and a fine of 1.5 billion Saudi riyals (\$400 million) to be deposited in the CMA account as well as a variety of other strict sanctions for auditors and master

²⁶³ Ibid, article 25/b.

²⁶⁴ Ibid, article 13.

²⁶⁵ Ibid, article 14.

executive managers. In addition, the resolution invites any individual shareholder or third party who sustained damages from this violation to file a case before the CRSD and to claim compensation.²⁶⁶

3.2.4.2 Suggested Reform

As discussed earlier, the long-term disagreements between Shari'ah scholars who dominate the judicial authority and the Saudi policy-makers have brought into existence several administrative committees that have a judicial jurisdiction. Such a dispute has negatively affected the structure of the judicial authority and pushed the Shari'ah courts to refuse to introduce and implement some legislation that conflicts with Shari'ah and, at the same time, has pushed the government to create these kinds of semi-judicial committees. This disagreement negatively impacts on the requirement of the comprehensive development and damages the local economy, commerce and the needs of civil society. Therefore, both politicians and Islamic scholars should work together to end this conflict and find a solution that ensures that all kinds of disputes including securities disputes will be covered by the structure of judicial authority.

This serious dilemma may be solved by **two** main methods, which have some obstacles but these are fewer than the problems that may come from the current situation.

First, the policy-makers can recognise and comply with numerous articles in different laws in Saudi Arabia that emphasise that all legislation must be formulated in accordance with the principles and the sources of Shari'ah including regulations relevant to development.²⁶⁷ These articles also impose on the courts to apply the provisions of Islamic Shari'ah exclusively.²⁶⁸ This would mean banning all practices whether national or international that depart from Shari'ah in all sectors, including commerce, corporate, banking and securities market. There is nothing that prevents a country from enacting legislation that harmonises with local culture and responds to the demands of the majority of citizens, as long as it does not damage third parties. These

²⁶⁶ See the CMA announcement on the Issuance of a Final Decision by The Committee for the Resolution of Securities Disputes on 09/02/2017 available at: http://cma.org.sa/en/News/Pages/CMA_N_2182.aspx, accessed on 18/8/2016.

²⁶⁷ Articles 1, 46, 55 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia. And see article 2 of Law of the Shura Council 1992 in the Kingdom of Saudi Arabia.

²⁶⁸ Article 48 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

rights and local particularities should be respected by foreign investors who want to work or invest in Saudi Arabia.

On the other hand, Shari'ah scholars could be more proactive and respond to the requirement of the development and the economic needs and also be more harmonised with the global commercial system and international agreements. Moreover, the negative position against the codification needs to be reviewed by Shari'ah scholars and be made flexible to follow specific provisions that have been codified in some fields and then been adjudicated thereunder, as long as this codification does not conflict with Shari'ah teachings. This will be achieved in two ways: encouraging research to find appropriate solutions and new products to meet economic and financial needs that are compatible with Shari'ah; and by improving the judicial authority, qualifying programmes, curriculums and judges' competence so that they are qualified and have sufficient experience to deal with the cases filed before semi-judicial committees.

It should be noted that these two actions, to some extent, are already in place. A good example comes from banking sector that was once very removed from the provisions of Shari'ah. However, now the Islamic banking system provides a wide variety of financial products that are internationally applicable and globally recognised. Moreover, the Islamic universities in Saudi Arabia offer several postgraduate programmes concerned with legal comparative studies, including financial and commercial law.²⁶⁹ Furthermore, they have implemented, especially in the last decade, scholarship programmes abroad and sent many students who have undergraduate degrees in Shari'ah to study in the most prestigious universities around the world. Many of them return with useful knowledge and experience.²⁷⁰ This solution is more suitable to the recent trend that is clearly stipulated by the Saudi law issued in 2007 which allows the commercial courts to cover all authorities of the commercial judiciary and aims to abolish the current administrative judicial committees over time.²⁷¹

²⁶⁹ See for example the postgraduate programs in Higher Judicial Institute, available at <http://t.co/nvyhKG74Aa> And those programs in Islamic University in Medina available at <http://www.iu.edu.sa/Page/20780>, accessed on 18/8/2016.

²⁷⁰ In addition, there are thousands of students who take advantage the Custodian of The Two Holy Mosques Scholarship Program based on the royal decree number mb/5387 in 25.5.2005 and continued for 10 years.

²⁷¹ Section 8 of the Operational Mechanism of Judicial law, available at the official website of Supreme Judicial Council: <https://iservices.scj.gov.sa:9113/home/pdflist> , accessed on 18/8/2016.

The second way to solve the judicial dilemma and its negative effects caused by the semi-judicial committees in Saudi Arabia is to improve these committees, transforming them into authentic courts with two levels: first instance and appellate. This would require the Saudi legal system to recognise these committees as part of the judicial authority or at least for them to be recognised by the government as courts with all their powers, authority and independence. This applies also to appointing their members, their tenures, work locations and the nature of their decisions to be similar to those in the judicial authority. Moreover, the members of these committees should be selected from highly qualified individuals according to standards that meet the functions of judicial authority and the specific jurisdictions they will deal with.

It may be difficult to create courts, under the current judicial authority, which deal with some cases that conflict with Shari'ah and the Basic Law of Governance. However, this exactly applies to the current committees that are run in the same location and legal environment but with different names and procedures. This may point to a problem with names and not actual practice. Therefore, these committees can have the same characteristics and procedures of the courts regardless of the name they are given.

In conclusion, it should be noted by both politicians and Islamic scholars that the unfairness, the abuse and the neglect of rights that may arise from the current situation of vesting some judicial functions to administrative committees are, in fact, in much greater conflict with both Shari'ah teachings and the Basic Law of Governance.

3.2.5 The Major Legislation Affecting the Board of Directors of Listed Companies in Saudi Arabia Compared to those in England

3.2.5.1 The Saudi Legal Family

According to Hanson, the Arab World was a fertile ground for the transplantation of French legal concepts as a result of two main reasons. The first was the events of the previous centuries that involved Europe, particularly France, and the Ottoman Empire, at the level of politics and economics. These strengthened the transplantation of the

French legal system into Middle Eastern countries. The second was the concept of the immutability of Shari'ah that is consistent with the principle of the personality of the law and its dependence on the texts of the Quran and the teachings of the Prophet Muhammed as well as the broad administrative and political powers of the Islamic government under the principles of public policies and interests. Those factors are more harmonised with French jurisprudence and its distinction between public and private law which led to establishing a separate system of administrative law.²⁷²

Saudi Arabia has developed its legal system by benefiting from its neighbours' expertise as long as this does not conflict with Islamic law. Egypt was the foremost country at integrating Western civilisation, including French legal concepts, with Islamic principles. This allowed Egypt to modernise its legal system and create associated institutions. This made Egypt a window for receiving French legal principles into Islamic culture, and then on to Saudi Arabia.²⁷³

In contrast, the UK legal system has been built on common law, which is developed through case law. Unlike Saudi Arabia, this makes the UK legal system more flexible in the creation of rules and in involving judges in the process of law-making. This differs from the process of law-making in Saudi Arabia which is subject to bureaucratic procedures that are assigned exclusively to the legislature, which is held by the king or the Council of Ministers, the executive authority.

The Saudi Arabian legal system, to some extent, has been built on civil law like many Middle Eastern countries which belong to the French legal family. Therefore, the rule of stare decisis or any doctrine that restricts judges to case law are not followed by Saudi courts, whether those decisions are issued by lower or higher courts. This makes a judge independent to rule in a different way even if the facts presented are similar.²⁷⁴ However, the law of the Board of Grievances issued in 2007 instructs that the Board shall classify the rendered courts' judgments as well as print and publish them.²⁷⁵ The

²⁷² Hanson, M. (1987). The Influence of French Law on the Legal Development of Saudi Arabia. *Arab Law Quarterly*, 2(3), at 290-291.

²⁷³ Ibid, at 291.

²⁷⁴ Karl, D. (1991). Islamic Law in Saudi Arabia: What Foreign Attorneys Should Know. *The George Washington Journal of International Law and Economics*, 25(1), at 149 -150.

²⁷⁵ Article 21 of Law of the Board of Grievances 2007 in the Kingdom of Saudi Arabia.

Board of Grievances has published several volumes of those court judgments including commercial cases, even those issued before the recent law.²⁷⁶ This requirement of publishing and collecting judgments does not oblige Saudi courts to follow the rule of stare decisis compulsorily but it does create general legal principles and judicial norms that may be considered a judicial resource. This is very helpful in assisting the principles of transparency and justice as well as supporting judges to make their decisions quickly, as well as being more likely to be approved by the higher courts.²⁷⁷

The analytical study by La Porta et al., which compares legal families in terms of legal enforcement, should be referred to here. They point out that:

"The French family has the weakest quality of accounting ... An investor in a French-civil-law country is poorly protected by both the laws and the system that enforces them. The converse is true for an investor in a common-law country, on average ... legal families with investor-friendlier laws are also the ones with stronger enforcement of laws. Poor enforcement and accounting standards aggravate, rather than cure, the difficulties faced by investors in the French-civil-law countries".²⁷⁸

3.2.5.2 The New Company Law

On the 4th of December 2015, the new Law of Companies was published in Saudi Arabia which superseded the previous law issued in 1965 and gave existing companies a one-year time limit to comply with its new rules.²⁷⁹ This law is designed to meet the contemporary needs of the company sector and create a motivating environment for them to increase their contribution to the national economy. It also tackles the shortcomings of the obsolete law and the dispersed decrees that tried to amend it. The new law removes several barriers and restrictions in front of the growth of the company sector. It also includes numerous rules that enhance the good practices of corporate governance. On the one hand, the new law reduces the costs and the procedures for the establishment of a firm. For instance, it minimises the statutory reserve capital and the

²⁷⁶ For further details, see the official website of the Board of Grievances available at <http://bog.gov.sa/ScientificContent/JudicialBlogs/Pages/default.aspx>, accessed on 18/8/2016.

²⁷⁷ Ibid.

²⁷⁸ Porta, R., Lopez-de-Silanes, F., Shleifer, A., and Vishny, R. (1998). Law and Finance. *Journal of Political Economy*, 106(6), at 1141- 1145.

²⁷⁹ Articles 224- 226 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

capital required for establishing a public company. Also, the number of members required to set up a joint stock company has been reduced.²⁸⁰ According to this law, a single person who meets certain conditions can set up a company.²⁸¹ Moreover, the new law gives modern communications technology a vital role, it allows companies to maximise shareholder participation by holding the meetings of general assemblies via modern means of communication. The website of the Ministry of Commerce becomes adequate on its own for a firm to advertise itself and publish its Memorandum of Association electronically. Those facilitated rules may encourage Saudi businessmen to modify their institutions to shape firms and to encourage family companies, which receive greater attention in the new law, to become joint stock companies.²⁸²

On the other hand, the new law makes several principles of corporate governance compulsory rather than remaining optional or being considered soft law. For example, it prevents the position of the chairman of the board of directors and any other executive position in the company from being combined.²⁸³ Moreover, it forces companies to adopt a cumulative election method in appointing members of the board of directors. The new law also minimises the loss ratio of capital of a company which necessitates an extraordinary meeting of the shareholders within prescribed timelines to solve the problem or the company will be dissolved by force of law. This rate of loss was 75% of the capital whereas it is only 50% in the new law.²⁸⁴ There are also strict sanctions of imprisonment and fines stipulated by the new law which act as a strong warning against the board of directors or any company parties not to breach the provisions of this law or provide false data and so on.²⁸⁵

England is one of the foremost countries that has issued rules that organise operations of firms and serve to develop corporate governance. The Companies Act 2006 has over 1,300 sections and is considered the prime piece of legislation that regulates English law in the company sector. This Act has emerged as a result of a long term cumulative experience which made it simple, efficient and cost effective for companies to use in

²⁸⁰ Ibid, article 54.

²⁸¹ Ibid, article 55.

²⁸² Ibid, articles 13, 86/3.

²⁸³ Ibid, article 81.

²⁸⁴ Ibid, article 95, 150. This figure also is consistent with the UK legislation, see section 656(1) of the Companies Act 2006.

²⁸⁵ Ibid, articles 211, 218.

the modern era. It also codifies directors' duties, clarifies shareholders' rights and simplifies the administrative procedures required.²⁸⁶ Using such a law comparatively will help attempts to reform company law in other nations.

There is other legislation in England related to the board of directors which cannot be found in Saudi Arabia – the Company Directors Disqualification Act 1986. This Act is an important part of English company law as it disqualifies directors who are suspected of misconduct and prevent them from "being directors of companies, and from being otherwise concerned with a company's affairs".²⁸⁷

3.2.5.3 The Corporate Governance Regulations and Others Regulations Issued by the Capital Market Authority

The Capital Market Authority has issued the Corporate Governance Regulations as well as many other regulations in order to organise the conduct of listed companies; these aim to protect the rights of shareholders and stakeholders as well as to create a healthier environment for investment. There are more than a dozen regulations, such as the Listing Rules, the Resolution of Securities Disputes Proceedings Regulations, Merger and Acquisition Regulations, Investment Funds Regulations, Securities Business Regulations, Market Conduct Regulations, Offers of Securities Regulations, Credit Rating Agencies Regulations, Investment Accounts Instructions, Procedures and instructions for companies whose losses have reached 50% of their capital.²⁸⁸ Some of these regulations and their annexes of applications and forms are very useful for the board of directors in raising their awareness about discharging their duties perfectly. They may also guide them in dealing with some crucial situations which may help them to tackle problems and avoid prosecutions in the first place.

The first Corporate Governance Regulations was issued in 2006 with 5 sections and 19 articles that highlight the rules and standards required to ensure compliance of joint stock companies with best governance practices.²⁸⁹ This regulation comes under the

²⁸⁶ The description of the UK Companies Act 2006, the National Archives of the UK government, available at <http://www.legislation.gov.uk/ukpga/2006/46/notes> , accessed on 18/8/2016.

²⁸⁷ See the Introductory text of Company Directors Disqualification Act 1986.

²⁸⁸ To look at all those regulations, see the official website of the Capital Market Authority available at <http://www.cma.org.sa/en/Regulations/Pages/default.aspx> , accessed on 18/8/2016.

²⁸⁹ Article 1/a of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia.

approach of "comply or explain" for all listed companies; this means that "a company must disclose in the board of directors' report, the provisions that have been implemented and the provisions that have not been implemented as well as the reasons for not implementing them".²⁹⁰ However, over time many decrees have been issued which have forced listed companies to follow certain rules; several of these compulsory rules were inserted in the new Company Law 2015.²⁹¹

On the 13th of February 2017, the Capital Market Authority in Saudi Arabia issued a new Corporate Governance Regulation (CGR) which superseded the previous regulation issued in 2006. The new regulation has changed many provisions, tackled numerous shortcomings and provided copious details. The main characteristics and key differences of the new CGR can be summarised as follows:

- The new CGR aims to provide some details to explain the provisions of the new Saudi Law of Companies issued on the 4th of December 2015, as the old CGR was not in harmony with it and conflicted with some of its provisions.²⁹²
- Unlike the previous CGR, which comes under the approach of "comply or explain" for all listed companies,²⁹³ the articles of the new CGR, except a few guidance rules, are compulsory for all listed companies.²⁹⁴
- The number of parts and rules in the new CGR is greater than the number in the old one. There are twelve parts in the new CGR, containing 98 articles with copious details, compared to just 5 parts, including 19 articles, in the old one.
- The new CGR provides some forms and schedules for disclosing remunerations and obliges listed companies to prepare their remuneration documents accordingly.²⁹⁵

²⁹⁰ Article 1/c of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia. There are more than 8 articles in Saudi CGR became mandatory on all listed companies.

²⁹¹ There are more than 8 articles in Saudi CGR became mandatory for all listed companies by different decrees, see the footnotes of the Corporate Governance Regulations 2006.

²⁹² Many of these relevant new provisions will be discussed in the chapter four and five of this thesis.

²⁹³ Article 1/c of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia. There are some articles of old CGR have become mandatory by different decrees from the Capital Market Authority.

²⁹⁴ Article 1/c of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia. According to Resolution number 8-16-2017 dated 13 February 2017, all provisions of the new CGR entered into force on 22 April 2017 except for a small number which entered into force on 31 December 2017. This means that all parts have now been implemented except some guidance articles which are not mandatory.

²⁹⁵ Ibid, article 93/b.

This thesis will deal with all of the relevant changes and shortcomings considered in the new regulation. It also clarifies the extent of the improvement in corporate governance that could result from the new regulation and those aspects related to the thesis that require further reform.

The regulations of listed joint stock companies and the capital market rules can be found also in England. There are, for example, the Rules of the London Stock Exchange and the requirements of the United Kingdom Listing Authority which regulate the operation of the trading system. In addition, there are the UK Corporate Governance and Stewardship Codes and UK standards for accounting, auditing and actuarial work which have been set by the Financial Reporting Council.²⁹⁶

This thesis will review the relevant Saudi rules that are related to the board of directors in the light of those in England and global standards of corporate governance.

²⁹⁶ See the introduction of the UK Corporate Governance Code 2016.

3.3 The Economic Environment in Saudi Arabia Affecting Corporate Governance

3.3.1 Structure of Saudi Economy

The Saudi economy is characterised by a dependency on oil and by the many petrochemical productions which are controlled or run by a limited number of state-owned companies. Oil output represented more than 73% of the total government revenues in 2015, with petrochemical exports representing the majority of the remaining percentage of non-oil national income.²⁹⁷

Much of the oil revenues have been redistributed in the economy through government spending on goods, services and employee salaries. Because of this the government has raised spending on wages in government works and used employment in the public sector as a simple tool to distribute and participate in the national wealth. Hence, the expenditure ratio of wages and salaries and allowances exceeded 50% of the approved budget for 2015 expenses.²⁹⁸ The sudden oil wealth assisted Saudi Arabia in developing its infrastructure quickly and in increasing living standards of its citizens. At the same time, it reduced the role of the private sector which depended too heavily on public sector activities and spending plans. The private sector, in turn, relies on foreign workers who represent more than 74% of the labour force in its companies where wages, benefits and rights are lower.²⁹⁹

For decades, the public sector and government expenditure in Saudi Arabia has been the main engine for the economy and has dominated most economic activities.³⁰⁰ At the

²⁹⁷ Ministry of Finance of Saudi Arabia, (2015). Ministry of Finance Statement About the National Budget for 2016, available at <https://www.mof.gov.sa/en/docslibrary/Budget/Documents/2016.pdf>. See also, General Authority for statistics in Saudi Arabia, (July 2016). Saudi Arabia's exports of goods and non-oil imports in January 2016, available at: <http://www.cdsi.gov.sa/en/1282>, accessed on 18/8/2016.

²⁹⁸ Ministry of Finance of Saudi Arabia, (2015). Ministry of Finance Statement About the National Budget for 2016, at 5, available at <https://www.mof.gov.sa/en/docslibrary/Budget/Documents/2016.pdf>, accessed on 18/8/2016. See also, Al Bakr A., 2015, Challenges to Production Base Diversification in Saudi Arabia, *Economic Research Department, Saudi Arabian Monetary Agency (SAMA)*, at 7.

²⁹⁹ General Authority for statistics in Saudi Arabia, (2015). The annual report 2015, at 61, available at: <http://stats.sharedt.com/en/3084>, accessed on 18/8/2016.

³⁰⁰ Saudi Arabian Monetary Agency, (2016). Financial Stability Report 2016, at 7, 43. available at <http://www.sama.gov.sa/en->

same time, the company sector has grown in the shadow of the public sector through government tenders or providing services to it.³⁰¹ This situation has created several problems in the governance of the public sector such as the excessive expansion in employment, weakness of productivity, difficulty in evaluating the level of performance and accountability, weak competitiveness in light of automatic promotions, and weakness in selecting the most efficient employees and in the management of human resources.³⁰² This situation has also created another problem in the labour force structure. The unemployment rate for the national labour force reached 11.5% even though there were more than 8 million foreign workers in Saudi Arabia.³⁰³

The Saudi economy has been influenced by government expenditures, which moves in parallel with the volatility of oil prices. This dependency meant that the macroeconomic indicators and the government revenues declined by 42% in 2015 as a direct consequence of weak oil prices (down 48%) in 2014. The Saudi stock exchange also decreased by 17.1%.³⁰⁴

Dignam and his colleague argue that:

“Macroeconomic conditions matter in corporate governance outcomes, and recognising the interdependent relationship between micro-level corporate legal structure and macroeconomic factors, such as trade, capital controls and demand, alters our understanding of the way corporate governance systems operate and, in turn, how policy can be formulated. This is important because the relationship is often overlooked or misunderstood”.³⁰⁵

Hence, structural reforms should be made in the Saudi economy to redirect its policies and tools in order to stimulate non-oil economic diversification, job creation for citizens

US/EconomicReports/Financial%20Stability%20Report/Financial%20Stability%20Report%202016_en.pdf , accessed on 18/8/2016.

³⁰¹ Elasrag, H., (2014). Unemployment and Job Creation in the GCC Countries, *MPRA Paper No. 54600*, at pp 4-13, (Arabic) available at <http://mpa.ub.uni-muenchen.de/54600>, accessed on 18/8/2016.

³⁰² Ibid, at 36, 40.

³⁰³ Saudi Arabian Monetary Agency, (2016). Financial Stability Report 2016, at 11. available at <http://www.sama.gov.sa/en->

US/EconomicReports/Financial%20Stability%20Report/Financial%20Stability%20Report%202016_en.pdf, accessed on 18/8/2016.

³⁰⁴ Ibid, at 7,43. And see General Authority for statistics in Saudi Arabia, (2015). The annual report 2015. available at: <http://stats.sharedt.com/en/3084>, accessed on 18/8/2016.

³⁰⁵ Dignam, A., and Galanis, M., (2008). Corporate Governance and the Importance of Macroeconomic Context, *Oxford Journal of Legal Studies*, Vol. 28, No. 2, at 240.

as well as reduce the wage bill in the public sector. The economy's plan-makers in Saudi Arabia have drawn attention to the need for economic diversity, something which has also been recommended by the International Monetary Fund.³⁰⁶ Thus, the Saudi Five-Year Plan emphasised the importance of enabling the private sector to play a vital role in both developing the economy and staffing 95% of the new national labour force.³⁰⁷

3.3.2 The Listed Companies in Saudi Arabia

The first joint stock company in Saudi Arabia was established in 1932, which is considered as the historical beginnings of the Saudi stock market. From that time, the market has gradually added joint stock companies every year. In 1984, the stock market became regulated by the Saudi Arabian Monetary Agency (SAMA); this went on to introduce an electronic settlement and clearing system in 1989. The Capital Market Authority (CMA) was established in 2003 pursuant to a Royal Decree in 2003. It has a direct link with the Prime Minister and enjoys financial and administrative autonomy. The CMA has made a quantum leap of the market in terms of developing the regulatory and supervisory aspects. It seeks to secure efficiency in the stock market and has full power to set up and impose rules in order to protect investors and maintain fairness.³⁰⁸ Hence, The CMA issued the first Corporate Governance Regulation in 2006 and revised it by adding numerous amendment decrees. It also issued a new CGR in 2017 to harmonise its regulations with the new provisions and trends found in the Law of Companies issued in 2015.

The Saudi stock market consists of sixteen sectors containing a total of 175 listed companies. In terms of market value (market capitalisation), the Saudi stock market is at the forefront of the rankings of emerging markets. Moreover, it is the largest Arab

³⁰⁶ Staff of International Monetary Fund, (2014). Labor Market Reforms to Boost Employment and Productivity in the GCC, *International Monetary Fund*, at 4.

³⁰⁷ Almatrody, H., (2009). Employment in the Private Sector and the Graduates of Higher Education in Saudi Arabia, *Riyadh: King Saud university*, at 9. (Arabic)

³⁰⁸ See the royal decree number M/30 in 31.7.2003

market with a market capitalisation of 1.6 trillion Saudi riyals (\$427 billion) according to a 2016 assessment.³⁰⁹

There are eight listed companies whose accumulated losses have reached between 50% and 75% of their capital while there is one company which has accumulated losses between 75% and less than 100% of its capital. There are four companies that have lost 100% or more of their capital.³¹⁰

It should be noted that the ten biggest companies of the Saudi market represent almost half of the Saudi market value. The ownership of these companies is concentrated in the hands of the government.³¹¹ There are three governmental organisations: the Public Investment Fund of Saudi Arabia, General Organization for Social Insurance and the Public Pension Agency, and these account for 39% of the Saudi stock market.³¹² Moreover, the governmental institutions are among the major shareholders of more than 54 listed companies.³¹³

³⁰⁹ Saudi Arabian Monetary Agency, (2016). Financial Stability Report 2016, at 2. available at http://www.sama.gov.sa/en-US/EconomicReports/Financial%20Stability%20Report/Financial%20Stability%20Report%202016_en.pdf. See also the official website of Saudi Capital Market Authority, Investing in the Stock Market, *Capital Market Authority publications, Investor Awareness Guidebooks*, at 1-3. Available at: http://cma.org.sa/En/Documents/IA/Booklet_2.pdf, accessed on 18/8/2016.

³¹⁰ See the official website of Saudi Stock Exchange (Tadawul), available at: <https://www.tadawul.com.sa/wps/portal/tadawul/markets/equities/market-watch/companies-with-accumulated-losses>, accessed on 18/8/2016.

³¹¹ According to the updated on 18/8/2016, the total market value of those ten companies is SAR 822.8 billion, See the official website of The Saudi Stock Exchange (Tadawul) <https://www.tadawul.com.sa/wps/portal/tadawul/home>, accessed on 18/8/2016.

³¹² See Saudi Stock Exchange (Tadawul), Weekly Stock Market Ownership and Trading Activity Report, Week Ending 18 August 2016, at 10. Available at: <https://www.tadawul.com.sa/wps/wcm/connect/66aeb048-f719-479c-b002-c5962c5ac08f/3.+Weekly+Trading+and+Ownership+By+Nationality+Report+4-18-2016.pdf?MOD=AJPERES>, accessed on 18/8/2016.

³¹³ According to the report of Major Stake Holder as the updated on 18.8.2016, See the official website of Saudi Stock Exchange (Tadawul) available at: <https://www.tadawul.com.sa/wps/portal/tadawul/markets/reports-%26-publications>, accessed on 18/8/2016.

3.3.3 Saudi Arabia's Vision for 2030

Extensive changes occurred in Saudi Arabia at the beginning of 2015. A new king with a different economic agenda and leadership team was installed. On the political level, Saudi Arabia was forced into military intervention in Yemen to support its legitimate government and stop Houthi militias backed by Iran. Moreover, the price of oil reached its lowest level in a decade. These events have had a massive impact on the Saudi economy and its administrative methods. Thus, the new government issued 'Saudi Arabia's Vision for 2030' in early 2016, including a number of programmes such as the National Transformation Program and many substantial changes to the structure of the Saudi economy. This vision is directed by the king's son, Prince Mohammed, who enjoys a level of power that no other Saudi prince has ever had since the kingdom was founded in 1932. He is the kingdom's Crown Prince, the Defence Minister and the Chief of Council for Economic and Development Affairs, which supervises the ministries of finance, oil and the economy, as well as the Public Investment Fund and Saudi Arabian Oil Company (Aramco).³¹⁴

Saudi Arabia's Vision for 2030 can be considered a major historical turning point that may have a broad impact on the diversification of the economy, the culture of work and corporate governance practices. Its target is to maximise the role of the private sector in the long-term with a view to contributing to gross domestic product (GDP) and increasing the economy liberalisation in terms of ownership, employment, trade and competition. This is necessary to facilitate investment, remove all obstacles preventing the participation of the private sector, encourage investment in new fields and improve regulations and the environment of the market economy. The Vision also seeks to enhance the level of efficiency in the private sector and its ability to manage various production units to meet the requirements of production base diversification of the national economy.³¹⁵

³¹⁴ For all these positions, see the royal decrees number, a/159 on 29.4.2015, a/68 and a/70 on 29.1.2015.

³¹⁵ See the official website of Saudi Arabia's Vision for 2030, at 45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016. See also, Al Bakr A., 2015, Challenges to Production Base Diversification in Saudi Arabia, Economic Research Department, Saudi Arabian Monetary Agency (SAMA).

In order to achieve this target, the government is intending to launch a series of executive programmes. One of the most important programmes that could pave the way for the private sector is the government restructuring programme. It aims to reduce the government's outlay and promote efficient planning. This will be implemented within some ministries, institutions and government entities. This will also boost coordination among them to align them to the requirements of the new phase. The Vision aims to transform the government's role from providing services to regulating and monitoring them.³¹⁶

Privatisation is another significant tool that is emphasised by Vision for 2030. There is a strong trend to create a comprehensive privatisation programme that involves most government functions, public agencies and state-owned companies whether complete or partial. For example, healthcare, municipal services, housing, finance, energy, the national airline, telecoms firm, electricity company and so on. Such an ambitious privatisation plan will even cover some parts of education services (charter schools), military industries, some services in the ministry of justice and the national oil industry icon, Aramco.³¹⁷ This enthusiastic trend towards privatisation drove The Economist magazine to ask prince Mohammed, who is at the head of the Saudi economy, whether this was a 'Thatcher revolution for Saudi Arabia' to which he replied 'most certainly'.³¹⁸

As part of the privatising strategy, Saudi Arabia is considering an IPO of around 5% of Aramco, the world's biggest oil company.³¹⁹ This will happen in 2018 and will include some of its subsidiaries. The aim is to turn it into an energy/industrial conglomerate in order to diversify Saudi income and secure the continuity and growth of Aramco.³²⁰

³¹⁶ See the official website of Saudi Arabia's Vision for 2030, at 45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016.

³¹⁷ Ibid. See also The Economist magazine, 9 Jan 2016, The Saudi blueprint, available at: <http://www.economist.com/news/leaders/21685450-desert-kingdom-striving-dominate-its-region-and-modernise-its-economy-same?cid1=cust/ednew/n/n/n/2016017n/owned/n/n/nwl/n/n/ME/email>. And see Bloomberg magazine, 4 April 2016, Saudi Arabia's Deputy Crown Prince Outlines Plans: Transcript, available at: <http://linkis.com/www.bloomberg.com/ne/UQn19>, accessed on 18/8/2016.

³¹⁸ The Economist magazine, 6 Jan 2016, Transcript: Interview with Muhammad bin Salman, available at: http://www.economist.com/saudi_interview, accessed on 18/8/2016.

³¹⁹ Ibid.

³²⁰ Bloomberg magazine, 4 April 2016, Saudi Arabia's Deputy Crown Prince Outlines Plans: Transcript, available at: <http://linkis.com/www.bloomberg.com/ne/UQn19>, accessed on 18/8/2016.

The new Saudi government seeks to bring multiple benefits through privatisation and effective participation with the private sector to create initiatives and joint programmes. In this way, the Saudi Vision aims to slash government waste, increase the rate of transparency and counter corruption, as well as increase the private sector's contribution to GDP and non-oil production. Moreover, this marks an attempt to raise the rate of nongovernment jobs in the private sector to employ more than 50% of the national labour force. Through this cooperation, Saudi Arabia will expand its investments in the religious tourism sector, the development of the petrochemical sector, gas production, mineral wealth and so on.³²¹

Privatisation will create numerous listed companies in the Saudi market which will be directed by boards of directors rather than being dominated by government. This situation will raise the demands of nominating employees to boards because privatisation significantly impacts the structure of labour force in Saudi Arabia, representing a serious concern for the government, which needs to give them further protection in corporate sectors. Moreover, this will increase the need to apply the principles of corporate governance, including transparency and accountability over the boards of the targeted sectors. This could be similar to the situation in England, particularly in the 1980s, when a number of significant issues were reconsidered such as excessive remuneration for directors and standards of transparency.³²²

3.3.4 The Impact of Saudi Political and Economic Environments in Corporate Governance

Starting from above facts of culture values in Saudi Arabia and the prominent characteristics of legal, political, and economic environment, Saudi Arabia is a non-democratic country that is based on an absolute monarchical system which puts all authority in the hands of the king. Laws are issued by royal decree or the decree of the Council of Ministers which is presided over by the king. There are also wide powers for a minister in issuing bylaws and legal decrees in their ministry and interpreting

³²¹ See the official website of Saudi Arabia's Vision for 2030, at 45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016.

³²² Bloomfield, S. (2013). *Theory and Practice of Corporate Governance: An International Approach*. Cambridge: Cambridge University Press, at 127.

legislations. Judicial authority and its administrative affairs are managed by the Minister of Justice. Moreover, the semi-parliament members are appointed by the king, not via public elections. By contrast, corporate governance relies on a number of fundamental principles and concepts of a democratic regime such as participation, transparency and accountability.

According to the report of the World Bank, the ownership and control of Saudi listed companies appears to be highly concentrated in the State and its founding families.³²³ The report mentions that several laws and institutions in Saudi Arabia are in their early stages and remain untested, and awareness of the importance of good corporate governance and implementation need to be raised. Thus, corporate governance in Saudi Arabia needs to make additional efforts to focus on enforcement and to turn the ‘law on the books’ into practice. Moreover, attention is drawn to the importance of the public disclosure of information related to ownership structure, beneficial ownership and other non-financial, board member qualifications, nomination procedures and so forth to reduce the current concern.³²⁴

A number of researchers have raised concerns about the ability to move forward in the new Vision for 2030 safely in this situation whilst maintaining the rights of shareholders and stakeholders and ensuring the success and diversification of the economy, as well as solving employment problems. The Economist Magazine which met the leader of the Saudi Vision, doubted that the Vision could be successful. It argued that there was a huge difference between plan and practice as there are massive obstacles that need to be solved. The capital markets in Saudi Arabia are weak and have not yet gained the trust of domestic and foreign investors. Moreover, the economic environment and structure of the financial system are suffering from bureaucracy and poor infrastructure.³²⁵

³²³ Ibid.

³²⁴ The World Bank, February 2009, Report on the Observance of Standards and Codes (ROSC), Country Assessment, Kingdom of Saudi Arabia, at 1, 4.

³²⁵ The Economist magazine, 9 Jan 2016, The Saudi blueprint, available at: <http://www.economist.com/news/leaders/21685450-desert-kingdom-striving-dominate-its-region-and-modernise-its-economy-same?cid1=cust/ednew/n/n/n/2016017n/owned/n/n/nwl/n/n/ME/email>, accessed on 18/8/2016.

Developing countries have different circumstances such as basic legal frameworks, corporate ownership model, structure of the financial system, the strength of ties between business interests and government, rule of law, quality of accounting standards and transparency, crony capitalism, the rate of law enforcement and the existence of capital market institutions. It may be difficult to undertake fundamental reform against the interests of main actors, and the government may not have sufficient ability to deal with serious potential threats of privatisation. Therefore, the corporate governance problem in a broader perspective is an equilibrium problem, which prevents financial markets from flourish. However, following the guidelines of developed countries in terms of privatisation may result in counterproductive effects.³²⁶ Hence, despite the claim that the comprehensive privatisation programme will make use of the best international practices, follow a balanced and scientific manner and reform the laws and processes as necessary, the ability to implement it is still a concern. Privatisation in such an environment may be more likely to imitate the Russian or Egyptian models rather than the English one.

These characteristics draw attention to the importance of the internal corporate structure, including the board of directors. This is the central aspect that needs to be considered when reviewing the corporate governance system in Saudi Arabia. This research will try to provide some suggestions to help board of directors in the Saudi context to deal with the deficiencies in the political, legal and economic environment and the lack of oversight institutions as well as to protect the interests of all parties in a company. The upcoming chapters will discuss the rules that need to be added to corporate governance regulations in Saudi Arabia to meet the requirements and conditions of good corporate governance practices. Therefore, the research will discuss the composition of the board of directors that is most appropriate to the Saudi economic environment and the main actors so that the board of directors can build an efficient relationship with them in line with Saudi conditions.

³²⁶ Erik Berglöf, E., and Thadden, E., (1999). *The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries*, at 17,18 and 26.

3.4 Conclusion

This chapter highlighted the unique environment in Saudi Arabia in terms of the political, legal and judicial aspects, as well as the structure of the Saudi economy and listed companies. This environment has some anomalous characteristics which create challenges in corporate governance that significantly influence the roles and relationships of the board of directors in listed companies. The chapter discussed the key environmental factors that affected corporate governance in Saudi Arabia. These can be summarised in the following points:

- The state apparatus broadly consists of judicial, executive and regulatory authorities but there is no separation between them in Saudi Arabia; they are all controlled by the Council of Ministers which is presided over by the king. In other words, the king is the final authority for all these bodies. Legislation is issued through royal decree or the decree of the Council of Ministers which is presided over by the king. The listed companies fall under the supervision of the Capital Market Authority which has its own jurisdiction and is not subject to the jurisdiction of commercial courts.
- The competent authority responsible for disputes of listed companies works outside the jurisdiction of the commercial courts. The listed companies in Saudi Arabia are subject to the CMA and the jurisdiction of the Committee for the Resolution of Securities Disputes (CRSD) established by the CMA, which also has the authority to issue regulations and rules. This may create an atmosphere of uncertainty about the credibility of litigation in the Saudi capital market and may have serious negative effects on both the role of the board of directors and attracting foreign investors. The chapter recommended that politicians and Islamic scholars should work together to end all administrative committees that have a judicial jurisdiction in Saudi Arabia.
- The chapter discussed the new Law of Companies published in Saudi Arabia on 4 December 2015 which superseded the 1965 law. This new law provides many different provisions related to corporate governance. It is designed to meet the contemporary needs of the company sector. The new law removes several barriers and restrictions to the growth of the company sector and reduces the costs and the procedures for the establishment of a firm. Moreover, it includes numerous rules

that enhance the good practices of corporate governance. It provides some simplifications to shareholder participation and further protection of their rights. One critical addition in the new law gives the audit committee a stronger position and further independence, in particular over appointing and removing members of such a committee by the AGM. There is also a tendency to expand the power of the board of directors in the new law and remove obstacles that may prevent the board from fulfilling its duties. However, there are also strict sanctions of imprisonment and fines stipulated by the new law which act as a strong warning to the board of directors or any company parties not to breach the provisions of this law or provide false data and so on.

- This chapter described the key features of the new Saudi Corporate Governance Regulation (CGR) introduced in 2017 to respond to the changes in the new Saudi Law of Companies. The new CGR superseded the previous regulation issued in 2006. Numerous provisions have been changed, many shortcomings tackled and copious details provided. This makes the new CGR a quantum leap in corporate governance legislation in Saudi Arabia, which will improve corporate governance practices and contribute towards meeting the standards of good corporate governance. Moreover, unlike the old CGR, the provisions of the new CGR are compulsory for all listed companies, except a small number of guidance articles.
- The structure of the Saudi economy is another factor that creates challenges for the corporate sector. It relies on oil and many petrochemical products that are controlled or run by a limited number of state-owned companies. The public sector and government expenditure has been the main engine for the economy and has dominated most economic activities. Moreover, the ownership and control of Saudi listed companies appears to be highly concentrated in the state and its founding families. The ten biggest companies of the Saudi market represent almost half of the whole Saudi market value. Governmental institutions are among the major shareholders of more than 30% of listed companies.
- The Saudi Vision for 2030 issued in 2016 may have a broad impact on the diversification of the economy, the culture of work and corporate governance practices. Its target is to maximise the role of the private sector in the long-term and increase economic liberalisation. There is a strong trend to create a comprehensive privatisation programme that involves most public agencies and state-owned

companies in order to slash government waste, increase the rate of transparency and counter corruption. This chapter discussed the vision in light of the essential characteristics of the current economy and corporate sector and the current legal and political environment. Concerns have been raised about the ability to move forward in those programmes safely whilst maintaining the rights of shareholders and stakeholders and ensuring the success and diversification of the economy, as well as solving employment problems.

These environmental characteristics draw attention to the importance of the internal corporate structure, including the board of directors. This is the central aspect that needs to be considered when reviewing the corporate governance system in Saudi Arabia. Therefore, the upcoming chapter will discuss the composition of the board of directors that is most appropriate to the Saudi economic environment to meet the requirements and conditions of good corporate governance practices.

Chapter Four

The Composition of the Board of Directors in Saudi Law as Compared to English Law and Global Standards

4.1 Introduction and Definition of ‘Board of Directors’

The board of directors is considered a cornerstone of corporate governance and it is a body that plays a key governance function on behalf of shareholders. It exists because many listed companies have a large number of shareholders who individually do not have ability to monitor and evaluate the executive managers.³²⁷ Furthermore, some shareholders do not have sufficient incentives to meet their expected roles. Therefore, they delegate these roles to a group of elected directors. This method is the most efficient way of observing and evaluating the conduct of executives and of protecting the rights of all parties involved.³²⁸

Generally, any person who occupies the position of director can be called a ‘Director’ even if he or she does not form part of a board of directors.³²⁹ Thus, it is necessary here to clarify exactly what is meant by the board of directors. A short definition is that it is a group of people who are responsible for governing a firm legally.³³⁰ The board of directors may be broadly defined as “a group of people who are elected by a company's shareholders to represent them as a governing body of a corporation, and who meet periodically to monitor the company's management and represent the interests of the shareholders”.³³¹ As such, the board has extensive powers to manage and oversee the company's business. These responsibilities are vested by the articles of association and these allow them to act collectively as a board. It is therefore the board of directors, rather than the members, which has authority to act and transact in the company's name and on its behalf.³³² At the same time, the directors are jointly responsible for the method of administration and they will be held accountable for all damages sustained

³²⁷ Boubaker, S., Nguyen, Bang Dang, Nguyen, Duc Khuong, and SpringerLink. (2012). *Corporate Governance: Recent Developments and New Trends*. Berlin, Heidelberg, at 185.

³²⁸ Ibid.

³²⁹ Section 250 of the Companies Act 2006.

³³⁰ Boubaker, S., Nguyen, Bang Dang, Nguyen, Duc Khuong, and SpringerLink. (2012). *Corporate Governance: Recent Developments and New Trends*. Berlin, Heidelberg, at 160.

³³¹ See “Board of Directors”, Credo Reference. (2007). *Dictionary of accounting [electronic resources]*. (4th ed.). London: A and C Black, available at: <http://www.accountingtools.com/board-of-directors-definition>, accessed on 19/7/2014.

³³² Cane, P., and Conaghan, J. (2008). *The New Oxford Companion to Law*. Oxford: Oxford University Press. available at:

<http://www.oxfordreference.com.ezproxy.lancs.ac.uk/view/10.1093/acref/9780199290543-e-173>, accessed on 19/7/2014.

by the company arising from their misconduct, violation and breach of any provisions of the law or the company's bylaws.³³³

In order to understand the role of the board of directors under corporate governance, this research should consider issues that are more profound than merely the duties of the board of directors. One of the major issues in this context is the composition of the board of directors as this plays a pivotal role in any function carried out by the board of directors thereafter. There is a strong relationship between the role and duties of the board of directors and the issues of board composition, including, the size of the board of directors, the types of membership and the percentage of these types on the board and their qualifications. As well as, the issues of standards required to select the board members and the duration of the membership.

It should be noted that trust in boards of directors has reduced dramatically because of their involvement in the many scandals that have emerged in recent decades. They have been accused of taking poor decisions and neglecting their monitoring responsibilities.³³⁴ Therefore, putting the issues of composition of the board of directors under careful consideration by improving corporate governance legislation becomes an important requirement that needs to be implemented. These rules will allow shareholders to receive superior representation on boards of directors and assist protecting the interests of both shareholders and stakeholders as well as dealing with the diverse interests and conflicts safely.

³³³ Article 78 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

³³⁴ Lückcrath-Rovers, M., and De Bos, A. (2011). Code of Conduct for Non-Executive and Supervisory Directors. *Journal of Business Ethics*, 100(3), at 465.

4.2 Appointing the Board of Directors and its Tenure

4.2.1 Appointing the Board of Directors

According to English law, the board of directors shall be elected on an individual basis,³³⁵ whereas the new Saudi Law of Companies 2015 stipulates that voting in listed companies must be based on an accumulation of votes. Accumulative voting gives shareholders voting rights equivalent to the number of shares they hold, whether they use all of them for one nominee or divide them between several nominees.³³⁶

The new Saudi Law of Companies issued in 2015 brings an end to a confusing issue related to the relationship between the positions of chairman of the board of directors and the managing director. This issue had been mentioned in conflicting articles present in old Saudi laws. The old Saudi Law of Companies clearly states that the chairman of the board of directors is also able to hold the office of managing director.³³⁷ In contrast, the Saudi CGR issued in 2006 prohibits the chairman of the board of directors from holding any executive positions in the company, including that of managing director.³³⁸ Despite this, Saudi legislators made many of the articles in the old CGR compulsory for all listed companies, but not this article. This conflict continued for eight years without any legal revision, which suggests that the Saudi legislature had intended to give boards of directors more executive powers at that time, as long as the company's bylaws specified the duties of these two positions. However, both the new Saudi Law of Companies 2015 and the new Saudi CGR issued in 2017 prohibit holding the position of the chairman of the board of directors in conjunction with any other executive position in the company.³³⁹ The law also emphasises that in all cases, one individual shall not have exclusive powers to make decisions in the company.³⁴⁰

There is a strong view in the UK Code which states that “there should be a clear division of responsibilities at the head of the company between the running of the board and the

³³⁵ Section 160 of the Companies Act 2006.

³³⁶ Article 95/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And article 8/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia. For further details about this issue, see the section of “Adopting Cumulative Voting” in chapter five.

³³⁷ Article 79 of the Law of Companies 1965 in the Kingdom of Saudi Arabia.

³³⁸ Article 12/d of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia

³³⁹ Article 81/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And article 24/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

³⁴⁰ Article 24/d of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision".³⁴¹ This separation between the chairman and chief executive creates a significant benefit for the company as well as giving greater consistency to the real functions of both the chairman and the chief executive. One of the major roles of a chairman is to focus on strategic issues whereas the CEO has responsibility for day-to-day management. In other words, it is a genuine board member role which focuses on issues of 'directing' the business instead of 'managing' the business.³⁴² This does not mean that all other members of the board of directors should not take on the role of CEO. However, many studies argue that firms with appointed CEOs as directors enjoy a positive stock market reaction and are less vulnerable to bankruptcy and they are better able to comply with laws.³⁴³ Nevertheless, both Saudi and British laws determine that the majority of the members of the board of directors should be non-executives.³⁴⁴

There is an important issue which relates to the nature of the membership of the board of directors in England. The Small Business, Enterprise and Employment Act 2015 requires all company directors to be natural persons and prohibits the appointment of legal persons as directors.³⁴⁵ When this provision has come into force it will nullify the provisions of the Companies Act 2006 which requires companies to have at least one director who is a natural person.³⁴⁶

In Saudi law, there are no equivalent sections that deal with this issue, but there are some references to the representation of the legal person. These indicate that there is nothing to prevent a legal person or body corporate from placing a representative on boards. For example, the new CGR defines the term "person" as covering any natural

³⁴¹ Section a/2 of the UK Corporate Governance Code 2016.

³⁴² Cook, J., and Vernon, G. (1998). Building the Board of Directors. *Nature Biotechnology*, 16 Suppl, at 41.

³⁴³ Johnson, S., Schnatterly, K., and Hill, A. (2013). Board Composition Beyond Independence: Social Capital, Human Capital. *Journal of Management*, 39(1), at 241. available at <http://jom.sagepub.com/content/39/1/232>, accessed on 19/7/2014.

³⁴⁴ Article 16/2 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia. See also section b/1.2 of the UK Corporate Governance Code 2016.

³⁴⁵ Section 87 of Small Business, Enterprise and Employment Act 2015. It should be noted here that in September 2016 the UK government indefinitely postponed implementation of the ban to consider permitting exceptions in limited circumstances, as authorized by the statute. As of this writing the government had not yet defined the scope of such exceptions or the situations in which they will be granted. For further details, see Bainbridge, S. (2017). Corporate Directors in the United Kingdom. *UCLA School of Law, Law-Econ Research*, Paper No. 17-04.

³⁴⁶ Sections 155 and 164 of the Companies Act 2006.

or legal person recognised by Saudi law.³⁴⁷ Moreover, the Saudi CGR prevents an independent director from “being a representative of a legal person that holds five percent or more of the issued shares of the company or any of its group”.³⁴⁸ That means a legal person in Saudi law can be represented by any kind of membership except an independent director in the particular case above. However, the minister of commerce in Saudi Arabia issued a resolution to regulate the appointment of a representative of a legal person on the board of directors. This resolution requires a legal person to present forward a natural person permanently with all the personal responsibilities of other directors. Therefore, this representative can be held accountable under both criminal and civil liability for their wrongful acts towards the company and for all damages sustained by the company arising from their misconduct.³⁴⁹

Nevertheless, clear amendments in Saudi law should take place in this regard to avoid the detrimental conduct and opportunistic behaviour that may exploit the inadequate legislation of representation of a legal person. There was nothing to prevent the Saudi legislature from including the rule from the above resolution issued in 1998 in the new CGR issued in February 2017 to combine all requirements in one piece of legislation.

4.2.2 The Tenure of the Board of Directors

The law provides the general framework for the duration of membership to ensure that all directors are submitted for re-election at regular intervals.³⁵⁰ The other detailed provisions for the duration of membership should be stipulated by the articles of association of the company or bylaws according to the particular needs and circumstances of firms.³⁵¹

Saudi law prevents the appointment of directors, including the chairman, the managing director and the secretary as directors for a term that exceeds three years even if the

³⁴⁷ Article 1 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

³⁴⁸ Ibid, article 20/c- 2.

³⁴⁹ See the resolution number (423) of Minister of Commerce in Saudi Arabia, dated 7/1/1998. See also AI-Jabre, M. (1996). *The Saudi Commercial Law* (5th ed.). Riyadh: King Fahd National Library, at 333-334.

³⁵⁰ Section b/7 of the UK Corporate Governance Code 2016.

³⁵¹ Article 68/3 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And article 17 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

company constitution provides otherwise. Nevertheless, directors will always be eligible for re-appointment, provided that does not conflict with the company bylaws.³⁵²

The UK Corporate Governance Code deals with this issue from much wider perspective than Saudi CGR, it considers the different circumstances of firms and classifies the duration of membership for the re-election by shareholders into **three** levels:

- The annual re-election for three kinds of membership: first, all directors at the first annual general meeting after their appointment; second, the directors of FTSE 350 companies; third, non-executive directors who have served longer than nine years.³⁵³ All those kinds should be subject to annual election by shareholders.
- Intervals that do not exceed three years for re-election of all directors of non-FTSE 350 companies.³⁵⁴
- The six-year review: a rigorous review for a non-executive director holding term beyond six years.³⁵⁵

It has long been known that shareholders also have a right to remove all or some of the board of directors' members at any time even if the company's constitution provide otherwise. In a similar manner, Saudi laws and those of England have provided rigorous articles about this issue to demonstrate this power of shareholders in their meetings.³⁵⁶

The above-mentioned measures and rules of accumulative voting, the board of directors consisting of a majority of non-executive members, the separation of function of the chairman of the board of directors and the managing director and finally the provisions for the tenure of the board of directors, will work side by side to prevent the board of directors from becoming a circle of familiar associates, but, instead, a decision-making group that adds real value. Moreover, these will qualify the board of directors' members

³⁵² Ibid.

³⁵³ Section b/7.1 of the UK Corporate Governance Code 2016.

³⁵⁴ Ibid.

³⁵⁵ Ibid, section b/2.3.

³⁵⁶ Article 68/3 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And section 168 of the Companies Act 2006.

to offer constructive criticism and protect the interests of shareholders and other stakeholders.³⁵⁷

³⁵⁷ Cook, J., and Vernon, G. (1998). Building the Board of Directors. *Nature Biotechnology*, 16 Suppl, at 41.

4.3 The Structure of the Board of Directors

It is important to bear in mind that the structure of the board of directors significantly depends on the system of corporate governance adopted. There are several systems of corporate governance and these have been formed in different legal and economic environments. According to Shleifer et al,³⁵⁸ the best corporate governance systems in the world are the Anglo-Saxon model in the United States and the United Kingdom and the models that have been adopted by Germany and Japan. Some researchers have outlined the differences between these corporate governance models. They argue that the Anglo-Saxon model has three main features; it is market-oriented, outsider-dominated and shareholder-focused. In contrast, in the German model there is a bank-oriented trend which gives banks the dominant role in a complex system of cross-shareholding and company financing; an insider-dominated culture which is production-oriented and has a company-centred management system; and also, there is a stakeholder-focused culture.³⁵⁹

Taking above characteristics into account, it can be argued that it is very important to consider the role of an internal corporate structure as the cornerstone that needs to be considered when reviewing any corporate governance system, especially in developing countries.

4.3.1 The Types of Boards of Directors

A board of directors is the most important internal corporate institution for coordinating the interactions within company boundaries, for regulating the relationships between the different constituencies and for enacting corporate bylaws. Moreover, it plays other

³⁵⁸ Shleifer, A., and Vishny, R. (1997). A Survey of Corporate Governance. *Journal of Finance*, 52(2), at 737.

³⁵⁹ Weil, G., and Manges, L. (2002). *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States*, European Commission, Final report and Annexes, Weil, Gotshal and Manges, at 23-34. See also Rupp, J., and Jürgens, U. (2002). The German System of Corporate Governance: Characteristics and Changes. *FS II*, at 2.

roles such as creating strategies, delegating responsibilities and monitoring fulfilment in order to safeguard the interests of different stakeholders.

The traditional models of the board of directors which are most common are the one-tier system which derives from the Anglo-American tradition and the two-tier system which owes its basic structure to the German culture.³⁶⁰ The structure of a corporation's board of governance is one of the major differences between American and German business models. This research aims to highlight these two types of board of directors and attempts to identify their supreme principles and characteristics. This will help in reforming the laws of the board of directors in corporate governance in Saudi law.

4.3.1.1 The Unitary Board

The one-tier board system which has been adopted by most western economies, including the United States and the UK, has also been selected by Saudi legislators. In this type of board, both executive directors who manage the business of the corporation and non-executive directors who indirectly oversee management work together on the same board.³⁶¹ This combination of the monitoring and the managing bodies of the corporation is one of the most important features of the unitary model of governance.³⁶²

In the unitary model of corporate governance, the board of directors, which manages the corporation, is appointed at the shareholders' meeting. The board of directors then selects some of its members to work with the Audit committee to perform the monitoring function.³⁶³ The shareholders in this model have more power in the final decision on the composition of the controlling body and the members who sit on

³⁶⁰ Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 1.

³⁶¹ Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 237.

³⁶² Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 16.

³⁶³ Ibid.

management bodies. Furthermore, through the shareholders' meeting, shareholders have the power to remove all or some members of the board of directors at any time.³⁶⁴

Taking into account the difference between the US and the UK systems as discussed earlier, the unitary system of corporate governance in the US and in the UK depends on the dispersed ownership of companies which puts shareholders in the dominant position in relation to other stakeholders, such as creditors, employees, suppliers and the wider community, who may be able to protect their rights through contractual agreements or external entities. The priority of companies that belong to this system of corporate governance is to maximise the profits for their investors.

The Saudi legislators have dealt with the board of directors through the one-tier model and they have not provided any text for using any alternative models. The Saudi Law of Companies makes it compulsory for joint stock companies to form a board of directors that consists of at least three members and not exceeding eleven members.³⁶⁵ The law gives such a unitary board of directors the full powers and joint and ultimate responsibilities in the administration of the company.³⁶⁶

4.3.1.2 The Two-Tier Board

The two-tier model of governance has a supervisory board and another board of management that create more separation between ownership and control.³⁶⁷ The upper tier of the supervisory board is directly appointed by the shareholders' meeting. Subsequently, this supervisory board appoints a lower tier of management and is also able to remove them at any time.³⁶⁸ However, the supervisory board cannot become directly involved in managing the company as it excludes all executives.³⁶⁹ Thus, the

³⁶⁴ Ibid, at 16-17.

³⁶⁵ Article 68/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And article 17/a of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

³⁶⁶ Article 75/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And article 22 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

³⁶⁷ Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 9.

³⁶⁸ Ibid, at 13.

³⁶⁹ Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 237.

main role of the supervisory board is to monitor the management board of executives which has a wide authority, even in major transactions of the corporation excepting some specific transactions which have been subject to the approval of the supervisory board.³⁷⁰ It could be said that this monitoring function is somewhat similar to what is implemented by the Audit committee in the one-tier model.³⁷¹

It should be noted that, in the two-tier model, some of the powers and duties of the shareholders' meeting are transferred to the supervisory board. For example, this board can approve the balance sheet which is unknown to the Audit committee in the unitary model.³⁷² In other words, the two-tier model gives the shareholders' meeting a limited power that can be divided into two main roles: amending the bylaws, and appointing and removing the members of the supervisory board.³⁷³ Some researchers consider this limited function of the shareholders' meeting to be a beneficial characteristic, especially for firms that have widely distributed shares. They argue that this situation maximises the interests of minority shareholders who are represented by the supervisory board and gives them better service than what they may receive from their vote at a shareholders' meeting.³⁷⁴

Germany is considered one of the most notable countries to have adopted the two-tier model³⁷⁵, also having been adopted by many other European countries and Japan.³⁷⁶ This model is most prevalent where corporate governance rules explicitly maximise the value of stakeholders and support labour participation on the board of directors.³⁷⁷

³⁷⁰ Hopt, K., and Leyens, P. (2004). Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy. *European Company and Financial Law Review*, 1(2), at 141.

³⁷¹ Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 19.

³⁷² Ibid.

³⁷³ Ibid, at 20,21.

³⁷⁴ Aste, L. (1999). Reforming French Corporate Governance: A Return to the Two-tiered Board? *George Washington Journal of International Law and Economics*, 32(1), at 50-51. And Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 21.

³⁷⁵ Glau, T. (2009). Lessons From Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 237.

³⁷⁶ Goergen, M., Manjon, M., and Renneboog, C. (2008). Is the German System of Corporate Governance Converging Towards the Anglo-American model?. *Journal of Management and Governance*, 12(1), at 38.

³⁷⁷ Ibid.

However, despite both shareholders and employees being represented on the German supervisory board, it is frequently common that representatives of large shareholders dominate the supervisory board.³⁷⁸

Both Aste and Glau identified several factors that make the two-tier model highly advantageous. First, the structure of responsibilities is explicitly evident. This separated structure and its associated efficiencies allow for further independent supervision of the management. It also has a clearer scope of duties and better application than a unitary model and this helps to control the problem of conflicts of interest. Second, due to the two boards, the decision-making is quicker and has a more procedural efficiency, such as enabling private meetings to be held for various matters. Third, the two-tier system creates an environment conducive to diversity and open discourse among directors and explores the potential candidates of directors in lower tier to transfer to the upper tier. Finally, the two-tier board attracts more investors, principally foreigners, who are generally more confident about two-tier boards as they have a better chance of checking corporate management.³⁷⁹

However, there are some disadvantages that appear to be the major causes of the limitation of the spread of two-tier boards. These shortcomings can be summarised in the following points:

“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. Too rigid. The structurally restrictive nature of the two-tier board. Increased costs. Compensating additional directors and the time costs generated from regular meetings, which must be scheduled and rescheduled, between directorate and supervisory board members.”³⁸⁰

Moreover, other disadvantages may arise through a potential power imbalance between the two levels of boards. Whether when the supervisory board exercises too much power over the directorate or if the supervisory board is dominated by the directorate,

³⁷⁸ Ibid, at 50.

³⁷⁹ Aste, L. (1999). Reforming French Corporate Governance: A Return to the Two-tiered Board? *George Washington Journal of International Law and Economics*, 32(1), at 32. And see Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 237,238,246.

³⁸⁰ Aste, L. (1999). Reforming French Corporate Governance: A Return to the Two-tiered Board?. *George Washington Journal of International Law and Economics*, 32(1), at 36.

which is familiar problems in the German two-tier model.³⁸¹ Exploiting minority shareholders is another significant shortcoming that is more visible in the two tier model where a robust of separation between ownership and control. This situation may create an opportunity to limit the expression of shareholders' voice at approving of the balance sheet.³⁸²

In addition, the exclusion of the supervisory board from management may cause a lack of direct information which they need to develop an objective picture of the company's performance. This is especially the case when the legal environment and circumstances of the firm prevent them from obtaining information in other ways, such as regular meetings with employees, corporate auditors, customers, government auditors, suppliers and creditors.³⁸³

4.3.1.3 Types of Boards of Directors in View of the Saudi Context

There is no need to search for the best foreign system for the board of directors to be imitated without taking into account the problems and negative aspects ensuing from the local setting, that need to be changed. Corporate governance systems in most countries, whether developed or developing, need to continually revise the mechanisms for the legal protection of investors.³⁸⁴ Therefore, the principal practical issue in this context is not whether to emulate the United States, Germany, or Japan, but rather to find significant legal protection so that mechanisms of corporate governance systems can develop.³⁸⁵

³⁸¹ Ibid, at 37-38.

³⁸² Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 19.

³⁸³ Hopt, K., and Leyens, P. (2004). Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy. *European Company and Financial Law Review*, 1(2), at 147. And see Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 240.

³⁸⁴ Shleifer, A., and Vishny, R. (1997). A Survey of Corporate Governance. *Journal of Finance*, 52(2), at 739.

³⁸⁵ Ibid.

It is difficult to say which model of the board of directors is better because both are based on strong principles and have beneficial characteristics. On the other hand, they also have various disadvantages that need to be avoided. However, adopting the two-tier board model will be a significant step toward controlling the conflicts of interest and introducing a truly independent supervisory board.³⁸⁶ In contrast, adoption of the one-tier board structure will be a significant step toward a genuine combination of the managing and monitoring functions in the board of directors, where the controlling and the managerial functions coincide.³⁸⁷

It should be noted that corporate governance is based on two types of mechanisms: the first one is internal to the company and it seeks to give shareholders some level of ability to influence the board of directors; the second one is external to the company, it exists in the regulatory environment and it depends on state agencies for the detection of corruption.³⁸⁸ It should be recalled that the success or failure of corporate reform may depend greatly on the political and economic climate as a result of the close connection between politics and corporate governance. For example, the failure of the two-tier board, which happened in the French business community in the 1960s, was not because it was a flawed structure but rather because it was introduced at a difficult time in French political and economic history. By 1966, the business community was strongly dominated by the French government and it had adopted a policy of nationalisation. Therefore, it formed many state-owned companies as well as exercising indirect control over many private companies and business executives who showed allegiance to the government. This contrasts with the great success of the developed German two-tier board where the German government curbed the state control over big businesses early.³⁸⁹

In chapter three, the research discussed the limited role of the company sector in the Saudi economy, which relies on oil exportation, and where the government owns a high

³⁸⁶ Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 237- 338.

³⁸⁷ Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 23.

³⁸⁸ Pettet, B., Lowry, J., and Reisberg, A. (2009). *Pettet's Company Law; Company and Capital Markets Law* (3rd ed.). New York: Pearson Longman, at 137.

³⁸⁹ Aste, L. (1999). Reforming French Corporate Governance: A Return to the Two-tiered board?. *George Washington Journal of International Law and Economics*, 32(1), at 39-40.

percentage of the majority of blue chip companies listed on the market. Moreover, the majority of the labour force in Saudi Arabia works in the government sector. Consequently, the government supports and drives companies to achieve the national development goals and accommodate of the national workforce as much as possible. Therefore, the government is looking forward to the corporate sector contribution in this issue. Moreover, the chapter discussed the political and legal environment in Saudi Arabia as a developing country, and the lack of democratic principles that successful corporate governance depends on.

It can be said that the adoption of the two-tier board structure in the Saudi context may seem more beneficial than the one-tier structure as it best represents minority shareholders and is able to cover the deficit of the general assembly, which already transfers some of its powers to the supervisory board. Therefore, this model maximises the role of the board of directors which becomes better able to exercise many activities towards achieving the targets of corporate governance. This model is extremely beneficial in developing countries where there is a not a well-established legal environment and a scarcity of supervision, as well as many obstacles preventing the shareholders association from playing their role. Furthermore, the two-tier model protects the interests of stakeholders more, particularly employees who receive further support from the Saudi government.

The two-tier board structure could be more suitable to the Saudi context, but this does not necessarily mean that it is the only way to reform corporate governance in Saudi Arabia. Both models of board structure should be revised and improved. The two-tier model, for instance, still needs some measures to improve its structure from a corporate governance perspective, which could be done by:

“More clearly defining the responsibilities of supervisory board members. Restricting the number of boards on which a supervisory board member may sit. Requiring supervisory board members to hold a minimum number of shares. Formally soliciting director nominations from shareholders. Encouraging board meetings to be held by video conference. These alternatives are based on a related set of underlying principles: limiting the power of the executive directors and increasing the power of the supervisory board”.³⁹⁰

³⁹⁰ Aste, L. (1999). Reforming French Corporate Governance: A Return to the Two-tiered Board?. *George Washington Journal of International Law and Economics*, 32(1), at 53.

However, the majority of these measures already existed in the Saudi laws of corporate governance, which has adopted the one-tier system. And the research will deal with all of these measures in its sites in coming topics.

This research aims to study the principles and characteristics, whether in the one-tier or the two-tier model, along with the local circumstances and the legal environment. An attempt will then be made to determine which principles are more suitable for the Saudi context and which would make it easier to achieve the targets of corporate governance in Saudi Arabia. These steps are very important in order to improve the corporate governance law, according to the real needs and may guarantee a greater chance of quality of implementation.

One of the superior principles that can be derived from the two-tier model is the robust system of checks and balances which creates an effective deterrent against abuse of power, even if it increases the authority of auditing. The effective implementation of this principle is better in the two-tier system where there is a separation between managerial and monitoring functions.³⁹¹ Nevertheless, this feature of a balance of power is not exclusive to the two-tier model. It is also possible to detect within the structure of the one-tier system, where members of the board of directors are allocated to sit on the Audit committee, especially with the continually assessed on the system of checks and balances.³⁹²

The Saudi law takes into account this principle as it makes it compulsory for listed companies to take the majority of the members of the board of directors' members from non-executive positions.³⁹³ Moreover, it requires the board of directors to set up a committee using non-executive board members called the 'Audit Committee'³⁹⁴ along with the 'Nomination and Remuneration Committee'³⁹⁵ and clarifies all of their powers

³⁹¹ Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 242.

³⁹² Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 23. And see Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 241.

³⁹³ Article 16/2 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

³⁹⁴ Article 101 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

³⁹⁵ Article 51/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

and tasks. These two committees carry out, to a limited extent, a similar task to the supervisory board in the two-tier system.³⁹⁶

There are useful rules and concepts of corporate governance in the German two-tier system that can help to reform corporate governance in Saudi Arabia. One of the best such practices is giving employees a role in corporate governance which enhances the employees' participation in decision-making without negative impact on shareholder influence.³⁹⁷

On the other hand, the most interesting principle of the unitary system is the integration of the managing and monitoring functions in one board of directors.³⁹⁸ The members of the Audit committee in one-tier models are playing another role in the process of decision-making as they also belong to the boards of directors. This situation helps to harmonise the functions of managing and monitoring,³⁹⁹ as well as to create opportunities for self-dealing.⁴⁰⁰ However, it is difficult to deny that the two-tier system also performs similar functions to a certain extent.⁴⁰¹

On the whole, it is recommended that Saudi law should be more flexible in allowing the adoption of both models of the board of directors in order to give firms an opportunity to select which one is more suitable for their needs and circumstances. This flexibility is already existed in several countries, such as Italy⁴⁰² and France, where the law offers companies the option to choose the traditional model of the unitary board or the alternative board structure of the two-tier board.⁴⁰³

³⁹⁶ Ibid, part 4 articles 50 – 72.

³⁹⁷ Weil, G., and Manges, L. (2002). *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States*, European Commission, Final report and Annexes, Weil, Gotshal and Manges, at 34.

³⁹⁸ Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 19.

³⁹⁹ Ibid, at 23-24.

⁴⁰⁰ Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 237-338.

⁴⁰¹ Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 19.

⁴⁰² Ibid, at 4.

⁴⁰³ Aste, L. (1999). Reforming French Corporate Governance: A Return to the Two-tiered Board?. *George Washington Journal of International Law and Economics*, 32(1), at 6.

It is difficult to ignore the fact that the adoption of the two-tier model is considered as a typical solution for numerous specific cases. These can be summed up below:

- The two-tier board is an effective tool of governance for state-owned firms.⁴⁰⁴ Accordingly, public servants are allowed to be members of the supervisory board, and it facilitates the political functions of monitoring and managing.⁴⁰⁵
- It is extremely beneficial for family companies, especially in cases of succession between two generations.⁴⁰⁶
- The two-tier model can play a major role in facilitating privatisation in order to transfer the control from the state to the private sector.⁴⁰⁷
- The two-tier board could help large multinational corporations to make quick decisions.⁴⁰⁸ Moreover, large international companies prefer to make the two-tier board compulsory for their branches subsidiaries, because they often want to exercise more formal control over them.⁴⁰⁹ Otherwise, it could be said that it may help branches to be independent and to liberate them from their parent company.⁴¹⁰
- Adopting the two-tier board in a merger between two companies may guarantee satisfaction for both parties. It will be able to give each one a leadership position, either the head of the directorate or the head of the supervisory board.⁴¹¹

⁴⁰⁴ Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review*, 5(1), at 35.

⁴⁰⁵ Ibid, at 35-36.

⁴⁰⁶ Ibid, at 44.

⁴⁰⁷ Aste, L. (1999). Reforming French Corporate Governance: A Return to the Two-tiered Board?. *George Washington Journal of International Law and Economics*, 32(1), at 70.

⁴⁰⁸ Ibid, at 32.

⁴⁰⁹ Ibid, at 47.

⁴¹⁰ Ibid, at 47.

⁴¹¹ Ibid, at 46.

4.3.2 The Size of the Board of Directors

Both the Saudi and English company laws require listed companies to be administered by multiple directors: no less than three directors under Saudi law,⁴¹² and no less than two under English law.⁴¹³ From the point of view of decision-making, which is based on voting, determining the minimum number of board members at three or any odd number makes more sense than two. The Law of Companies in Saudi Arabia obliges a company to specify the number of directors in its bylaws.⁴¹⁴ Moreover, if a position on the board becomes vacant, the board of directors can appoint a replacement director from the top of the list of candidates provided that 5 days' notice is given to the Ministry of Commerce and the CMA for listed companies, as well as adding such appointments to the schedule for the next AGM, unless the company constitution states otherwise.⁴¹⁵ However, if the number of directors falls below the minimum prescribed in the law or in the company's bylaws, the remaining directors must convene an AGM within 60 days.⁴¹⁶

The Saudi law prevents companies from appointing more than eleven directors.⁴¹⁷ However, the data show that in practice the average size of a board of a listed company in Saudi Arabia is 8.2 members.⁴¹⁸ In England, the Corporate Governance Code provides more flexibility. It gives companies the freedom to have a board size which is suitable for the requirements of their business provided that it is not so large as to be unwieldy.⁴¹⁹

There is an inaccurate conventional wisdom, that smaller boards are always better boards.⁴²⁰ In fact, larger boards are very suitable for many types of firms; for instance, those that have diversified functions or depend on debt financing or rely on specific knowledge. These types of companies should adopt a higher fraction of insiders and

⁴¹² Article 68/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁴¹³ Ibid. And section 154 and 160(1) of the Companies Act 2006.

⁴¹⁴ Article 68/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁴¹⁵ Article 70/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁴¹⁶ Ibid, 70/2.

⁴¹⁷ Article 68/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁴¹⁸ See the Capital Market Authority in Saudi Arabia, Annual Report 2016, at p. 83.

⁴¹⁹ Section b/1 of the UK Corporate Governance Code 2016.

⁴²⁰ Coles, D., and Naveen. (2008). Boards: Does One Size Fit All?. *Journal of Financial Economics*, 87(2), at 330.

outsiders on their boards which meet their greater advising requirements by bringing more representatives on the board who provide advice and expertise.⁴²¹ A large board contributes to maximising firm value as it is more qualified to collect specialists from various functional fields.⁴²² Moreover, the board size is positively correlated with a firm's size. Therefore, large firms require more directors on the board.⁴²³

On the contrary, Guest⁴²⁴ sets out some negative aspects of a large board. In terms of communication and coordination issues, there is a greater difficulty in arranging board meetings because there are a larger number of directors. This also impacts on reaching a consensus which has a negative effect on decision-making. Furthermore, many weaknesses appear in a board's cohesion, such as the board being undermined and an ambiguity of purpose. The 'director free-riding' problem is another disadvantage that results from diffusing the responsibility of monitoring and diluting personal responsibility.⁴²⁵ This situation gives managers on large boards a greater opportunity to dominate the boards and reduce the monitoring efficiency of the board of directors to become merely symbolic.⁴²⁶

Nevertheless, smaller boards can be more cohesive, more productive, and create a perfect environment for monitoring.⁴²⁷ Moreover, a small board encourages each member to take personal responsibility for monitoring, whether that is management activity or financial statements.⁴²⁸ These advantages drive some studies to identify the optimal board size as less than 10 members.⁴²⁹

However, there are several overlapping factors that impact the size of the board of directors not only with regard to firm specific characteristics but also country

⁴²¹ Ibid.

⁴²² Maria, S., and Alves, G. (2011). The Effect of the Board Structure on Earnings Management: Evidence from Portugal. *Journal of Financial Reporting and Accounting*, 9(2), at 145.

⁴²³ Coles, D., and Naveen. (2008). Boards: Does One Size Fit All?. *Journal of Financial Economics*, 87(2), at 340.

⁴²⁴ Guest, P. (2009). The Impact of Board Size on Firm Performance: Evidence from the UK. *The European Journal of Finance*, 15(4), at 387.

⁴²⁵ Maria, S., and Alves, G. (2011). The Effect of the Board Structure on Earnings Management: Evidence from Portugal. *Journal of Financial Reporting and Accounting*, 9(2), at 146.

⁴²⁶ Ibid, at 145.

⁴²⁷ Coles, D., and Naveen. (2008). Boards: Does One Size Fit All?. *Journal of Financial Economics*, 87(2), at 331.

⁴²⁸ Maria, S., and Alves, G. (2011). The Effect of the Board Structure on Earnings Management: Evidence from Portugal. *Journal of Financial Reporting and Accounting*, 9(2), at 146.

⁴²⁹ Guest, P. (2009). The Impact of Board Size on Firm Performance: Evidence from the UK. *The European Journal of Finance*, 15(4), at 401.

circumstances. The legal environment and nature of the institution sometimes require a particular role and function of a board.⁴³⁰ Moreover, the size of the company and the presence of growth opportunities, the firm's age and ownership structures, the diversification of company scope, and complexity of a firm's operations are greatly impact on the board size.⁴³¹ In addition, the majority of company boards are tailored to their unique competitive environment and process. Therefore, restricting board size is unlikely to enhance their value.⁴³²

It is worth noting that any regulatory framework that applies to all companies with very different needs and subjects them to uniform requirements on board structure could be imperfect and lead to redundant and costly monitoring.⁴³³ The strong relationship between board structure and firm characteristics and environmental conditions should mean that each firm is given a choice to select its board size independently.⁴³⁴

⁴³⁰ Ibid, at 389.

⁴³¹ Yermack, D. (1996). Higher Market Valuation of Companies with a Small Board of Directors. *Journal of Financial Economics*, 40(2), at 210. And see Boone, A., Field, L., Karpoff, J., and Raheja, C. (2007). The Determinants of Corporate Board Size and Composition: An Empirical Analysis. *Journal of Financial Economics*, 85(1), at 76.

⁴³² Boone, A., Field, L., Karpoff, J., and Raheja, C. (2007). The Determinants of Corporate Board Size and Composition: An Empirical Analysis. *Journal of Financial Economics*, 85(1), at 91.

⁴³³ Linck, J., Netter, J., and Yang, T. (2008). The Determinants of Board Structure. *Journal of Financial Economics*, 87(2), at 327.

⁴³⁴ Vafeas, N., and Theodorou, E. (1998). The Relationship Between Board Structure and Firm Performance in the UK. *The British Accounting Review*, 30(4), at 403.

4.4 Membership of the Board of Directors

4.4.1 Diversity of the Board Membership

Depending on affiliations and transactions, directors can be classified into **three** groups:⁴³⁵ First, the executive directors, such as firm officers; Second, the affiliated non-executive directors who are not full-time employees of the firm but are associated with it in some way, including senior investors in the firm or those providing services to it; Third, the independent non-executive directors who are business executives, academics, and leading experts from the private or public sectors with some specific conditions about their association with the firm. However, all directors have the same powers in the board of directors whatever category they occupy. This applies to management decisions and whether or not they belong to the executive directors who are involved in the running of the day-to-day business of the company.⁴³⁶

According to the last published report of the CMA in Saudi Arabia, the percentage of independent members' seats in listed companies' boards of directors is 50.1%; also, the executive members represent 40.1% of total seats in the boards of directors of listed companies. Hence, both non-executive and independent members accounted for almost 90.3% of total seats in the boards of directors of listed companies in 2016.⁴³⁷

Saudi law obliges firms to clarify in the annual report of the board of directors the structure of the board of directors and classify their membership into three levels: executive board member, non-executive board member and independent board member.⁴³⁸ In a similar manner, the UK Code expressed reservations over a board's decision-taking being dominated by individuals or small groups of individuals. Thus, a board of directors should consist of an appropriate combination of executive and non-executive directors, including independents.⁴³⁹

⁴³⁵ Byrd, J., and Hickman, K. (1992). Do Outside Directors Monitor Managers?: Evidence From Tender Offer Bids. *Journal of Financial Economics*, 32(2), at 199.

⁴³⁶ Hopt, K., and Leyens, P. (2004). Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy. *European Company and Financial Law Review*, 1(2), at 150.

⁴³⁷ See the Capital Market Authority in Saudi Arabia, Annual Report 2016, at p. 83.

⁴³⁸ Article 90/4 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴³⁹ Section b/1 of the UK Corporate Governance Code 2016.

Both regulations in England and those in Saudi require that the nomination of board members be subjected to objective criteria which guarantee the appropriate balance of capabilities required such as skills, experience, independence and knowledge of the company. This variety of experiences and positions of the boards' members and its committees allow effective discharging of board duties and responsibilities.⁴⁴⁰ A growing tendency towards putting more standards to selection of membership of the board of directors can be observed in corporate governance provisions as they play a pivotal role in companies' activities. These conditions are assumed to have an important impact on achieving the goals of corporate governance, especially in the environments that face a lack of monitoring institutions for board of directors.

The regulations in Saudi Arabia and England not only provides some of the required standards and conditions of membership for the board of directors but also obliges the board of directors to lay down approved policies and standards by the General Assembly and specify this issue explicitly. The board of directors should allocate a particular committee to hold this nomination and pursuit functions to implement them.⁴⁴¹ To emphasise this important matter, the UK Code requires those approved standards and conditions to be included in the annual report in a separate section,⁴⁴² as well as being available for inspection by any person at the company's registered office during normal business hours and at the Annual General Meeting.⁴⁴³

4.4.2 The General Conditions of the Board Membership

One of the main powers of the Nomination Committee is to suggest clear policies and standards for membership of the board of directors and prepare a description of the capabilities and qualifications required,⁴⁴⁴ as well as the other common conditions

⁴⁴⁰ Section b and b/2 of the UK Corporate Governance Code 2016. And article 18 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁴¹ Articles 22/3, 13 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁴² Section b/2.4 of the UK Corporate Governance Code 2016.

⁴⁴³ Ibid, section b/3.2.

⁴⁴⁴ Article 65 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

related to the personal details of board members, such as age and whether or not they have previous criminal convictions etc.⁴⁴⁵

The new Saudi CGR, unlike the old one, stipulates some details about the conditions of professional competence, experience, knowledge and skill that should be met by every individual to be eligible to sit on a board of directors in a listed company. It requires the company's policy to consider **five** points in particular to ensure the board's duties are efficiently discharged and to apply best practices:

- 1- Ability and skills of leadership.
- 2- Competence, academic qualifications, and proper professional and personal skills especially in businesses, management, economics, accounting and law or governance.
- 3- Ability to guide and strategic and long-term planning as well as understanding technical requirements related to the job.
- 4- Ability and knowledge of finance.
- 5- Physical fitness.⁴⁴⁶

It should be noted that the Saudi Law prevents a member of the board of directors from being a board member of more than five joint stock companies at the same time.⁴⁴⁷ By contrast, the UK Corporate Governance Code differentiates between executive and non-executive members. It prevents a full-time executive director from taking more than one non-executive directorship in a FTSE 100 company or the chairmanship of such a company.⁴⁴⁸ Whilst it limits non-executive directors by setting out the expected time commitment in the letter of appointment, which should be sufficient to meet what is expected of them.⁴⁴⁹ These logical differences between executive and non-executive and between small and large companies need to be considered by Saudi legislators.

⁴⁴⁵ Section b of the UK Corporate Governance Code 2016. And article 65/2 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁴⁶ Ibid, article 18.

⁴⁴⁷ Article 17/c of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁴⁸ Section b/3.3 of the UK Corporate Governance Code 2016.

⁴⁴⁹ Ibid, section b/3.2.

The principles of corporate governance tend to place limits on the number of multiple directorships to avoid the problems of directors becoming too busy and overstretched. In such cases, directors would be unable to get involved effectively with many board appointments because they would be unable to discharge their monitoring duties. There is an inverse relationship between too many multiple directorships and firm value as well as the fact that it increases agency costs.⁴⁵⁰ Limited participation in directorships may provide an additional value to a firm. It prompts CEO outside directors to select strategically the best board seats offered by many firms for them. They are keen to take a place in mature firms that have a favourable trade-off between total expected compensation and workload, and also have the same policies and practices of their own firm to use their experience and protect their reputations.⁴⁵¹

There are, however, many advantages in multiple directorships whether for individuals or companies. This participation enhances the boards as they receive the individual benefits from executive experience from elsewhere and gain a broader perspective and develop skills and attributes that are relevant. This encourages the sharing and dissemination of best practice.⁴⁵² The appointment of a CEO as an outside director enables the firm to take advantage of their status and reputation to certify the firms and their appointment and management.⁴⁵³ Therefore, some researchers argue that “the stock market reacts more favourably to the appointment of a CEO outside director than to the appointment of a non-CEO outside director when the firm has no outside CEO on its board”.⁴⁵⁴

On a different note, the new Saudi Law of Companies 2015 abolishes a controversial condition stipulated in the old Law of Companies for all directors whatever the type of directorship they are occupied. The old law required each member of the board of directors to own a number of shares whose value is not less than 10,000 Saudi riyals

⁴⁵⁰ Jiraporn, P., Kim, Y., and Davidson, W. (2008). Multiple Directorships and Corporate Diversification. *Journal of Empirical Finance*, 15(3), at 433.

⁴⁵¹ Fahlenbrach, R., Low, A., and Stulz, R. (2010). Why do Firms Appoint CEOs as Outside Directors?. *Journal of Financial Economics*, 97(1), at 30.

⁴⁵² Higgs, D. (2003). Review of the Role and Effectiveness of Non-Executive Directors. The Department of Trade and Industry, sections 10, 26.

⁴⁵³ Fahlenbrach, R., Low, A., and Stulz, R. (2010). Why do Firms Appoint CEOs as Outside Directors?. *Journal of Financial Economics*, 97(1), at 30.

⁴⁵⁴ Ibid.

and this remains non-negotiable even after the removal of membership until the lapse of the period specified for hearing the action in liability.⁴⁵⁵

It could be said that Saudi legislators at that time, to some extent, had sought to involve directors in the company's share ownership to guarantee further protection to shareholder interests. There is a different perspective in the English context as there is no requirement for any shares to be held by a member of the board of directors. Instead, the UK Corporate Governance Code prevents an independent director from owning any shares or having any material business relationship with the company.⁴⁵⁶ This also includes the remunerations for non-executive directors which should not include any shares. However, "if, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board".⁴⁵⁷ In this exceptional case, the non-executive director who owns these approved shares is not considered an independent director. Nevertheless, it could be said that executive directors have the right to the enjoyment of those business relationships according to English context.

There are several conflicting studies which either support or oppose the ownership of shares by board members. A study in favour of this practice is that by Gao and Song⁴⁵⁸ which finds that the separation of ownership and management does not always work well in joint stock companies. Their empirical analyses by different models find a positive relationship between the proportion of shares held by top management and firm performance and profitability, whether those shares are owned by managerial personnel, board directors or supervisors. It also reflects the convergence of interests between managers and shareholders.⁴⁵⁹ However, meeting highly effective performance from using stock options as incentives is dependent on a variety of

⁴⁵⁵ Article 68 of the Law of Companies 1965 in the Kingdom of Saudi Arabia.

⁴⁵⁶ Section b/1.1 of the UK Corporate Governance Code 2016.

⁴⁵⁷ Ibid, section d/1.3.

⁴⁵⁸ Gao, L., and Song, S. (2008). Management Ownership and Firm Performance; Empirical Evidence from the Panel Data of Chinese Listed Firms Between 2000 and 2004. *Frontiers of Business Research in China*, 2(3), at 373,382.

⁴⁵⁹ Weisbach, M. (1988). Outside Directors and CEO Turnover. *Journal of Financial Economics*, 20(1-2), at 434.

standards, such as the proportion held and their market value, and the extent that firm shares are owned by the state.⁴⁶⁰

On the other hand, some negative impacts might arise from board ownership in terms of disclosure and transparency. This increases information asymmetry for the managers at the expense of other competitors.⁴⁶¹ Moreover, giving non-executive directors the opportunity to take part of their remuneration in the form of shares may increase the chance of an undesirable focus on share price instead of the underlying company performance.⁴⁶² Moreover, the directors who hold shares are concerned about the reputational threats associated with increasing information asymmetry. Thus, they may reduce their support for managing earnings to protect their reputations.⁴⁶³

4.4.3 Executive and Non-Executive Directors

Both Saudi and English regulations allow executive directors, including CEOs, to be members of boards of directors and participate with non-executive and independent board members on the board's decision-taking. As Saudi Arabia and the England are based on unitary boards, this guarantees that no individual or small group of individuals can dominate the board of directors.⁴⁶⁴

The new Saudi CGR identifies a criterion that distinguishes the executive from the non-executive director: a non-executive director is "a member of the Board who is not a full-time member of the management team of the company and does not participate in its daily activities".⁴⁶⁵ This definition deletes the confusing element in the definition provided by the old CGR, which adds a clause that states "... or who does not receive [a] monthly or yearly salary".⁴⁶⁶ The final part of that definition may create some

⁴⁶⁰ Gao, L., and Song, S. (2008). Management Ownership and Firm Performance; Empirical Evidence From the Panel Data of Chinese Listed Firms Between 2000 and 2004. *Frontiers of Business Research in China*, 2(3), at 373.

⁴⁶¹ Akhtaruddin, M., and Haron, H. (2010). Board Ownership, Audit Committees' Effectiveness, and Corporate Voluntary Disclosures. *Asian Review of Accounting*, 18(1), at 72.

⁴⁶² Higgs, D. (2003). Review of the Role and Effectiveness of Non-Executive Directors. The Department of Trade and Industry, sections 12, 27.

⁴⁶³ Rose, J., Mazza, C., Norman, C., and Rose, A. (2013). The Influence of Director Stock Ownership and Board Discussion Transparency on Financial Reporting Quality. *Accounting, Organizations and Society*, 38(5), at 400.

⁴⁶⁴ Sections b and b/1 of the UK Corporate Governance Code 2016. And article 90/4 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁶⁵ Article 1 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁶⁶ Article 2/b of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia.

misunderstanding as it might lead to it becoming impossible for a non-executive director to exist. This is because all directors, including non-executive directors, receive remunerations which could be composed of different parts, such as a lump sum amount, attendance allowance, rights in rem or a certain percentage of the profits;⁴⁶⁷ some of these remunerations may be paid monthly or annually.

The principles of corporate governance consider non-executive directors as guardians of the firms' interests and it is felt that they enhance representation of the shareholders and stakeholders. They play a major role in monitoring executives and they guarantee that the company is acting in a responsible way by sitting on various committees, such as duties committee, nominations committee and remuneration committee.⁴⁶⁸ The financial scandals and economic crisis did not prevent executives in many firms from receiving large payments, even those that suffered losses or lower profits.⁴⁶⁹ Therefore, one of the top priorities for reforming the legislation related to corporate governance should be maximising the representation of outside directors on corporate boards and prime committees. These independent directors are qualified to protect shareholder interests and stand up to chief executive officers.⁴⁷⁰ In addition, legal and commercial independence of directors is necessary in order to fulfil the monitoring role and guarantee the integrity and accountability of firms.⁴⁷¹

It is compulsory for firms in Saudi Arabia to have a board of directors in which non-executive members represent the majority of the members of the board of directors.⁴⁷² This includes the Chairman of the board of directors who is prohibited from holding any other executive position in the company.⁴⁷³ According to the new Saudi law, the approach of "comply or explain" is no longer available for Saudi listed companies. Hence, it is not allowed for a company to have one person occupy the two positions of chairman of the board of directors and chief executive officer. The board of directors'

⁴⁶⁷ Ibid, article 17.

⁴⁶⁸ Pass, C. (2004). Corporate Governance and the Role of Non-Executive Directors in Large UK Companies: An Empirical Study. *Corporate Governance*, 4(2), at 53.

⁴⁶⁹ Ibid.

⁴⁷⁰ Duchin, R., Matsusaka, J., and Ozbas, O. (2010). When are Outside Directors Effective?. *Journal of Financial Economics*, 96(2), at 195.

⁴⁷¹ Beleya, P., Raman, G., Ramendren, C., and Nodeson, S. (2012). Independent Directors and Stakeholders Protection: A Case of Sime Darby. *International Journal of Academic Research in Business and Social Sciences*, 02(04), at 424.

⁴⁷² Article 16/2 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁷³ Article 81/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And article 24/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

report would then explain the reasons for not implementing the rule as was the case in the old CGR.⁴⁷⁴ Not only that, but the new CGR prevents the chief executive officer from being the chairman of the board during the first year following the end of his/her service.⁴⁷⁵

More realistic rules can be found in English legislation as well as there being stringent rules in other parts at the same time; the UK Code distinguishes between large and small companies, whereas it requires combining independence and non-executive when dealing with the requirement of members. The UK Code requires small firms which are below the recent list of the FTSE 350 report to have at least two independent non-executive directors. In contrast, large firms have to have at least half the board made up of independent non-executive directors, excluding the chairman.⁴⁷⁶ This means that the majority of the members of the board of directors in large firms should be independent. However, Saudi law differentiates between independent and non-executive directors and deals with independence separately and compulsorily. It requires all companies to have either two independent members or one-third of the board, whichever is greater.⁴⁷⁷

4.4.4 Dependent and Independent Directors

The non-executive director may not necessarily be an independent director. The member must meet certain criteria to be considered an independent director. One of the main roles of the board of directors is to follow criteria stipulated by the law and to clearly define the policies of membership of the board of directors. The board should also review these policies annually and evaluate the extent of the member's independence. Moreover, the board should consider the details of the relationships or circumstances which are likely to affect, or could appear relevant to its determination. This significant function of the board of directors is stipulated in both the Saudi and English regulations.⁴⁷⁸

⁴⁷⁴ Article 1/c of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia.

⁴⁷⁵ Article 28 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁷⁶ Section b/1.2 of the UK Corporate Governance Code 2016.

⁴⁷⁷ Article 16/3 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁴⁷⁸ Section b/1.1 of the UK Corporate Governance Code 2016. And article 20/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

To guarantee complete independence, the regulations in both Saudi Arabia and England lay down strict rules pertaining to independent board members to ensure that they shall be able to perform their duties objectively without bias to help the board to make the correct decisions. Both sets of laws deal with this case by providing some examples of situations and circumstances but they are not limited to them. These situations are considered as an infringement of the independence of directors whatever those circumstances relate to, whether ownership, leadership or employment.

By way of example, the Saudi CGR deems any of the following as an infringement of the independence of directors:

- “if he/she holds five percent or more of the shares of the Company or any other company within its group; or is a relative of who owns such percentage.
- if he/she is a representative of a legal person that holds five percent or more of the shares of the Company or any company within its group;
- if he/she is a relative of any member of the Board of the Company, or any other company within the Company’s group;
- if he/she is a relative of any Senior Executive of the Company, or of any other company within the Company’s group;
- if he/she is a Board member of any company within the group of the Company for which he/she is nominated to be a Board member.
- if he/she is an employee or used to be an employee, during the preceding two years, of the Company, of any party dealing with the Company or any company within its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, held a controlling interest in any such parties;
- if he/she has a direct or indirect interest in the businesses and contracts executed for the Company’s account;
- if the member of the Board receives financial consideration from the Company in addition to the remuneration for his/her membership of the Board or any of its committees;
- if he/she engages in a business where he competes with the Company, or conducting businesses in any of the company's activities.
- if he/she served for more than nine years, consecutive or inconsecutive, as a Board member of the Company”⁴⁷⁹

Likewise, the UK Code provides several situations that are partly parallel with those in Saudi law:

- “[he/she] has been an employee of the company or group within the last five years;
- [he/she] has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;

⁴⁷⁹ Article 20/c of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

- [he/she] has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance related pay scheme, or is a member of the company's pension scheme;
- [he/she] has close family ties with any of the company's advisers, directors or senior employees;
- [he/she] holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- [he/she] represents a significant shareholder; or
- [he/she] has served on the board for more than nine years from the date of their first election".⁴⁸⁰

The above requirements draw attention to the fact that legislators seek to exclude and close any opportunities that create personal interest for independent directors as these may create a negative impact on their objective attitudes. The UK Code considers any material business relationship with the company an infringement of independence of a director without any limitation mentioned except that it must have occurred in the preceding three years.⁴⁸¹ In comparison, the Saudi legislator has restricted the period to the last two years. Moreover, the Saudi law allows independent directors to hold shares and it does not prevent all types of business relationships for them. However, the Saudi legislator determines the ownership that breach the independence on limits of owning five percent or more of the issued shares of the company or any of its group or those who represent a legal person who holds that percentage.⁴⁸²

4.4.5 The Advantages of Non-Executive Directors

Regardless of the benefits of the monitoring role of non-executive and independent directors which aims to protect shareholder interests, the contribution of non-executive and independent directors provides additional value to firms. Pass draws attention to the **four** main advantages of non-executive participation:

The first is the additional value of experience that comes from external business expertise. They may have been former executive directors or honourable decision-makers from the public sector. Moreover, some of them may have a significant

⁴⁸⁰ Section b/1.1 of the UK Corporate Governance Code 2016.

⁴⁸¹ Ibid.

⁴⁸² Article 20/c of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

background in politics or the government sector which means they can offer good advice.⁴⁸³

Another important benefit is the detachment which comes from not being involved in the day-to-day business of the company. They are in a position that allows them to see the ‘big picture’, whether of company circumstances or the outside macro-environment. This broader outlook assists the board of directors to be more objective when dealing with the company’s affairs. Moreover, they are more capable of seeing both the risks and the opportunities for the company.⁴⁸⁴

Thirdly, firms could widen their network through non-executive directors who come from diverse backgrounds of government and academia, for example. Their previous contacts may create promising opportunities for corporations with commercial benefits.⁴⁸⁵

Finally, non-executive directors are considered a perfect tool in terms of making checks and balances in cases of conflicts of interest of stakeholders, including the executive board, shareholders and employees.⁴⁸⁶

4.4.6 The Disadvantages of Non-Executive Directors

In contrast, doubts have been raised about the role of non-executive directors and their contributions. In particular, this has occurred after the increasing numbers of corporate scandals which created an atmosphere of mistrust in all types of directors. This includes non-executive and independent directors as they have sometimes been involved in those scandals.⁴⁸⁷

There are, however, many disadvantages to non-executive participation on boards of directors. Their part-time contribution is considered as the main shortcoming of non-

⁴⁸³ Pass, C. (2004). Corporate Governance and the Role of Non-Executive Directors in Large UK Companies: An Empirical Study. *Corporate Governance*, 4(2), at 59.

⁴⁸⁴ Ibid.

⁴⁸⁵ Ibid.

⁴⁸⁶ Ibid.

⁴⁸⁷ Lückcrath-Rovers, M., and De Bos, A. (2011). Code of Conduct for Non-Executive and Supervisory Directors. *Journal of Business Ethics*, 100(3), at 465.

executives because they often only meet a few times a year. This remoteness generates ineffective internal decision-making processes and insufficiency of information. The limited time they are involved does not qualify them to make critical decisions, especially those issued by a nomination committee, a remuneration committee and an audit committee, which have a majority of non-executives.⁴⁸⁸

Another disadvantage is that many non-executive directors sit on several boards in different firms at the same time. These multiple directorships can be distracting and can mean that one company benefits at the expense of others. Moreover, this situation may create divided loyalties.⁴⁸⁹

A controversial issue has been raised about the increase in the number and the role of non-executive directors and the extent of its compatibility with the unitary board. More outsiders, and more power for them, will widen the division between executive and non-executive directors which would render the one-tier board an unworkable model.⁴⁹⁰ The unitary board relies on collective responsibility and there are limits to what non-executives can achieve in a part-time role.

Pass argues that a big criticism of the way non-executives are recruited to the unitary board is that it is not like a two-tier board structure which has a separate supervisory board consisting of non-executives and other stakeholders such as employees. He suggests **three** procedures that should take place together. Firstly, non-executive representation should be tightened up. Secondly, the effectiveness of executive directors should be improved by making them directly accountable for their actions by law. Thirdly, the role of a company's annual general meeting should be enhanced and this would give shareholders more opportunities to express their views.⁴⁹¹

⁴⁸⁸ Pass, C. (2004). Corporate Governance and the Role of Non-Executive Directors in Large UK Companies: An Empirical Study. *Corporate Governance*, 4(2), at 56.

⁴⁸⁹ *Ibid*, at 60.

⁴⁹⁰ Treadwell, D. (2006). The Role of the Non-Executive Director: A Personal View. *Corporate Governance*, 6(1), at 64.

⁴⁹¹ Pass, C. (2004). Corporate Governance and the Role of Non-Executive Directors in Large UK Companies: An Empirical Study. *Corporate Governance*, 4(2), at 62-63.

4.4.7 Membership of the Board of Directors in View of the Saudi Context

In taking the above drawbacks into account, it can be said that corporate governance will not be improved by merely putting regulatory numerical limitations on outside directors' membership. This factor may not prevent CEOs or dominant owners from appointing their allies to the board. They may be legally independent directors but they can still prove to be unduly sympathetic to the executive directors. This situation may create collusion which makes the CEOs powerful and at the same time takes them away from the challenges of board monitoring.⁴⁹²

Evidence supporting this view comes from the US where, since 2003, the law requires the majority of the members of the board of directors to be non-executive members; this, in practice, has been the case in most firms since 1996.⁴⁹³ In other words, increasing the representation of non-executive or independent directors is not new. It in fact was common before 2008 yet this was not enough to avoid the financial crisis. Therefore, the leaders of some companies believe that there is no commercial justification for involving non-executive directors and they cannot rely on them. In addition, they also believe that non-executive directors may not have sufficient incentives or information to carry out their duties, particularly, those against CEOs.⁴⁹⁴

Firms should in fact focus on the circumstances in their environment and appreciate the strengths and weaknesses of both insiders and outsiders.⁴⁹⁵ In addition, the roles of outside directors, their relationships and remuneration should be reviewed, and the way they are appointed should be improved, in order to better measure the extent of dependence, their effectiveness and accountability.⁴⁹⁶ It is important to bear in mind that increasing the number of outside directors on the board will not necessarily generate positive effects on performance that are largely free from internal problems. Nevertheless, the effectiveness of outsiders actually relies on the cost of gaining

⁴⁹² Duchin, R., Matsusaka, J., and Ozbas, O. (2010). When are Outside Directors Effective?. *Journal of Financial Economics*, 96(2), at 198. And Arshad, R., Ismail, R., Noruddin, A., and Mohamad, M. (2010). Corporate Governance Structure, Regulatory Regimes and Voluntary Disclosures. *Science and Social Research (CSSR), 2010 International Conference on*, at 421.

⁴⁹³ Pass, C. (2004). Corporate Governance and the Role of Non-Executive Directors in Large UK Companies: An Empirical Study. *Corporate Governance*, 4(2), at 62.

⁴⁹⁴ Ibid.

⁴⁹⁵ Duchin, R., Matsusaka, J., and Ozbas, O. (2010). When are Outside Directors Effective?. *Journal of Financial Economics*, 96(2), at 212.

⁴⁹⁶ Pass, C. (2004). Corporate Governance and the Role of Non-Executive Directors in Large UK Companies: An Empirical Study. *Corporate Governance*, 4(2), at 62.

information about the company. Hence, there is an inverse result if the cost of information is high with rising numbers of outsiders on the board.⁴⁹⁷

It may be true that having a board composed entirely of outsiders may not be ideal for a company. However, it is becoming increasingly difficult to ignore the fact that outsiders may be better able to evaluate the management of the firm, replacing them if they fail to perform well or are involved in misconduct.⁴⁹⁸ Moreover, ensuring that the company is run effectively is a very important role of outside directors as well. They also have a strong incentive to demonstrate their skills and competence in the market. Generally, independent non-executive directors come from business or academic backgrounds where they play respected roles. They are very keen to protect their reputations and avoid any function or situation that may negatively impact on them. Likewise, they wish to improve their skills by performing as decision-taking managers and raise their value as a human capital.⁴⁹⁹ Thus, success requires a combination of inside and outside directors on the board to fulfil the numerous fiduciary duties required.⁵⁰⁰

A good recommendation in this case is that careful attention should be paid to the purpose of independents' participation. Hence, if the target of board independence is to monitor and discipline executive directors then increasing the board's independence has merit. However, if the purpose of board's independence is to improve operating performance and to maximise value, that will produce negative results.⁵⁰¹ It is, therefore, very important to take into account the target of board independence and the inverse relationship between effectiveness of outside directors and the cost of acquiring information, whether that is when firms compose their boards or when corporate governance legislation is reformed.

⁴⁹⁷ Duchin, R., Matsusaka, J., and Ozbas, O. (2010). When are Outside Directors Effective?. *Journal of Financial Economics*, 96(2), at 195.

⁴⁹⁸ Weisbach, M. (1988). Outside Directors and CEO Turnover. *Journal of Financial Economics*, 20(1-2), at 433-434.

⁴⁹⁹ Ibid, at 433.

⁵⁰⁰ Ibid.

⁵⁰¹ Olubukunola, O., and Stephen, O. (2011). The Role of Non-Executive Directors in the Profitability of Banks: A Study of Universal Banks in Nigeria. *International Journal of Business and Management*, 6(2), at 252. See also Duchin, R., Matsusaka, J., and Ozbas, O. (2010). When are Outside Directors Effective? *Journal of Financial Economics*, 96(2), at 196.

In evaluating the debates in a broader context, some researchers⁵⁰² argue that each of these views about outside directors' contributions is plausible, and they are not necessarily incompatible. Moreover, all risks mentioned could be legally addressed by corporate governance rules and principles. Hence, there is no cause for concern as they will be addressed by raising transparency and defining the roles of all types of directors clearly.

Quite rightly, the law makes no distinction between types of directors in terms of responsibilities but does recognise that there are differences between the roles of executive and non-executive directors. In one-tier boards, it is unrealistic to expect an outsider to be fully able to monitor the executive, and be accountable for the ethical management of the business, remuneration policy and board composition. These are impossible demands on those fulfilling part time roles. Similarly, it is also unrealistic to expect that all executives are honest, competent, ethical and committed to the business. However, these demands are, in fact, the collective responsibility of the board of directors, as they are jointly responsible for all these functions according to the law.⁵⁰³

This chapter has sought to discuss the importance of the existence of outside directors and highlight their most important functions. The corporate governance system does not consider non-executives as unique champions who are able to solve all board problems. However, the corporate governance system provides many rules, principles and constraints that, taken together, can deal with most of the shortcomings of both non-executive and executive directors. Even if all risks are not eliminated, the regulatory efforts in strengthening corporate governance will limit their impact.

⁵⁰² Arshad, R., Ismail, R., Noruddin, A., and Mohamad, M. (2010). Corporate Governance Structure, Regulatory Regimes and Voluntary Disclosures. *Kuala Lumpur, Malaysia: Science and Social Research (CSSR), International Conference on Science and Research*, 5(7), at 421. And see Duchin, R., Matsusaka, J., and Ozbas, O. (2010). When are Outside Directors Effective?. *Journal of Financial Economics*, 96(2), at 199.

⁵⁰³ Treadwell, D. (2006). The Role of the Non-Executive Director: A Personal View. *Corporate Governance*, 6(1), at 65, 66 and 68.

4.5 The Shadow Director

The concept of shadow director has a significant standing on directorship provisions “for regulating people who exercise indirect influence or control by giving instructions or directions to a company's board of directors which the directors are accustomed to obey”.⁵⁰⁴ This concept applies to any individual who controls a company but is unwilling to appear to be doing so.⁵⁰⁵ Working in the shadows allows such an individual to avoid any liabilities imposed on official directors, and at the same time enables him to act as a director without the concern of disqualification as well as the individual seeks to remain unaccountable for his wrongful acts. The shadow director provisions therefore have an obvious role in anti-avoidance rationale.⁵⁰⁶

The UK Companies Act 2006 defines the shadow director as “a person in accordance with whose directions or instructions the directors of the company are accustomed to act”.⁵⁰⁷ Accordingly, there is no an official position of director occupied by a shadow director and there is a difficulty to consider such an individual as a de jure or a de facto director. However, a shadow director instead usurps either the primary or ultimate decision-making functions of the board⁵⁰⁸

It should be noted that there are some important criteria for a person to be deemed a shadow director. The UK Companies Act 2006 provides some restrictions and exceptions for a person to be regarded as a shadow director. For example, a professional adviser and a body corporate with its subsidiary companies.⁵⁰⁹ Therefore, merely giving good advice is not sufficient for an individual to be a shadow director even if the board follows this advice. The Small Business, Enterprise and Employment Act 2015 provides additional clarifications for advice to be deemed as an instruction:

“A person is not to be regarded as a shadow director by reason only that the directors act (a) on advice given by that person in a professional capacity; (b) in accordance with instructions, a direction, guidance or advice given by that person in the exercise of a function conferred by or under an enactment; (c) in

⁵⁰⁴ Idensohn, K., (2010). The Regulation of Shadow Directors. *SA Mercantile Law Journal*, 22(3), at 326.

⁵⁰⁵ Noonan, C., and Watson, S. (2006). The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?. *The Journal of Business Law*, at 12.

⁵⁰⁶ Ibid.

⁵⁰⁷ Section 251(1) of the UK Companies Act 2006.

⁵⁰⁸ Noonan, C., and Watson, S. (2006). The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?. *The Journal of Business Law*, at 5.

⁵⁰⁹ Section 251(2), (3) of the UK Companies Act 2006.

accordance with guidance or advice given by that person in that person's capacity as a Minister of the Crown".⁵¹⁰

To sum up, there are two conditions to treat a person who provides instructions or directions as a shadow director: First, the instructions provided to the members of the board must relate to their activities when they are acting as the board; Another condition relates to the manner of receiving those instructions from the board when they follow those instructions without independent reflection or discussion.⁵¹¹

4.5.1 Types of Shadow Director

The usage of the term 'shadow director' does not necessarily imply anonymity or a hidden working; there are many positions and ways that may make a shadow director able to operate above board.⁵¹² Nevertheless, such positions cannot protect them from their liability for what they do. According to English law and the above standards, the key factor that identifies a shadow director is the exercise of control over the regular directors. Consequently, the role of shadow director may easily be filled even by a member of the board who exercises control over other directors.⁵¹³ Furthermore, there are many possible influences over the regular directors with examples stemming from duress, bribery or social and moral obligations, such as the influence of one partner over the other in a marriage.⁵¹⁴

There are overlapping factors that may generate a significant opportunity for someone to become a shadow director. Thus, any natural or corporate person could be a shadow director if the necessary elements are present. Such elements include the presence of a holding company, the owners of a majority of shares and a major creditor or other controllers like banks.⁵¹⁵ Nevertheless, being a significant investor, such as a major

⁵¹⁰ Section 90(3) of Small Business, Enterprise and Employment Act 2015.

⁵¹¹ Noonan, C., and Watson, S. (2006). The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?. *The Journal of Business Law*, at 4,8.

⁵¹² See *Secretary of State for Trade and Industry v Deverell* [2001] Ch. 351.

⁵¹³ Noonan, C., and Watson, S. (2006). The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?. *The Journal of Business Law*, at 5.

⁵¹⁴ *Ibid*, at 12.

⁵¹⁵ Idensohn, K., (2010). The Regulation of Shadow Directors. *SA Mercantile Law Journal*, 22(3), at 330. And see Noonan, C., and Watson, S. (2006). The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?. *The Journal of Business Law*, at 11.

creditor and owner of a majority of shares is not sufficient to be a shadow director as long as the individual who occupies one of these positions does not exploit them to exercise control over the company board.⁵¹⁶ In addition, there is a significant controversy over the issue of considering a holding company as a shadow director. According to a recent decision, the Court of Appeal upheld a finding that a director of a holding company had not become a de facto or shadow director of its subsidiary.⁵¹⁷

Moreover, it is important to bear in mind that the majority of shareholders have a legal ability to influence the management of the company through their real functions in the general assembly.⁵¹⁸

4.5.2 The Shadow Director from a Legal Perspective

Legally, the ultimate responsibility for all the company's business remains vested in the board of directors, and they cannot escape liability for the company's decisions whatever the justifications.⁵¹⁹ However, corporate governance, including provisions of shadow director, plays the major role to protect the board of directors from any interference and regulate the majority of their relationships with all kinds of officers or stakeholders via several legal principles.

Noonan and Watson draw attention to the causal relationship between the shadow director and the actions of the board of directors which allows a shadow director to dominate the board. Consequently, the law deals with the liability of the shadow director in the light of the duties of directors that have been breached. Therefore, each individual director must be aware of the extent of their inescapable personal responsibilities acquired by virtue of being a member of the board of directors. They may be deceived or exploited by the shadow director but allowing this interference to happen will put them in breach of their own duties.⁵²⁰ Even so, the legislation aims to support the independent decision-making duty of directors, as well as tries to tackle the

⁵¹⁶ Noonan, C., and Watson, S. (2006). The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?. *The Journal of Business Law*, at 12.

⁵¹⁷ See *Smithton v Naggar* [2014] EWCA Civ 939.

⁵¹⁸ See chapter five.

⁵¹⁹ Article 21/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁵²⁰ Noonan, C., and Watson, S. (2006). The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?. *The Journal of Business Law*, at 14,16,18.

unfairly detrimental conduct and opportunistic behaviour whatever its source. Thus, the shadow director provisions impose liability on shadow directors to pay the costs of their wrongful enterprise.⁵²¹

It should be recalled that English legislators dealt with the issue of shadow directors early on through several pieces of legislation. This provides many provisions whether in respect of determining the concept of a shadow director or clarifying their liabilities. The Small Business, Enterprise and Employment Act 2015 states that “the general duties apply to a shadow director of a company where and to the extent that they are capable of so applying”.⁵²² Thus, English law considers and treats a shadow director as an officer of the company and imposes on them many provisions and obligations that are related to director duties. These include the following: misleading information; misleading indication of activities; criminal consequences of failure to make required disclosures; making appointments; register of directors; scope and nature of general duties; declaration of interest in transactions; transactions requiring members’ approval; directors’ service contracts; derivative claims; direction requiring; duty to notify registrar of changes; and a company’s annual return.⁵²³ There are also many other provisions that apply to shadow directors in various company-related statutes, such as the Insolvency Act⁵²⁴ and the Company Directors' Disqualification Act.⁵²⁵

Moreover, the concept of a shadow director and its applications and constituent elements have been the subject of extensive commentary and an increasing number of high-profile cases before the English courts; for instance, *Secretary of State for Trade and Industry v Deverell*, *Ultraframe (UK) Ltd v Fielding & Ors* and *Smithton v Naggar*.⁵²⁶

⁵²¹ Ibid, at 2, 11, 14.

⁵²² Section 89(1) of Small Business, Enterprise and Employment Act 2015.

⁵²³ See the UK Companies Act 2006 sections 75, 76, 84, 156, 162, 170, 187, 223, 230, 260, 272, 276, 859.

⁵²⁴ See the UK Insolvency Act 1986, sections 206(3), 208(3), 210(3), 211(2), 214(7), 216(1), 249/a, 251.

⁵²⁵ See the UK Company Directors' Disqualification Act, sections 4(2), 6(3)/d, 8(1), 9(1), 22(4), (5).

⁵²⁶ *Secretary of State for Trade and Industry v Deverell* [2001], *Ultraframe (UK) Ltd v Fielding & Ors* [2005] and *Smithton v Naggar* [2014] EWCA Civ 939. See also leading cases include *Re Tasbian Ltd (No 3)* [1993] BCLC 297 (CA); *Re Unisoft Group Ltd (No 3)* [1994] 1 BCLC 609; *Re Hydrodan (Corby) Ltd* [1994] 2 BCLC 180 (ChD); *Re Kaytech International plc*; *Secretary of State for Trade and Industry v Kaczer & Others* [1999] 2 BCLC 351 (CA); *Secretary of State for Trade and Industry v Becker* [2003] 1 BCLC 555.

4.5.3 The Shadow Directorship in Saudi Arabian Law

It can be said that the first mention provided about shadow directors in Saudi law was in the new Saudi CGR issued in February 2017. It partly deals with the concept of shadow directors without any provisions to hold them responsible for any interference in company matters. In the article one, the new CGR provides some definitions including the term “Related Parties” which involves 11 parties, including substantial shareholders, board members, senior executives and their relatives and so on. Those related parties also include “any person whose advice or guidance influence the decisions of the company, the board and the senior executives”.⁵²⁷ Despite this acceptable definition of the shadow director, there is no further reference to this concept in any other articles in the CGR, and there are no requirements made of that person who influences the company’s decisions that would make them responsible for their actions. Instead, the CGR deals only with the integral concept of “Related Parties” as a whole by stipulating some requirements of the board of directors to regulate their relationships with “Related Parties”. There are also some articles that require the board of directors to set policies to remedy conflicts of interest,⁵²⁸ including dealing with transactions with related parties,⁵²⁹ avoiding conflicts of interest,⁵³⁰ disclosing conflicts of interest⁵³¹ and not accepting gifts.⁵³²

By comparison, English legislation has dealt with shadow directorship provisions for a century,⁵³³ and it distinguishes clearly between a director and a shadow director by providing two separate definitions for them.⁵³⁴ Meanwhile, it can be said that Saudi law has, unfortunately, not provided any legislation to deal with its provisions. Instead, the Saudi CGR places all the responsibilities on the board of directors:

⁵²⁷ Article 1 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁵²⁸ Ibid, article 22/2-a.

⁵²⁹ Ibid, article 42.

⁵³⁰ Ibid, article 44.

⁵³¹ Ibid, article 45.

⁵³² Ibid, article 49.

⁵³³ Idensohn, K., (2010). The Regulation of Shadow Directors. *SA Mercantile Law Journal*, 22(3), at 326.

⁵³⁴ Sections 250, 251(1) of the UK Companies Act 2006.

“the Board is responsible for the Company’s business even if it delegates some of its powers to committees, individuals or other third parties. In any case, the Board may not issue a general or an open-ended delegation”.⁵³⁵

Consequently, according to Saudi law the term ‘shadow director’ does not take on the appearance of a director in any shape or form in Saudi law and does not have any legal name or position of de jure directors that is controlled by Saudi law. However, this absence of legislation does not negate the existence of practices and applications of shadow directorship which might impact and control several companies in Saudi Arabia indirectly. This particular influence of a circuitous nature is problematic and needs appropriate mechanisms to address it. Hence, Saudi law should introduce express statutory provisions to regulate shadow directors. These desired legislations will assist to control any individual who exercises an actual influence over the board of a company and make them accountable for such interference.

This crucial legislation is a highly recommended, especially in developing countries where a culture of participation, transparency and accountability are lacking in many respects. The political structure in some of these countries creates the perfect environment for the persistence of class divisions where power, money and influence are concentrated in the hands of certain groups in society. Corporate governance is in its infancy in many developing countries, including Saudi Arabia, and so it suffers from inadequate legislative, judicial, investment and supervisory settings. There is also a lack of independent media and strategies for combating corruption.⁵³⁶

Idensohn summarises the advantages and achievable targets that may be met by enacting legislations to regulate the shadow directorship:

“Responding to current international calls for better corporate governance practices in a way that correlates legal responsibility and accountability with sufficiently significant actual influence or control. It may also have economic benefits in the form of improved corporate management, and in providing claimants who suffer loss as the result of a shadow director's influence with an additional defendant to pursue, especially if that additional defendant is one with greater financial resources. Perhaps more compelling is the sense of unfairness about allowing shadow directors to exercise real power and control

⁵³⁵ Article 21/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁵³⁶ For further information see chapter three.

over companies and yet avoid directors' duties and responsibilities simply by acting through a number of intermediaries".⁵³⁷

In the Saudi context, there is an urgent need to enact legislation to deal with shadow directors and strongly deter their practices. Such legislation should keep pace with increased global legislative developments in this regard, such as the recent English law of Small Business, Enterprise and Employment Act 2015. This law contains several measures against shadow director practices and amends some sections in the Companies Act 2006. For example, the CA 2006 leaves the determination of duties and potential liability of shadow directors to the English courts with some restrictions from English common law and the principles of equity.⁵³⁸ However, the recent law imposes directors' duties on shadow directors without those restrictions.⁵³⁹ Moreover, it requires every company to keep a register of people with a significant control over the company.⁵⁴⁰

⁵³⁷ Idensohn, K., (2010). The Regulation of Shadow Directors. *SA Mercantile Law Journal*, 22(3), at 344.

⁵³⁸ Sections 170(3), (4), (5) of the UK Companies Act 2006. See also *Smithton v Naggar* [2014] EWCA Civ 939.

⁵³⁹ Section 89 of Small Business, Enterprise and Employment Act 2015.

⁵⁴⁰ *Ibid*, section 81.

4.6 Female Representation on Boards of Directors

Increasing diversity in the board of directors is a significant way of enlarging the pool of talent and attracting business as a result of the fact that different classes and people come with different skills and talents. Moreover, it is a solution to the continuing problem of discrimination.⁵⁴¹ Gender diversity and equality is still an issue on boards of directors. It has received increasing attention both in academia and in the legislature as the majority of board members are male, even in Europe.⁵⁴²

Poor female representation on corporate boards of directors is still a global phenomenon. For example, in Scandinavian countries females take up between 27% and 40% of the board positions available⁵⁴³ whereas in Western countries women comprise about 15% of corporate board members and only 0.2% in some Asian countries.⁵⁴⁴

4.6.1 The Arguments in Support of an Imposed Quota

Terjesen and Singh⁵⁴⁵ discuss some reasons for the increased attention to issues of gender inequality and support the presence of women in corporate boards as well as introducing quotas for women. First, the current demographic profile of the workforce and the fact that women are joining the labour force in increasing numbers and which now probably outnumber men. Second, the corporate scandals which caused amendments to corporate governance laws regarding the structures and the need to increase board diversity, including gender representation. Third, this situation has been affected by an increasing proportion of women in parliaments as is the case in more than 40 countries where quotas for women have been introduced.

⁵⁴¹ Villiers, C. (2010). Achieving Gender Balance in the Boardroom: Is it Time for Legislative Action in the UK?. *Legal Studies*, 30(4), at 556.

⁵⁴² Mathisen, G., Ogaard, E., and Marnburg, T. (2013). Women in the Boardroom: How Do Female Directors of Corporate Boards Perceive Boardroom Dynamics?. *Journal of Business Ethics*, 116(1), at 87.

⁵⁴³ Heemskerck, E., and Fennema, M. (2014). Women on Board: Female Board Membership as a Form of Elite Democratization. *Enterprise and Society*, 15(2), at 254.

⁵⁴⁴ Terjesen, S., and Singh, V. (2008). Female Presence on Corporate Boards: A Multi-Country Study of Environmental Context. *Journal of Business Ethics*, 83(1), at 55.

⁵⁴⁵ *Ibid*, at 62.

Scandinavian countries are considered leaders in adopting a strict quota system, particularly in Norway where legislation requires a 40% female representation on corporate boards with severe penalties for non-compliance, including corporate termination. Similar quota measures are now under serious consideration at the European level and several other countries are observing the outcomes carefully.⁵⁴⁶

There are numerous benefits to gender diversity on boards. Mathisen et al⁵⁴⁷ summarise some of these advantages. The first advantage is relevant with morality and justice, a result of applying quotas, which create a balance on equal opportunities for women and other minorities. Second, diversity promotes the value of organisations and their resource-dependence as a result of containing the different voices on their boards. This will assist them to widen their expertise and expand individual networking with other organisations. Widening relations may also increase the organisations' survival odds and resource acquisition.⁵⁴⁸ Third, a variety of perspectives and differences that come from gender diversity may bring more benefits to companies. Particularly, on the view argues that women are better on cross-cultural awareness and transformational leadership skills.⁵⁴⁹

Other researchers consider gender diversity as an indicator of the extent of the democratisation of the elite social networks which enhances the board culture.⁵⁵⁰ Larkin et al⁵⁵¹ argue that women tend to promote ethical behaviour and increased transparency within organizations. Thus, increasing female representation on corporate boards could indicate that companies are ethical and transparent. This will improve a corporation's image and enable firms to obtain the investors' trust as well as attracting a wider range of qualified individuals.⁵⁵² Moreover, a company is deemed to be a corporate citizen

⁵⁴⁶ Ibid, at 62.

⁵⁴⁷ Mathisen, G., Ogaard, E., and Marnburg, T. (2013). Women in the Boardroom: How Do Female Directors of Corporate Boards Perceive Boardroom Dynamics?. *Journal of Business Ethics*, 116(1), at 87.

⁵⁴⁸ Ibid, at 88.

⁵⁴⁹ Terjesen, S., and Singh, V. (2008). Female Presence on Corporate Boards: A Multi-Country Study of Environmental Context. *Journal of Business Ethics*, 83(1), at 62.

⁵⁵⁰ Heemskerck, E., and Fennema, M. (2014). Women on Board: Female Board Membership as a Form of Elite Democratization. *Enterprise and Society*, 15(2), at 252.

⁵⁵¹ Larkin, M., Bernardi, R., and Bosco, S. (2013). Does Female Representation on Boards of Directors Associate with Increased Transparency and Ethical Behavior?. *Accounting and the Public Interest*, 13(1), at 147.

⁵⁵² Ibid, at 146.

with full responsibility for both society and its surrounding environment. Therefore, gender diversity reflects the corporation's values in this area.⁵⁵³ According to Williams, female directors are better able to enrich a board of directors in specific fields such as law, education, or non-profit activities, as well as being more aware of corporate social responsibility compared to male directors.⁵⁵⁴

4.6.2 Gender Diversity in the England

In England, the government's ambition is to achieve gender parity on boards and raise the female numbers in business.⁵⁵⁵ The UK Code has not yet introduced quotas for women but requires and emphasises gender diversity in the corporate boards through several sections, such as: "There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board".⁵⁵⁶ , "... should be conducted, and appointments made on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender".⁵⁵⁷ , "... A separate section of the annual report ... should include a description of the board's policy on diversity, including gender".⁵⁵⁸ 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".⁵⁵⁹

It is worth noting the significant role played by the Davies recommendations in increasing female representation on firms' boards in the UK. Lord Davies was appointed by the government and supported by a Steering Committee of experts from business and academia. Doldor and his colleagues argue that a precipitating jolt for institutional change has occurred and the national debate on women on boards changed after the 2011 Davies Review. It set a change agenda and outlined a national strategy for women being appointed onto boards, with a target of 25% for FTSE 100 boards by

⁵⁵³ Ibid.

⁵⁵⁴ Williams, R. (2003). Women on Corporate Boards of Directors and their Influence on Corporate Philanthropy. *Journal of Business Ethics*, 42(1), at 2.

⁵⁵⁵ Martin, L., Warren-Smith, I., Scott, J., and Roper, S. (2008). Boards of directors and gender diversity in UK companies. *Gender in Management: An International Journal*, 23(3), at 205.

⁵⁵⁶ Section b/2 of the UK Corporate Governance Code 2016.

⁵⁵⁷ Ibid, Supporting Principles of Section b/2.

⁵⁵⁸ Ibid, section b/2.4.

⁵⁵⁹ Ibid, section b/6.

2015. Furthermore, the Davies Report recommended that a Voluntary Code of Conduct should be drafted up to ensure more gender-inclusive board appointments. These measures enabled accountability and coordination across key players and constant monitoring by the Steering Committee. As a result, the percentage of women on FTSE 100 boards doubled between 2011 and 2015, and more than 30% of new board appointments were taken up by women.⁵⁶⁰

The Third Report of Session 2016–17 of the Business, Energy and Industrial Strategy Committee recommends that the Financial Reporting Council should amend the UK Corporate Governance Code to promote gender equality and ethnic diversity on boards.⁵⁶¹ It recommends:

"that the Government should set a target that from May 2020 at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women. Companies should explain in their annual report the reasons why they have failed to meet this target, and what steps they are taking to rectify the gender inequality on their Executive Committees".⁵⁶²

Some researchers believe that the corporate culture in some European countries such as Norway is by its nature more accepting of imposing quotas than might be possible in England.⁵⁶³ Choudhury argues that quotas rely on societal consensus regarding the importance of gender equality as a public norm in society. This idea already existed in Norway but does not necessarily have comparable importance elsewhere. He also states that:

"... some important differences between Norway and the UK suggest that the effectiveness of the quota system in Norway will likely not be able to be replicated in the UK. For example, gender equality is the prevailing norm in Norway. Indeed, the need to bolster its already prominent international reputation for gender equality was one of the reasons the quota laws were introduced in the first place. Norwegian political tradition has similarly emphasised gender equality, although mainly in the public sector, through

⁵⁶⁰ See Doldor, E., Sealy, R., & Vinnicombe, S. (2016). Accidental Activists: Headhunters as Marginal Diversity Actors in Institutional Change Towards more Women on Boards. *Human Resource Management Journal*, 26(3), 285-303. See also, Davies, M. (2011). Women on boards – the Davies report (No. URN 11/745), London: GEO/BIS. And Davies, M. (2013). Women on boards – the Davies report (No. URN 13/P135), London: GEO/BIS.

⁵⁶¹ UK Parliament Business, Energy and Industrial Strategy Committee. (2017). *Business, Energy and Industrial Strategy Committee 3rd Report. Corporate Governance Volume 1. Report*, HC 702, at 54.

⁵⁶² Ibid, at 53.

⁵⁶³ Villiers, C. (2010). Achieving Gender Balance in the Boardroom: Is it Time for Legislative Action in the UK?. *Legal Studies*, 30(4), at 557.

measures designed to encourage female employment or to promote work family reconciliation”.⁵⁶⁴

4.6.3 The Arguments Against Imposed Quotas

Several European countries have struggled to make substantial changes to increase the number of women on boards. Therefore, many of them have adopted the approach of imposing regulations prescribing quotas of different percentages. These countries have had varying levels of success but the highest outcome was achieved by Norway with its 40% quota for female representation on boards. This indicates that there are different overlapping circumstances that may have an impact on this issue. For example, the presence of state-owned firms, the extent of state intervention on boards, their composition and the ability to impose stringent sanctions for non-compliance. Furthermore, success depends on the amount of effort made and the capability of plan completion.⁵⁶⁵

There is no consensus on the suitability of the enforcement of quotas, even in the EU. Opposition to it is broad and fierce, particularly standing against those who stipulate a minimum quota of female board members (3 or more or 33 percent or more) as they argue that merely female participation is not sufficient.⁵⁶⁶ There is also more extreme demand which stipulates that women must constitute at least 40 percent of the board.⁵⁶⁷

German Minister Kristina Schröder is a supporter of women's participation on boards. She argues that specific female characteristics influence firm performance positively. However, she also criticises coercive quotas which reduce the value of individual achievement and merit. She said, “I think it is absurd to impose a uniform quota on very different companies ... On the surface, a quota may stimulate fairness but it tends to exacerbate unfairness for individuals rather than eliminate it ... I once benefited from

⁵⁶⁴ Choudhury, B. (2014). New Rationales for Women on Boards. *Oxford Journal of Legal Studies*, 34(3), at 533-534.

⁵⁶⁵ Ibid, at 533.

⁵⁶⁶ Larkin, M., Bernardi, R., and Bosco, S. (2013). Does Female Representation on Boards of Directors Associate with Increased Transparency and Ethical Behavior?. *Accounting and the Public Interest*, 13(1), at 146.

⁵⁶⁷ Heemskerck, E., and Fennema, M. (2014). Women on Board: Female Board Membership as a Form of Elite Democratization. *Enterprise and Society*, 15(2), at 254.

a quota, people still smugly hold this against me today as if my abilities hadn't counted at all at the time. Many women have had the same experience."⁵⁶⁸ Generally, no one wants to be patronised and would prefer to be appointed on merit as they want their achievements and successes to be ascribed to them.⁵⁶⁹ Thus, gender diversity should be considered under the criterion of supply and demand.⁵⁷⁰

A number of studies have cast doubt on the positive effects of female representation on boards, especially in terms of corporate performance. They argue that there has been insufficient investigation into the mechanisms that underlie these inconclusive results. They give some negative aspects of imposed female quotas, such as the privileging of groups over individuals and the undermining of equality of opportunity. Moreover, adopting female only quotas occurs at the expense of ignoring other more pressing social problems.⁵⁷¹ The arguments for gender board diversity are similar to other cultural and racial types of diversity. Thus, the steps recommended to promote gender diversity may also be valid to create many of the conditions necessary for other types of board diversity such as culture, age, occupation, or race.⁵⁷²

Quotas would not by themselves be sufficient and are unable to resolve the problem of gender imbalance on their own. Emphasising coercive quotas may lead to the tokenistic recruitment of women without any genuine positive impact.⁵⁷³ Many factors that limit women's participation need to be considered besides gender parity laws. Moreover, several variable circumstances are playing a major role in the ascendance of females to the corporate board, including levels of education, distributions of household tasks within families and preferences of working hours.⁵⁷⁴

⁵⁶⁸ Ibid.

⁵⁶⁹ Villiers, C. (2010). Achieving Gender Balance in the Boardroom: Is it Time for Legislative Action in the UK?. *Legal Studies*, 30(4), at 557.

⁵⁷⁰ Heemskerk, E., and Fennema, M. (2014). Women on Board: Female Board Membership as a Form of Elite Democratization. *Enterprise and Society*, 15(2), at 279.

⁵⁷¹ Mathisen, G., Ogaard, E., and Marnburg, T. (2013). Women in the Boardroom: How Do Female Directors of Corporate Boards Perceive Boardroom Dynamics?. *Journal of Business Ethics*, 116(1), at 88.

⁵⁷² Fitzsimmons, S. (2012). Women on Boards of Directors: Why Skirts in Seats aren't Enough. *Business Horizons*, 55(6), at 564.

⁵⁷³ Villiers, C. (2010). Achieving Gender Balance in the Boardroom: Is it Time for Legislative Action in the UK?. *Legal Studies*, 30(4), at 557.

⁵⁷⁴ Heemskerk, E., and Fennema, M. (2014). Women on Board: Female Board Membership as a Form of Elite Democratization. *Enterprise and Society*, 15(2), at 279.

4.6.4 Imposing Female Quota in View of the Saudi Context

Two significant aspects here need to be specified. The first is relevant to the fundamental target of gender diversity and quotas. From this context there are two potential goals: meeting gender parity or improving corporate governance. Dealing with one of these goals does not necessarily entail improving the other⁵⁷⁵ and each of them must be approached in a specific manner as they are influenced by overlapping factors.⁵⁷⁶ McCann and Wheeler try to identify the main goal of gender diversity and quotas as well. They say, “Women should be appointed as NEDs [Non-Executive Directors] as an issue of social justice and in recognition of their economic participation, not because it might be good or is thought to be good for business”.⁵⁷⁷

According to Fitzsimmons the female quota serves only the numbers themselves rather than benefits to the organisation. This tokenism resulted through forcing companies “to put women on their boards’ members and outsiders alike assume they are forced to do so because it is detrimental. Given that boards’ purpose is to provide oversight and guidance to organisations, companies should pursue wider breadth of experience and opinions toward the end of improving governance, not for social justice reasons”.⁵⁷⁸

The UK Corporate Governance Code clearly provides rules and standards to improve the conduct of firms and guarantee diversity on the boards including skills, experience, independence, knowledge and gender.⁵⁷⁹ Despite this legislation looking to support gender diversity the priority diversity in this context is still built according to objective criteria on merit, not gender. The UK Code clearly states that “The search for board candidates should be conducted, and appointments made, on merit, against objective criteria ...”.⁵⁸⁰

⁵⁷⁵ Villiers, C. (2010). Achieving Gender Balance in the Boardroom: Is it Time for Legislative Action in the UK?. *Legal Studies*, 30(4), at 557.

⁵⁷⁶ Mathisen, G., Ogaard, E., and Marnburg, T. (2013). Women in the Boardroom: How Do Female Directors of Corporate Boards Perceive Boardroom Dynamics?. *Journal of Business Ethics*, 116(1), at 88.

⁵⁷⁷ McCann, M., and Wheeler, S. (2011). Gender Diversity in the FTSE 100: The Business Case Claim Explored. *Journal of Law and Society*, 38(4), at 574.

⁵⁷⁸ Fitzsimmons, S. (2012). Women on boards of directors: Why Skirts in Seats aren’t Enough. *Business Horizons*, 55(6), at 564.

⁵⁷⁹ Section b/6 of the UK Corporate Governance Code 2016.

⁵⁸⁰ Ibid, section b/2.

The second important aspect is related to the function of law towards any kind of minority. Is the role of law to protect the minority participation or impose coercive participation? In other words, laws in general seek to guarantee justice and parity for all people by making sure that all have the same rights and there are no barriers preventing anyone from taking opportunities. This, however, does not mean that law could provide any extra privileges to a particular group. There are several laws that protect against discrimination especially in terms of gender, such as the Work and Families Act 2006 and the Equality Act 2010. A woman could use these to challenge her non-appointment to the board of directors if she feels discriminated against by the nomination committee, or any part of appointment procedures.⁵⁸¹

Villiers argues that "the result is that the legislation does not assist women effectively at the higher levels for which tribunal challenges are rare ... despite the existence of the Equal Pay Act 1970 and the Sex Discrimination Act 1975, the reality remains that women receive an overall average of 22.6% less pay than men, and they face occupational segregation and glass ceilings".⁵⁸² If this is the case, enacting further laws may be insufficient to tackle the dilemma of non-compliance and misconduct. Instead, creating further measures of monitoring or implementation and improving the procedures for women to get their rights seems more effective.

In conclusion, women in Saudi Arabia are welcome in boards of directors and are not discriminated against.⁵⁸³ There are no specific provisions based on gender in corporate governance in Saudi Arabia, but the law requires the board of directors to lay down specific and explicit policies, standards and procedures, for the membership of boards of directors.⁵⁸⁴ Moreover, the law emphasises the importance of an annual review of the requirements of suitable skills for membership of the boards of directors and the preparation of a description of the required capabilities and qualifications for such membership.⁵⁸⁵

⁵⁸¹ Villiers, C. (2010). Achieving Gender Balance in the Boardroom: Is it Time for Legislative Action in the UK?. *Legal Studies*, 30(4), at 542.

⁵⁸² Ibid.

⁵⁸³ There are no official data that refer to the real percentage of female representation on boards of directors in Saudi companies. Also, to the best of my knowledge, no studies or other secondary resources deal with this issue in the Saudi context.

⁵⁸⁴ Articles 22/3, 65/3 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁵⁸⁵ Ibid, article 65/5.

However, as a result of several overlapping factors of political and social systems in Saudi Arabia, there are many weaknesses on legislations in terms of popular participation and the participation in decision-making either in political or civilian sectors, which have currently a wide debate to reform. Apart from the context of corporate governance, there are shortcomings in particular parts of human rights legislation, especially in terms of gender. For instance, women in Saudi Arabia are still prevented from driving. Therefore, it is too early in the Saudi context to discuss quotas in corporate boards for social target. Many other legal reforms need to be given priority first.

4.7 Conclusion

This chapter discussed the composition of the board of directors, the appointment of its members and its tenure, as well as its structure, types and size in Saudi Arabia in the light of English law and global standards of corporate governance. It also reviewed some international experiences in this regard which may be appropriate to the Saudi context and capable of helping it to achieve the objectives of corporate governance. The chapter studied in depth the most common traditional models of boards of directors, which are the one-tier system and the two-tier system, to discover their main features that may be appropriate to the Saudi context and capable of facilitating the mechanisms of corporate governance needed. It also discussed the diversity of board membership and the role of executive, non-executive, dependent and independent directors. The provision of shadow directors received substantial attention as did female representation on boards of directors.

A number of suggestions have been provided to reform Saudi law related to board size, conditions and the tenure of directorships in the light of English practice. The UK Corporate Governance Code considers the different circumstances of firms and distinguishes between large and small companies when it deals with these issues. Moreover, it is recommended that Saudi law should be more flexible, similar to some European countries, in allowing the adoption of either the unitary system or the two-tier system, in order to give firms an opportunity to select which one is more suitable for their needs and circumstances. Separately, the chapter strongly recommends adding

proper rules to Saudi legislation to deal with shadow directors to prevent them from interfering.

Whilst this chapter makes an attempt to reform the rules related to the composition of the board of directors, the next chapter will try to review the Saudi legislation that regulates the roles and relationships of the board of directors with internal entities and actors in the company. Raising the effectiveness of the board of directors, general assembly and board committees will help companies deal with the deficiencies in the Saudi political, legal and economic environment and support good corporate governance practices.

Chapter Five

Roles and Relationships of the Board of Directors with the Main Actors under Corporate Governance in Saudi Law as Compared to English Law and Global Standards

5.1 Introduction

In chapter three, the prominent characteristics of the legal, political and economic environment in Saudi Arabia were discussed as well as the Saudi new vision and the national transformation programme, which aim to rapidly create a comprehensive privatisation programme. These characteristics raise significant concerns in terms of corporate governance which relies on a number of fundamental bodies and principles of democracy such as participation, transparency, accountability, and the presence of an independent media and civil oversight institutions. Such an environment also draws attention to the importance of the internal corporate structure, including the board of directors, which is the central aspect that needs to be considered when reviewing the corporate governance system in the Saudi context.

This chapter will try to review the Saudi legislation that regulates the roles and relationships of the board of directors with internal entities and actors such as the shareholders' general assembly, board meetings and board committees in the light of corporate governance in English law and global standards. The intention is to make some recommendations about the role and relationships of the board of directors that will contribute to enriching the respective laws in the form of greater detail, flexibility and enforceability, thus reforming and developing them.

It should be noted here that it is impossible for this research to cover all aspects of the board of directors and its duties and responsibilities. Instead, this chapter will focus on the roles and relationships of the board of directors that are linked with the main question of this research. Moreover, it will try to cover the vital issues that will help a company to deal with the deficiencies in the Saudi political, legal and economic environment which can be found in English law and global standards. The research will not discuss, for example, the detailed duties of the board of directors and the relationship of the board of directors with the CEO. Moreover, it will not cover the measures that ensure the quality of law enforcement and provisions related to breaches of corporate governance rules, negligence and abuse.

5.2 The Annual General Meeting of Shareholders (AGM)

5.2.1 The Importance of the Annual General Meeting in the Saudi Context

The term ‘annual general meeting’ (AGM) can be described as a gathering of the shareholders of a company with those who are entitled to attend⁵⁸⁶ in order to achieve certain goals and to make particular decisions. This compulsory annual meeting usually involves agreeing to the major actions of last year and on future actions and prospects. The AGM discussions cover specifics such as signing off the accounting year, considering whether the firm's goals were achieved as planned, and examining director accountability and electing new ones.⁵⁸⁷ Moreover, determining the company's main direction should be done in the AGM as well as other fundamental issues such as compensation of executives, takeover plans and distribution of profits.⁵⁸⁸

Running a corporation involves complicated operations and decisions that need to be decided on quickly by the board and management team. Therefore, it is impossible to manage the corporation through shareholder referendums as shareholders have different capabilities, interests, aims and investment tendencies.⁵⁸⁹ Hence, by law, directors alone have the ultimate responsibility for the company's affairs, therefore, they are entitled to exercise all powers required.⁵⁹⁰

The role of the AGM from the legal perspective is not to abolish the concept of separation of ‘ownership and control’ but to act as a vehicle to monitor the conduct of directors, which creates a ‘checks and balance’ mechanism within the firm. The administrative authority remains with the board of directors while the shareholders have

⁵⁸⁶ Pettet, B., Lowry, J., and Reisberg, A. (2009). *Pettet's Company Law; Company and Capital Markets Law* (3rd ed.). New York: Pearson Longman, at 144.

⁵⁸⁷ Catasús, and Johed. (2007). Annual General Meetings—Rituals of Closure or Ideal Speech Situations?. A Dual Analysis. *Scandinavian Journal of Management*, 23(2), at 186. And see, Martinez-Blasco, M., Garcia-Blandon, J., and Argiles-Bosch, M. (2015). Does the Informational Role of the Annual General Meeting Depend on a Country's Legal Tradition?. *Journal of Management and Governance*, 19(4), at 850.

⁵⁸⁸ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 762- 763. And see, Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles II/c, at 23.

⁵⁸⁹ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles II, at 19.

⁵⁹⁰ Article 75/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. See also, Pettet, B., Lowry, J., and Reisberg, A. (2009). *Pettet's Company Law; Company and Capital Markets Law* (3rd ed.). New York: Pearson Longman, at 142.

the ability to prevent managers from perpetrating abuses to the detriment of their interests. Beyond that, the shareholders in that meeting have a right to appoint or remove the board of directors or any single member by a simple majority vote of the shareholders.⁵⁹¹

The democratic mechanisms of leadership, control and accountability are the ideal way to identify and reconcile the diverse interests of the parties as well as ensure administrative efficiency, accountability and public scrutiny.⁵⁹² Therefore, discussing accountability issues of shareholders and management in a face-to-face encounter is part of social practice and democratic life which company law and corporate governance are very dependent on.⁵⁹³

Meetings are the backbone of democracy as they are the setting where people can debate decisions that may affect every member in their society, determine the will of the majority as well as probe leaders' accountability. This also applies to a company as it is a specific society where all members have the right to attend and vote for all decisions at the general meeting including appointments where members of the board of directors can be removed.⁵⁹⁴ Therefore, the relationship and interaction between shareholders and board of directors and the different agencies of these two parties are the substantial matters in the corporate governance discourse. Their recurring communications are officially can be done in the AGM which is an important element in any effective corporate governance system.⁵⁹⁵

These relationships and effective interactions in the AGM in the Saudi context are extremely important because the actors do not have experience of democratic practices in the political sphere and there are no civilian bodies that monitor companies' performance. Moreover, the ownership structure is concentrated in the large listed companies. A further issue is that the listed companies fall under the supervision of the

⁵⁹¹ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 762- 763.

⁵⁹² Apostolides, N. (2007). Directors Versus Shareholders: Evaluating Corporate Governance in the UK Using the AGM Scorecard. *Corporate Governance: An International Review*, 15(6), at 1277.

⁵⁹³ Pettet, B., Lowry, J., and Reisberg, A. (2009). *Pettet's Company Law; Company and Capital Markets Law* (3rd ed.). New York: Pearson Longman, at 148.

⁵⁹⁴ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 763.

⁵⁹⁵ Catasús, and Johed. (2007). Annual General Meetings—Rituals of Closure or Ideal Speech Situations?. A Dual Analysis. *Scandinavian Journal of Management*, 23(2), at 169- 170.

CMA which has its own jurisdiction and it is not subject to the jurisdiction of commercial courts.⁵⁹⁶ These increase the importance of the role of AGMs and the need to raise the efficiency of the AGM as it is an essential firewall and a useful tool for shareholders to practice their rights and protect their interests.

Even in developed countries, the AGM has a prominent place as a self-regulatory of corporate governance instruments and governments emphasise its value in reining in the excesses of corporate conduct.⁵⁹⁷ Enhancing for compliance with rules and following good corporate governance practices should arise from the company itself through the collective acts of those who have direct interests rather than the government. A well-run AGM is more capable than any other mechanism to compel directors to act prudently and implement both statutory and non-statutory regulations.⁵⁹⁸

5.2.2 Facilitating Attendance of the AGM

There are some factors that reduce the effectiveness of the AGM as a vital vehicle of corporate governance. Some of these have arisen due to the separation of ownership and control which created more dispersion of ownership and less shareholder control over the company. This is because a single shareholder usually holds only a small percentage of the overall voting shares. Moreover, there are insufficient incentives and instruments to encourage shareholders who are spread across a wide geographical area to pay the attendance costs or monitor directorial conduct.⁵⁹⁹

⁵⁹⁶ See chapter three.

⁵⁹⁷ Apostolides, N. (2007). Directors Versus Shareholders: Evaluating Corporate Governance in the UK Using the AGM Scorecard. *Corporate Governance: An International Review*, 15(6), at 1277- 1278. And see, Martinez-Blasco, M., Garcia-Blandon, J., and Argiles-Bosch, M. (2015). Does the Informational Role of the Annual General Meeting Depend on a Country's Legal Tradition?. *Journal of Management and Governance*, 19(4), at p 850.

⁵⁹⁸ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 763.

⁵⁹⁹ Dignam, A., and Lowry, John P. (2014). *Company Law* (8th ed., Core text series). Oxford: Oxford University Press, at 288.

This may create the impression to shareholders that the AGM itself is a ritual and all crucial matters have been decided in advance.⁶⁰⁰ Indeed, statistics show that the vast majority of shareholders may be indifferent to the AGM, both in terms of attending and voting, especially when the company is not in financial difficulties.⁶⁰¹ Instead, shareholders in listed companies whether individuals or institutions tend to focus much more upon investment returns as the principal concern. They usually diversify their investments, dividing them among several companies. When there is any instability, they prefer to sell their shares and leave.⁶⁰²

Nevertheless, it is important to bear in mind that shareholders' limited power may become very efficient if they act collectively through the AGM. However, certain things need to be in place in the general assembly in order to achieve this ambition. The first is efficient communication which could be boosted by facilitating attendance of shareholders, obtaining information and allowing questions and debates. The second is effective exercise of voting rights whether in person or by proxy, which determines the fate of the management team. These will assist the company to monitor the managers effectively and to pass well-informed resolutions.⁶⁰³

The principal role in a successful AGM is played by the board of directors as it is the body who calls for the convening of the annual general meeting. The board of directors must call the AGM annually in the first 6 months after the accounting reference date, as well as in a number of specific situations, such as when the board of directors receives a meeting request from the firm's auditor or the audit committee, or from shareholders who hold at least 5% of the company's shares⁶⁰⁴ – or even 2% of them in some certain circumstances through the capital market authority.⁶⁰⁵ Moreover, it is compulsory for the board of directors to call shareholders to the extraordinary general

⁶⁰⁰ Catasús, and Johed. (2007). Annual General Meetings—Rituals of Closure or Ideal Speech Situations?. A Dual Analysis. *Scandinavian Journal of Management*, 23(2), at 172.

⁶⁰¹ Apostolides, N. (2007). Directors Versus Shareholders: Evaluating Corporate Governance in the UK Using the AGM Scorecard. *Corporate Governance: An International Review*, 15(6), at 1278.

⁶⁰² Dignam, A., and Lowry, John P. (2014). *Company Law* (8th ed., Core text series). Oxford: Oxford University Press, at 288- 289. And see, Pettet, B., Lowry, J., and Reisberg, A. (2009). *Pettet's Company Law; Company and Capital Markets Law* (3rd ed.). New York: Pearson Longman, at 148.

⁶⁰³ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 765- 767.

⁶⁰⁴ Article 90/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶⁰⁵ *Ibid*, article 90/3.

meeting (EGM) when the company's losses have reached 50% of its capital.⁶⁰⁶ The general assembly is managed by the chairman of the board of directors who is also responsible for calling shareholders to the AGM, sending the topics and the itinerary of the meeting and preparing the drafts of decisions.⁶⁰⁷ One of the main roles of the board of directors in this context is to maximise the attendance and contributions of shareholders in the AGM, particularly minority shareholders. This has a high priority in Saudi listed companies where ownership and control are highly concentrated in the State and its founding families.⁶⁰⁸

The complexity of accounting reports is one of the things that discourages shareholders from entering into discussions on accountability and prevents them from attending the AGM at all.⁶⁰⁹ The OECD Principles of Corporate Governance draw attention to this important point of facilitation in the information obtaining. It recommends simplifying and summarising the reports and information sent to investors and clarifying the policies and standards that regulate the issues that will be discussed in the AGM, such as the standards of managers' remunerations, and the biographical information and experience (CVs) of candidates for membership of the board of directors. Moreover, the OECD Principles recommend taking into account in the AGM agenda the rights of minority shareholders to discuss some information and topics that impact on their interests.⁶¹⁰

Further ways to facilitate shareholder involvement can be found in the OECD suggestions which encourage shareholder participation in the AGM. Improvements have been made by some companies which enable shareholders to submit questions in advance of the AGM so that adequate replies to them may be given by the board of directors or management.⁶¹¹

⁶⁰⁶ Ibid, article 105/1.

⁶⁰⁷ Ibid, articles 86/1 and 90.

⁶⁰⁸ The World Bank, February 2009, Report on the Observance of Standards and Codes (ROSC), Country Assessment, Kingdom of Saudi Arabia, p1, 4.

⁶⁰⁹ Catasús, and Johed. (2007). Annual General Meetings—Rituals of Closure or Ideal Speech Situations?. A Dual Analysis. *Scandinavian Journal of Management*, 23(2), at 170.

⁶¹⁰ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles II/ c-4, at 22-23.

⁶¹¹ Ibid, Principles II/ c-3, at 22.

Proper arrangements should be made by the board of directors to encourage shareholders to take a place in the AGM. The first step is to announce the meeting which shall be done, under Saudi law, at least 10 days before the meeting date through a daily newspaper in the territory of the company's headquarters or by individual recorded mail.⁶¹² English law gives shareholders the longer period of at least 21 days between the notice of call and the meeting date so that they have sufficient time to prepare themselves.⁶¹³ It also provides greater convenience to shareholders by allowing the notice of AGM to be called through electronic means.⁶¹⁴ This modern means of calling shareholders to AGMs was only recently offered in the new Saudi CGR of 2017,⁶¹⁵ bringing it in line with the new Saudi law of companies 2015, which even allows the AGM to be conducted via modern means of communication.⁶¹⁶ However, the new CGR does not address a similar issue arising from the Saudi Law of Companies 2015 which requires the shareholder, who wishes to attend the AGM, to register his name at the headquarters of the company before the meeting date, unless the company constitution provides another way or place for registration.⁶¹⁷ This should be revised to be compatible with article 86 mentioned above, which allows the AGM to be held by means of modern technology. The registering of the names of the shareholders who want to attend the AGM is more need to be done by modern technology than holding the meeting.

Text messages could be used to call shareholders as they are the fastest and most direct way to reach people wherever they are. Especially in Saudi Arabia, where the government recognises that the text messages are an official way to call people, as well as there are several legal responsibilities and banking and governmental services linked with mobile phone numbers. This is due to the fact that all mobile phone numbers in Saudi Arabia are recorded with a personal ID and finger print.⁶¹⁸

⁶¹² Articles 90, 91 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶¹³ Section 307(2) of the Companies Act 2006.

⁶¹⁴ Ibid, section 338(4).

⁶¹⁵ Articles 12/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶¹⁶ Article 86 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶¹⁷ Article 92 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶¹⁸ The Communications and Information Technology Commission (CITC) ordered all mobile phone service providers in Saudi Arabia to enforce fingerprint authentication on all customers starting from 21.1.2016. It also gave current customers a period to do so and to link their mobile phone numbers with their ID cards, including their national ID number. Failure to comply would result in service being completely cut off on 2.6.2016. This decision was made in accordance with a directive from the Ministry

The tendency toward further facilitating the needs of the company sector can be observed in new Saudi Law of Companies issued in 2015 whose aim is to increase the corporate contribution to the national economy. It removes several barriers and reduces the costs and procedures previously imposed on companies. For example, according to the new Saudi Law of Companies, the percentage of shareholder representation in the AGM must reach one quarter or more of the company's capital value to be valid. If the percentage is lower, the law gives the company the right to convene another AGM within a month, regardless of the percentage of shareholders represented then. In addition, this alternative meeting can be held only one hour after the essential AGM provided that this alternative meeting has been mentioned in the statement of calling and the company constitution allows this action.⁶¹⁹ In contrast, the previous law required the announcement of the meeting to be done at least 25 days before the meeting date, unlike the new law which stipulates only 10 days.⁶²⁰ Also, the meeting may not be valid if attended by shareholders representing less than one half of the company's capital. If so, the alternative meeting cannot be held on the same day according to the old law.⁶²¹ In practice, according to the last report issued in 2016, 53.4% of AGMs of Saudi listed firms were convened validly from the first meeting whilst 46.6% of AGMs needed a second meeting to be convened successfully.⁶²²

The new law also provides some simplifications to shareholder participation and further protection for their rights. It gives any shareholder the right to attend an AGM regardless of the number of shares he holds⁶²³ rather than at least 20 shares required by the previous law.⁶²⁴ The new law minimises the loss ratio of capital of a company which necessitates an extraordinary meeting of the shareholders from 75% in the old law to 50%. Furthermore, the new law expands the use of modern means of communication, which increases the potential for shareholder participation.⁶²⁵

of the Interior and also covered visitors and tourists. See the official CITC website: <http://www.citc.gov.sa/en/Pages/default.aspx>, accessed on 7/2/2017.

⁶¹⁹ Ibid, article 93.

⁶²⁰ See the previous Law of Companies 1965 in the Kingdom of Saudi Arabia, article 88.

⁶²¹ Ibid, article 91.

⁶²² See the Capital Market Authority in Saudi Arabia, Annual Report 2016, at p. 87.

⁶²³ Article 86/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶²⁴ See the previous Law of Companies 1965 in the Kingdom of Saudi Arabia, article 88.

⁶²⁵ Article 86/3 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

Further simplifications and protection for shareholder rights can be found in the new Saudi CGR issued on 13th February 2017, which stipulates that one of the main functions and powers of the board of directors is “developing effective communication channels allowing shareholders to continuously and periodically review the various aspects of the company's business as well as any material developments”.⁶²⁶ The new CGR requires a company to announce on the stock market website all of the information about the nominees for the membership of the board. This shall include their experience, qualifications, skills and previous and current memberships and jobs. This information shall also be made available in the company's head office and on its website.⁶²⁷ Moreover, the new CGR requires that the invitation to the AGM, the items of its agenda, the reports of the board, the external auditor, audit committee and financial statements be made available to shareholders on the websites of both the company and the stock market to enable them to make an informed decision in this regard.⁶²⁸ These websites play another role in making the nomination announcement according to the new CGR. They should serve as a means to invite any person who wishes to be nominated to the membership of the board. The invitation shall remain open for at least a month.⁶²⁹

5.2.3 Modern Means of Communication and the AGM

Using modern means of communication may play a vital role in maximising shareholder participation, enabling them to observe their investments more closely and protect their interests. Hence, the traditional concept of a meeting needs to be widened and developed in accordance with the demands of the modern business environment and advancements in information and communication technology. A valid meeting no longer relies on the physical presence of all members in the same meeting room. The modernised concept of ‘virtual presence’ offers a borderless world where a meeting can be held and decisions can be made in separate locations or even without any physical place. This flexible platform is a useful way to accelerate decision-making procedures

⁶²⁶ Articles 22/12 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶²⁷ Articles 8/a of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶²⁸ Articles 14/c of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶²⁹ Articles 68 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

and simplify complicated materials for even unsophisticated shareholders through using graphics, sound and video.⁶³⁰ Holding an AGM through this method reduces the costs of the meeting for both shareholders and the company. It minimises the difficulty in travelling and its expenses for shareholders wishing to attend the meeting and saves the company money that it spends printing the circulating documents.⁶³¹

The Saudi CGR 2017 requests companies to use the most effective and hi-tech means in communicating with shareholders and facilitating the exercise of their rights and accessing information. It also emphasises that arrangements must be made for facilitating the participation of the greatest number of shareholders in the AGM.⁶³² Furthermore, Saudi new Law of Companies 2015 clearly stipulates that the AGM can be held through modern means of communication. This would also allow shareholders to get involved in deliberations and voting on the meeting's decisions according to the regulations laid down by the concerned authority, the CMA.⁶³³

This is compatible with the OECD Principles of Corporate Governance which greatly support effective shareholder participation in key corporate governance decisions.⁶³⁴ Moreover, the Principles recommend the enlarged use of information technology in voting including electronic voting in absentia. Also, processes and procedures for the AGM should not be made unduly difficult or expensive for shareholders, thus preventing them from casting their votes.⁶³⁵ The electronic AGM has obtained statutory recognition from many jurisdictions across the world as long as it ensures effective shareholder participation in the AGM. For example, a general meeting was convened by London Life Assurance which was held in several separate rooms connected by an electronic audio-visual aid. That meeting was considered valid in *Byng v London Life Assurance*.⁶³⁶ Some jurisdictions have gone beyond that such as Delaware in the USA

⁶³⁰ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 767- 768.

⁶³¹ Ibid.

⁶³² Articles 6, 13/g of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶³³ Article 86/3 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶³⁴ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles II/ c-4, at 22-23.

⁶³⁵ Ibid, Principles II/ c-5, at 24.

⁶³⁶ See *Byng v London Life Assurance* [1990] 1 Ch 170.

where holding the AGM is possible without any location through remote communication technology.⁶³⁷

Modern electronic technology has the advantage that it can open a secure window and create several innovative ways for communication and participation between a company and investors. This is especially the case with the development of encryption and the safe procedures of electronic signature. A company can enable every single shareholder to create their own account on the company's website. This gives shareholders access so that they can review the information, ask questions, register their attendance at the AGM, suggest subjects on the AGM agenda, attend the meeting, and discuss and vote for the AGM decisions from a distance. This gives shareholders a better opportunity to exercise their rights and protect their interests by themselves rather than voting by proxy, which is a practice recognised by most laws and internal company statutes.

However, holding the AGM through modern means of communication also has some disadvantages and challenges. For instance, it may give the board of directors an opportunity to avoid face-to-face dialogue with the shareholders and direct accountability. The directors may be more able in an electronic AGM to control the meeting and prevent questions being asked or refuse to answer them. Moreover, in order to ensure the integrity of the electronic AGM, there are some important procedures and requirements such as proper planning, and facilities and physical equipment that must be set up properly before convening the meeting. Thus, holding an electronic AGM with poor organising and with lack of observation procedures may result negative consequences and may destroy the true objective of the AGM.⁶³⁸

It can be concluded, therefore, that adopting both methods – physical and electronic – for holding the AGM may enable a company to benefit from the advantages and avoid the shortcomings. Moreover, the company should take into consideration the shareholders' local culture and the extent that communication technology is used. This means that the meeting may be much easier to arrange in some countries where it can

⁶³⁷ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 767.

⁶³⁸ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 768.

be held in a few separate rooms distributed across the main cities where the majority of the population lives as is the case in Saudi Arabia, for example.

5.2.4 Adopting Cumulative Voting

Voting is the most significant right that shareholders can exercise, and this can be done in the AGM. The effectiveness of this right depends on two factors: the rising number of shareholders who take part in the election, discussed in the previous section, and improving the way of voting. Unlike English law which allows members of the board of directors to be voted on individually,⁶³⁹ the Saudi new Law of Companies 2015 stipulates that companies must adopt cumulative voting for appointing the board of directors at the AGM. This method of election gives shareholders the equivalent rights to the number of shares they possess to vote for their representatives, whether they use all of them for one nominee or divide them between several nominees, as long as there is no duplication. Therefore, the right of voting of each share is unqualified to be used more than once in the election.⁶⁴⁰

This way of voting was recommended in 2006 by the Saudi CGR. It was not a mandatory requirement but falls under the approach of "comply or explain" for all listed companies.⁶⁴¹ This draws attention to the aim of the new Saudi law to maximise the role of minority shareholders by facilitating the appointment of their representatives on the board and protecting their interests by making the cumulative voting mandatory. Saudi law also requires each company to disclose its policy on voting at AGMs in its articles of association.⁶⁴² Whereas, the UK code goes further in terms of disclosure. It stipulates that "when, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result".⁶⁴³

⁶³⁹ Section 160 of the Companies Act 2006.

⁶⁴⁰ Article 95 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶⁴¹ Article 5 of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia.

⁶⁴² Article 95 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶⁴³ Section e/2.2 of the UK Corporate Governance Code 2016.

Cumulative voting allows minority shareholders to cast all of their available votes for a single director nominee. This way may enhance their voting power and give them a greater opportunity to guarantee representation on the board of directors. It is particularly efficient when majority shareholders distribute their available votes to several nominees which may weaken their voting ability.⁶⁴⁴

It can be argued that the concept of cumulative voting comes from the Anglo-American model of corporate governance where the managerial power depends on shareholder primacy rather than labour influence or state control. The late 19th century witnessed the expansion of cumulative voting in the US, where it became compulsory to adopt it in 22 states by the middle of the 20th century and optional in 15 others. However, after deregulation in the 1990s the adoption of mandatory cumulative voting declined rapidly.⁶⁴⁵ Instead, the US model provided alternative ideas to protect the interests of minority shareholders such as independent directors and facilitate the process for stockholders in selecting the directors. This may strengthen the role of minority shareholders, and avoid disharmony on the board and inefficiency by the firm's management in the US context which does not rely on concentrated ownership.⁶⁴⁶ Its misuse in hostile takeovers can be considered the major reason for the decline in the use of cumulative voting in the US. This is because it may provide an opportunity for persons who are motivated by their personal gain to access confidential information, pressure the management and work against the broader interests of all stockholders.⁶⁴⁷

Cumulative voting is also unsupported in EU countries where the stakeholder-centered model and the company is an integral part of the social fabric. As a result of giving minority shareholders a franchise in the board of directors at the expense of other

⁶⁴⁴ Aiwu Zhao, and Alexander J. Brehm. (2011). Cumulative Voting and the Conflicts Between Board and Minority Shareholders. *Managerial Finance*, 37(5), at 466.

⁶⁴⁵ Ibid. And see, Wenjia, Y. (2015). Cumulative Voting: In the US (Declining), in China (Rising) and the EU (Not-Adopted). *European Company and Financial Law Review*, 12(1), at 86.

⁶⁴⁶ Wenjia, Y. (2015). Cumulative Voting: In the US (Declining), in China (Rising) and the EU (Not-Adopted). *European Company and Financial Law Review*, 12(1), at 93.

⁶⁴⁷ Aiwu Zhao, and Alexander J. Brehm. (2011). Cumulative Voting and the Conflicts Between Board and Minority Shareholders. *Managerial Finance*, 37(5), at 466. And see, Wenjia, Y. (2015). Cumulative Voting: In the US (Declining), in China (Rising) and the EU (Not-Adopted). *European Company and Financial Law Review*, 12(1), at 88- 90.

stakeholders such as employees, banks and the local community may create conflicts, injustice and instability.⁶⁴⁸

The shortcomings of cumulative voting can be summarised in four main points. It interferes in the board structure in favour of minority shareholders; presumes a distrust between board members; creates disharmony in management acts; and serves the narrow personal interests of minority shareholders.⁶⁴⁹

The decline of cumulative voting in the US and EU does not mean that cumulative voting has no value for developing countries and emerging economies where market activities, external governance mechanisms, supporting institutions and legal enforcement are weak.⁶⁵⁰ In that context, the demand for insider corporate governance mechanisms including cumulative voting are high in order to enable shareholders to call on their rights directly and deter the board of directors from abusing their power.⁶⁵¹

High state-owned structure of corporations leads to the domination of government agencies over the board of directors through the control and monitoring of its responsibilities as well as by limiting minority shareholder participation. Most of these government agencies are suffering from bureaucracy and a deficiency of incentives to monitor the company's operation closely. This gives senior management more power and the situation may become worse by avoiding cumulative voting. As a consequence, the corporate sector may lose the ability to find a balance between the conflicting interests; the economy at large may become less attractive for investors; and the cost of capital may rise. This situation goes against the trend of improving the structure and efficiency of the capital markets, encouraging long-term investment, and transforming from the state-based economy and developing non-state-owned sectors.⁶⁵²

⁶⁴⁸ Wenjia, Y. (2015). Cumulative Voting: In the US (Declining), in China (Rising) and the EU (Not-Adopted). *European Company and Financial Law Review*, 12(1), at 107.

⁶⁴⁹ Aiwu Zhao, and Alexander J. Brehm. (2011). Cumulative Voting and the Conflicts Between Board and Minority Shareholders. *Managerial Finance*, 37(5), at 467.

⁶⁵⁰ Chen, Y., Li, W., and Lin, K. (2015). Cumulative Voting: Investor Protection or Antitakeover?. Evidence from Family Firms in China. *Corporate Governance: An International Review*, 23(3), at 234.

⁶⁵¹ Wenjia, Y. (2015). Cumulative Voting: In the US (Declining), in China (Rising) and the EU (Not-Adopted). *European Company and Financial Law Review*, 12(1), at 95. And see, Xi, C., and Chen, Y. (2014). Does Cumulative Voting Matter?. The Case of China: An Empirical Assessment. 15(4), at 594.

⁶⁵² Wenjia, Y. (2015). Cumulative Voting: In the US (Declining), in China (Rising) and the EU (Not-Adopted). *European Company and Financial Law Review*, 12(1), at 83,84,85.

It should be noted that adopting cumulative voting cannot succeed on its own to reduce the conflicts between the board of directors and minority shareholders, even in countries with highly concentrated ownership. Effective corporate governance requires using a variety of integrated mechanisms concurrently, such as through the idea of independent directors, the power to authorise a proxy and the rules that ensure an equitable takeover.⁶⁵³

⁶⁵³ Ibid, at 79.

5.3 The Board of Directors, its Members and Meetings

The composition and models of the board of directors were discussed in chapter four, whether that is a unitary or a two-tier system. The chapter also studied the structure of the board of directors including its size and diversity, independence and the conditions of membership. This section will focus on the role and relationships of the board of directors with its members and meetings, which impact on corporate governance in the Saudi context.

5.3.1 The Limits of the Powers of the Board of Directors

The board of directors enjoys full and extensive powers in administrating and overseeing the company's business in order to achieve its objectives. This is the case unless these powers belong to the jurisdiction of the general meeting or if they are restricted by the articles of association. On the other hand, the powers delegated to the executive management must be determined by the board of directors as well as the reserved powers that are subjected to the board decision.⁶⁵⁴ Likewise, the executive management shall provide to the board the periodic reports about their exercise of the delegated powers.⁶⁵⁵ Thus, the boards have the ultimate responsibility for the company even if they delegate some of their powers to the executive managers or to a third party. This is the case even when the board sets up committees and also when it alone is the official representative before government agencies.⁶⁵⁶ Moreover, the board should supervise and monitor the executive managers and is responsible for preparing the financial, economic and administrative policies of the company.⁶⁵⁷

Unlike the old Saudi Law of Companies, there is a tendency to expand the power of the board of directors in the new Saudi Law of Companies 2015 and to remove obstacles that may prevent the board from fulfilling its duties. Hence, the new law allows the board to contract loans whatever their tenures and release the debtors of the company from their liabilities. Furthermore, the board of directors becomes eligible to sell or

⁶⁵⁴ Article 23 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶⁵⁵ Ibid, article 26/17.

⁶⁵⁶ Article 75/1, 78, 82 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And see article 21/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶⁵⁷ Articles 22, 25 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

mortgage the real property or the place of business of the firm. The board of directors no longer needs the upfront permission to do these actions from the AGM or company's constitution, as long as they did not provide any provisions in this regard.⁶⁵⁸ Beyond that, the new Saudi law binds the company to all the acts performed by the board of directors even if these acts are outside the limits of its competence, except if the beneficiary party is acting *mala fide* (in bad faith).⁶⁵⁹

It is worth noting that this wide power of the board of directors needs to be under consideration from the shareholders and the principal investors through taking into account that they still have the right to prevent or provide some restrictions to these powers. They can make some of the above actions be subject to their approval at the general meeting. Moreover, they can require the board to call an extraordinary general meeting (EGM) to amend the articles of association and add some rules that restrict the powers of the board.⁶⁶⁰

To facilitate the fulfilment of the duties of the board of directors, the new Saudi law allows the board of directors to adopt resolutions by submitting them to the directors individually as long as there is no request in writing from any director asking to convene the board to deliberate on such resolutions.⁶⁶¹ It also allows a company to insert in its constitution the authority for a director who cannot attend the meeting to ask another director to vote/act on his behalf.⁶⁶²

5.3.2 The Limits of the Responsibilities of the Board of Directors

The OECD Principles refer to the two essential elements of the fiduciary duty of the board of directors alongside the standards of reference that reflect the extent of their application. Firstly, the duty of care which could be evaluated in accordance with the behaviour in similar circumstances that would be exercised by a reasonably prudent person. Secondly, the duty of loyalty for the company as one integral entity, which

⁶⁵⁸ Article 75/2 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. See the old Law of Companies 1965 in the Kingdom of Saudi Arabia, article 73.

⁶⁵⁹ Article 77 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶⁶⁰ *Ibid*, articles 75/2, 88, 90.

⁶⁶¹ *Ibid*, article 84.

⁶⁶² *Ibid*, article 83/3.

requires board members to monitor transactions of all related parties and to deal with all shareholders fairly.⁶⁶³ The duty of loyalty could be expressed by a duty of trust, which also requires directors to exercise their powers honestly and fairly for the benefit of the shareholders including minority shareholders and taking into account the overall objectives of the company to ensure its success.⁶⁶⁴ Whatever the term selected, the duty of loyalty is considered as a core factor which is central to ensuring good performance and effective implementation of other duties, rules and policies.⁶⁶⁵

Such loyalty could be enhanced through raising the awareness of the board members about the boundary of their role and individual responsibilities, gaining sufficient information about the company activities and potential risks and setting appropriate policies for directors' remunerations and sanctions for abuse of power. This will be discussed later.

The requirements for directors to exercise their powers with reasonable care, skill and diligence, including improving their knowledge, experience and skills needed or expected from the director, have been stipulated and emphasised by higher ranking legislation in England not only the soft laws.⁶⁶⁶ Section 172 of the Companies Act 2006 provides a clear formulation to take into account the duty of acting in good faith. It stipulates that

“a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters)... the likely consequences of any decision in the long term... the desirability of the company maintaining a reputation for high standards of business conduct... the need to act fairly as between members of the company”.⁶⁶⁷

Keay extensively analyses the issue of acting in good faith to promote the success of the company for the benefit of its members as a whole in the light of the interpretations

⁶⁶³ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI/a, at 52.

⁶⁶⁴ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 97.

⁶⁶⁵ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI /a, at 52.

⁶⁶⁶ Section 174 of the Companies Act 2006.

⁶⁶⁷ *Ibid*, section 172(1).

provided by the courts⁶⁶⁸, the scholarly discussion, rules of common law and equitable principles, as well as the role of lawyers in assisting interpretation and applying such duty.⁶⁶⁹ He emphasises that despite the fact that the concept of good faith has been widely used in both common law and civil law jurisdictions, providing a fixed definition is still difficult.⁶⁷⁰ It might receive further determining and distinctions in the future by deciding more law cases.⁶⁷¹ However, it is difficult to demonstrate the directors' breach of this duty under the circumstances and the various conflicting interests that surrounding their decisions and actions.⁶⁷²

Keay presents various explanations of what 'good faith' means that come from several law cases. The general use of 'good faith' is to connote honesty and propriety.⁶⁷³ This honesty may go beyond the personal level and the absence of malice.⁶⁷⁴ Objectively, it may express the concept of reasonableness to refer the fact that directors must act with the caution and diligence that is to be expected of an ordinary person of ordinary prudence.⁶⁷⁵ Many courts explain what 'bad faith' is to avoid stating what can be covered by acting in good faith.⁶⁷⁶

He also discusses at length the matter of the director's judgment and exercising their discretion, which cannot be covered by the criteria and assessment of reasonableness that apply when measuring good faith. Thus, the decision of determining what are the interests of the shareholders and how they can best be fulfilled is, in general, a matter for the directors and their views, not the court and its views.⁶⁷⁷ However, it is not enough for directors to merely declare that they were acting in good faith for the benefit

⁶⁶⁸ See for example, *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72; *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch); *Re Smith and Fawcett Ltd* [1942] Ch 304.

⁶⁶⁹ Keay, A. (2012). *The enlightened shareholder value principle and corporate governance [electronic resource]*. Oxford: Routledge, at 88.

⁶⁷⁰ *Ibid*, at 93.

⁶⁷¹ *Ibid*, at 128.

⁶⁷² *Ibid*, at 105,106.

⁶⁷³ *Olifent v Australian Wine Industries Ltd* [1996] 14 ACLC 510.

⁶⁷⁴ *Lucas v Dicker* [1880] 6 QBD 84; *Re Dalton* [1963] Ch 336.

⁶⁷⁵ *Mid Density Developments Pty Ltd v Rockdale Municipal Council* [1993] 116 ALR 460.

⁶⁷⁶ *Re Walt Disney Co. Derivative Litigation* [2006] 906 A 2d 27. See also, Keay, A. (2012). *The enlightened shareholder value principle and corporate governance [electronic resource]*. Oxford: Routledge, at 95- 97

⁶⁷⁷ Keay, A. (2012). *The enlightened shareholder value principle and corporate governance [electronic resource]*. Oxford: Routledge, at 99, and 104- 106. See also, *Re Smith & Fawcett Ltd* [1942] Ch 304; *Regentcrest plc v Cohen* [2002] 2 BCLC 80; *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598.

of the company regardless of the evidence and all of the surrounding circumstances, which should be gathered and considered by the court.⁶⁷⁸ This may justify a judge's decision not to believe directors' claims and to conclude that they were -in fact- not acting in good faith.⁶⁷⁹ Therefore, all of the factors surrounding this issue must be subjected to and understood in light of the fundamental requirement to promote the success of the company for the benefit of its members as a whole.⁶⁸⁰

The Third Report of Session 2016–17 of the Business, Energy and Industrial Strategy Committee reviews the opinions that are supportive of or criticise the existing section 172 of the Companies Act 2006 whether if it is clear, sufficient or ambiguous.⁶⁸¹ The report recognises that there is a lack of clarity and strength in section 172 of the Companies Act.⁶⁸² However, the report objects to making any amendments in section 172 at this time. It also argues that the primary cause of weaknesses surrounding this section is not its wording but these weaknesses, in fact, come from a failure to comply with such section. Therefore, the issue considering the reasons for failure to comply on the part of the regulator, not amending the relevant legislation.⁶⁸³ Thus, the report recommends that more effective measures should be made to ensure that directors take their duties more seriously in a way that is demonstrable. The report strongly recommend that firms should be required to prepare more specific and accurate reporting, which should be supported by robust enforcement.⁶⁸⁴ The report states that

“directors should be required to report in an accessible, narrative and bespoke form on how they have complied with their duties under section 172. This will force directors to at least actively consider how they meet these requirements during the year and increase the prominence of these other factors throughout the company and also in the minds of shareholders.”⁶⁸⁵

⁶⁷⁸ Ibid, at 104, See also, *Howard Smith Ltd v Ampol Petroleum* [1974] AC 821.

⁶⁷⁹ Ibid, at 102, See also *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 KB 9; *Westpac v Bell Group* [2008] WASC 239; *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598; *Regentcrest plc v Cohen* [2002] 2 BCLC 80; *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No2)* [1995] BCC 1000; *Simtel Communications Ltd v Rebak* [2006] EWHC 572 (QB); *Primlake Ltd (in liquidation) v Matthews Associates and others* [2006] EWHC 1227 (Ch).

⁶⁸⁰ Ibid, at 107. See also, Keay, A. (2011). Good Faith and Directors' Duty to Promote the Success of their Company. (United Kingdom). *The Company Lawyer*, 32(5), 138-143.

⁶⁸¹ UK Parliament Business, Energy and Industrial Strategy Committee. (2017). *Business, Energy and Industrial Strategy Committee 3rd Report. Corporate Governance Volume 1. Report*, HC 702, at 15-17.

⁶⁸² Ibid, at 17.

⁶⁸³ Ibid, at 16.

⁶⁸⁴ Ibid, at 17.

⁶⁸⁵ Ibid, at 18.

Even though the new Saudi Law of Companies gives the board of directors extensive powers to achieve the company's objectives,⁶⁸⁶ it provides detailed rules to ensure that there are no abuses or any personal interest for a director whether directly or indirectly from the transactions or contracts made on the company's account.⁶⁸⁷ The Saudi law states that a company should clarify the responsibilities of the board of directors in its articles of association.⁶⁸⁸ However, the new Saudi Law of Companies is silent regarding the duty of loyalty and acting in good faith and there is an absence of any express or specific reference to this issue unlike what is provided in the Companies Act 2006. This issue has been addressed by lower ranking legislation in the Saudi context.

The new CGR 2017 provides two separate sections that include a number of details about the powers and responsibilities of the board, the chairman, the board members and the executive management, which must be applied to all listed companies.⁶⁸⁹ The CGR stipulates that the board of directors must work “on the basis of complete information, in good faith and with the necessary care and diligence for the interests of the company and all shareholders”⁶⁹⁰ and the board “shall perform its duties of care and loyalty in managing the company's affairs and undertake all actions in the general interest of the Company and develop it and maximise its value”.⁶⁹¹ Every member of the board of directors must take it upon himself to look at the interests of the company as a whole in the long term. It should be made clear that by electing a person to be a board member, he or she becomes an official representative for all shareholders, not just those of the group who voted for them.⁶⁹²

The Saudi new CGR 2017 states that interpretations of the principles of truthfulness, honesty and loyalty shall include, in particular, the following:

"- Truthfulness: is achieved when the relationship between the board member and the company is an honest professional relationship, and he/she discloses to

⁶⁸⁶ Article 75 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁶⁸⁷ Ibid, articles 71,72,73.

⁶⁸⁸ Ibid, article 81.

⁶⁸⁹ See part three of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia, chapters two and three, articles 21 to 31.

⁶⁹⁰ Article 30/17 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶⁹¹ Ibid, articles 21/a.

⁶⁹² Ibid, articles 29, 30/17, 86/2.

the company any significant information before entering into any transaction or contract with the company or any of its affiliates.

- Loyalty: is achieved when the board member avoids transactions that may entail conflicts of interest and ensures fairness of dealing, in compliance with the provisions relating to conflicts of interest in these regulations.

- Care: is achieved by performing the duties and responsibilities set forth in the Companies Law, the Capital Market Law and their implementing regulations and the company's bylaws and other relevant laws".⁶⁹³

In evaluating the above interpretations, an important shortcoming can be found. They restrict the definitions of these principles in some procedural issues such as disclosing conflicts of interest or following relevant laws. This may restrict the application of these principles and have a negative impact on court judgments of different facts presented in different circumstances. It should be noted here that judges are not involved in the process of law-making in the Saudi context and the rules of stare decisis or any doctrine that restricts judges to case law are not followed by Saudi courts.

Exercising an independent and objective judgment is one of the pivotal duties of a director, which significantly relies on gaining the relevant information. Such a duty to exercise independent judgment is stipulated in both the UK Companies Act 2006 and the UK Code of Corporate Governance.⁶⁹⁴ This issue is also partly dealt with in the new Saudi CGR.⁶⁹⁵ Taking into account that the above duty, which shall be discharged by every single director, is different from the provisions emphasised by the Saudi CGR. It merely deals with the independent status of non-executive directors or the provisions preventing directors from having any personal interest in the transactions made for the account of the company.⁶⁹⁶ Independence in exercising an objective judgment needs to be understood in the light of the personal role and the individual responsibility of each director to gain the proper information, express his opinions objectively in the boardroom and serve the interests of the company in the long term. This is intended to improve the ability of the board as a whole, to make the right decisions and to prevent abuses of power. Such a broad definition of 'independence' needs to be considered in Saudi legislation.

⁶⁹³ Ibid, article 29.

⁶⁹⁴ Section 173 of the Companies Act 2006. And section b of the UK Corporate Governance Code 2016.

⁶⁹⁵ Articles 29 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶⁹⁶ Ibid.

5.3.3 The Role of the Board of Directors in its Meetings

In order to ensure the proper discharge of the boards' duties, the board of directors should convene meetings regularly. The new Law of Companies 2015 does not leave this issue up to the total discretion of the company's constitution as it was the case with the old law.⁶⁹⁷ The new law does require the boards to hold meetings at least twice a year, whereas, the new CGR recommends that the board should convene no less than one meeting every three months to make a total of at least four meetings per year.⁶⁹⁸ Furthermore, the chairman must call for a meeting once they receive a request to do so by two directors.⁶⁹⁹ It should be noted here that the number of meetings mentioned above is the minimum set out by the law for all companies regardless of the differences between them. Therefore, the articles of association for each company should take into account the number of board meetings that might be suitable for its circumstances and to meet its administrative needs.

It is difficult to specify the appropriate number of meetings that should be convened by the board annually but some reports suggest that the frequency of regular board meetings should be between four and six times per year in order to enable the directors to discharge their duties.⁷⁰⁰ However, the liability for allocating the proper number of meetings rests with the board of directors as there are no rules to prevent them from holding the meetings needed.

There is, in general, a positive relationship between more frequent meetings by the board of directors and performing their fiduciary duties more effectively, given the fact that a lack of time for directors to perform their duties is the most common problem that faces the board.⁷⁰¹ According to Saudi law, at least half the directors must attend a meeting for it to be valid, provided that the number of present directors is not less than three.⁷⁰² However, when the minimum membership that is required by law or a

⁶⁹⁷ See the old Law of Companies 1965 in the Kingdom of Saudi Arabia, article 80.

⁶⁹⁸ See guiding article 32/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁶⁹⁹ Article 83/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷⁰⁰ Baccouche, S., Hadriche, M., and Omri, A. (2014). Multiple Directorships and Board Meeting Frequency: Evidence from France. *Applied Financial Economics*, at 986.

⁷⁰¹ Vafeas, N. (1999). Board Meeting Frequency and Firm Performance. *Journal of Financial Economics*, 53(1), at 114.

⁷⁰² Article 83/2 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

company's constitution for convening the boards is not available, the new law gives the company a period of 60 days to solve this issue through requiring the remaining directors to contact the AGM to appoint alternative directors that meet the required number.⁷⁰³

The new law draws attention to the crucial importance of the board's meetings and the effective contribution of board members. It requires the board of directors to include in their annual report to the AGM a statement on the number of board meetings and the number of meetings attended by each individual director. The law allows an AGM, on the recommendation of the board, to remove the director who is absent from three successive meetings without giving legitimate excuses.⁷⁰⁴ A useful method can be found in the OECD Principles which enhances the legitimacy and confidence of the board in the eyes of shareholders. It recommends that companies should publish the attendance records for individual board members.⁷⁰⁵

Adopting the resolutions of the board must be made according to the majority vote of the directors either present or represented. The chairman's vote will be carried in case of a tie, unless the company's constitution provides otherwise.⁷⁰⁶ Acting collectively is a significant matter for the directors as they will be jointly responsible for the maladministration, misconduct or violation of the provisions of laws or the company's constitution. The liability rests with every single director who voted for the incorrect decision that caused damages sustained by the company, the shareholders or third parties, although a director who expressly recorded his objection of wrongful provision in the minutes of the meeting will not be liable.⁷⁰⁷ Thus, the board of directors must document its meetings and record them in signed minutes, including all deliberations, votes and resolutions that happened in the meeting. They should also arrange these records in chapters for ease of reference.⁷⁰⁸

⁷⁰³ Ibid, article 70.

⁷⁰⁴ Ibid, article 76/4, 5.

⁷⁰⁵ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI/e-3, at 60.

⁷⁰⁶ Article 83/4 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷⁰⁷ Ibid, article 78/1.

⁷⁰⁸ Ibid, article 85. And see article 37/a-1 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

In comparison, the UK Companies Act 2006 requires companies to take minutes of all proceedings at meetings of the boards and have them authenticated and kept for at least ten years, otherwise sanctions will be imposed.⁷⁰⁹ These authenticated minutes could be used as evidence to prove all proceedings of directors at the meetings.⁷¹⁰ The UK Corporate Governance Code goes beyond this as it widens the board minutes to cover even unresolved concerns or a proposed action about the running of the company to be recorded.⁷¹¹ These measures on recording minutes, keeping them for a long time and the sanctions for breach of these measures have a noteworthy role in promoting internal control and preventing abuse of power. Thus, these measures should be considered by the Saudi legislators.

Convening a board meeting is not only a matter of quantity (number of directors or frequency of meetings) but also a matter of quality. An effective meeting should consider the company's strategic plan, manage the expected risks and pre-empt crises, not just tackle any current problems.⁷¹² An effective board is formed by a variety of members, including executive and non-executive directors who work together as a cohesive team towards a common goal with a high degree of mutual understanding and trust. This depends on the personal qualities of members, their commitment to their duties and the leadership qualities of the chairman as he is the keystone for securing good corporate governance, which ultimately leads to the success of the board.⁷¹³

The chairman plays a central role in promoting independence of thought in the boardroom, opening discussions and at the same time keeping the discussion focused and dealing with all members fairly. Therefore, a successful board depends on the ability of the chairman to discharge **six** main functions:

1. Leadership of the board
2. Management of meetings
3. Strategic leadership
4. Linking the board with the management

⁷⁰⁹ Section 248 of the Companies Act 2006.

⁷¹⁰ Ibid, section 249.

⁷¹¹ Section a/4, 3 of the UK Corporate Governance Code 2016.

⁷¹² Vafeas, N. (1999). Board Meeting Frequency and Firm Performance. *Journal of Financial Economics*, 53(1), at 114.

⁷¹³ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 345- 346.

5. Arbitration between board members and others
6. Acting as the public face of the company⁷¹⁴

The company secretary is another central position in the board of directors that needs to be occupied by an expert to avoid the board from committing an unintentional fault and ensure compliance with applicable laws, policies and standards. The law in both England and Saudi Arabia require a listed company to have a secretary.⁷¹⁵ That person shall be appointed by the board of directors whether from one of its members or not.⁷¹⁶ The company secretary is responsible for coordinating communications with board members, documenting meetings and saving reports sent to the board.⁷¹⁷ Moreover, the secretary and all board members must sign the minutes of deliberations and resolutions of the board which must be entered in a special register signed by the chairman and the secretary,⁷¹⁸ as well as ensure that board procedures comply with the law and internal policies.⁷¹⁹

The company secretary can be considered a safety guardian of the board who ensures proper information flow to and from the board and its committees and advises the board on all matters of governance.⁷²⁰ English law requires that some conditions are met for those occupying such an important position in order to ensure that the company takes all reasonable steps to select a secretary with the correct experience and knowledge. Moreover, the law requires the secretary to have one or more of the qualifications below:

- (a) that he has held the office of secretary of a public company for at least three of the five years immediately preceding his appointment as secretary; (b) that he is a member of any of the bodies specified in subsection (3)⁷²¹; (c) that he is a barrister, advocate or solicitor called or admitted in any part of the United

⁷¹⁴ Ibid, at 347- 349.

⁷¹⁵ Article 81/3 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And see section 271 of the Companies Act 2006.

⁷¹⁶ Articles 37 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷¹⁷ Section b/5.2 of the UK Corporate Governance Code 2016.

⁷¹⁸ Article 85 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷¹⁹ Section b/5.2 of the UK Corporate Governance Code 2016.

⁷²⁰ Ibid, section b/5.

⁷²¹ The Companies Act 2006 states seven specific institutions of chartered accountants “the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants of Scotland, the Association of Chartered Certified Accountants, the Institute of Chartered Accountants in Ireland, the Institute of Chartered Secretaries and Administrators, the Chartered Institute of Management Accountants and the Chartered Institute of Public Finance and Accountancy”.

Kingdom; (d) that he is a person who, by virtue of his holding or having held any other position or his being a member of any other body, appears to the directors to be capable of discharging the functions of secretary of the company.⁷²²

Unlike the previous Saudi CGR, which did not provide any provisions in this regard, the new CGR issued on 13 February 2017 draws attention to the importance of this matter. It recommends that a candidate for the position of secretary have three years of related work experience and hold a degree in law, finance, accounting or management or any equivalent degree. Otherwise, the candidate should have five years of related work experience.⁷²³ It should be noted here that the above conditions are not compulsory for listed companies as they belong to the limited guiding articles of the Saudi new CGR. However, these new rules are necessary in the Saudi context and need to be compulsory in order to give the board of directors a sufficient ability to discharge their duties and improve their internal corporate governance, which may assist to counterbalance the weaknesses in the local environment.

5.3.4 The Importance of Information and Effective Contribution

The crucial liabilities and the vital role that the board of directors plays necessitates sufficient information to be available to the directors to enable them to make their decisions and discharge their duties in an effective manner. The board is responsible for gaining the required information from the executive management and any other reliable sources. Thus, the availability of information for all members shall be ensured by the chairman, particularly for non-executive and new members. Likewise, the board is also responsible for ensuring that there is an appropriate procedure for orienting and training the new board members about the company's business and any financial and legal aspects if necessary.⁷²⁴

Directors, particularly non-executive ones, shall seek to access accurate, relevant and timely information to fulfil their responsibilities independently and objectively. To do this, they need to make contact with the company's major actors such as key managers, the internal auditor, the company secretary and key shareholders, as well as access

⁷²² Section 273(2) of the Companies Act 2006.

⁷²³ Articles 38 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷²⁴ Articles 25/5, 27, 30/17, 39, 40 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

company operations and staff. This may require giving non-executive directors a right to hire an independent external adviser on the company's account.⁷²⁵

In contrast, unsuccessful attempts to gain sufficient information or to consider matters carefully, poor contributions and avoiding making crucial decisions may cause some damage and have consequences for the firm. Hence, being a silent and inactive member or supporting only the negative decisions in the boardroom do not absolve a director from being accountable and held liable. Every individual member needs to do his best and allocate ample time for fulfilling his responsibilities and preparing himself for the meetings of the board and the committees, as well as for ensuring his effective contribution and avoiding the negative consequences.⁷²⁶

The agenda and the relevant documentation on the meetings shall be received by the members with sufficient time to enable them to consider the matters and be prepared. Furthermore, all directors have the right to discuss and consult about the meeting agenda as it also needs to include the opinion of the CEO before it can be submitted by the chairman. In addition, the agenda also needs to be approved by the board once the meeting is convened. This does not abolish the right of any member to record his objection to this agenda in the minutes of the meeting.⁷²⁷

There is a need to develop the content and the manner of submission of the documents that are sent to all directors with the meeting agenda. These documents should provide useful and high-quality information that covers all aspects of the matter that will be discussed to help a director to see the whole picture properly and have enough time to study it. Depending on the meeting agenda, there are many reports that could be included such as the levels of business activity compared with the market, the recent financial accounts and the latest report from the chief executive officer. To facilitate this issue and reduce its cost, the documents needed could be provided electronically, taking into account the confidentiality and the necessity of safeguarding this commercially valuable information.⁷²⁸

⁷²⁵ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI/f, at 61.

⁷²⁶ Article 30 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷²⁷ *Ibid*, articles 35, 37/a-7.

⁷²⁸ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 417, 420.

5.3.5 The Remuneration of the Board Members and Top Executives

There is a close relation between director's remuneration and ensuring transparent corporate governance. This arose as a logical consequence of the separation between ownership and control and the relation of principal-agent. Such a relationship faces the difficult task of finding a balance between providing proper incentives and avoiding the major costs of risk.⁷²⁹ The level of financial returns that could be earned by directors and top executives is one of the significant matters that affect their role and relationship with the company. Therefore, both legislation and company constitutions pay careful attention to this issue and allocate a specific committee to prepare an appropriate policy of compensation and remuneration of directors which should also be reviewed annually.

The terms “compensation and remuneration” can cover all long and short-term incentive schemes, including salaries, allowances, percentage of profits and bonuses related to performance, whether they are annual or periodic.⁷³⁰ This matter of remuneration of board members and top executives is subject to the jurisdiction of three legislative elements: the law of companies, the articles of association and the relevant policy approved by the general meeting. There are also three actors involved in preparing, reviewing and approving such remunerations: the AGM, the board of directors and the remuneration committee.

According to the Saudi Law of Companies 2015, the articles of association of the company shall determine the method of board remuneration. It allows the remuneration to take the form of an attendance allowance, a lump sum amount, rights in rem, a certain percentage of the net profits or combining two or more of these privileges.⁷³¹ Moreover, the articles of association should also specify the emoluments of each chairman, deputy chairman, managing director and secretary in addition to the remuneration prescribed for board members. Otherwise, this determining duty shall be transferred to the board of directors,⁷³² which is also responsible for including in its annual report to the AGM

⁷²⁹ Aggarwal, R., and Ghosh, A. (2015). Directors' Remuneration and Correlation on Firm's Performance. *International Journal of Law and Management*, 57(5), at 377.

⁷³⁰ Article 1 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷³¹ Article 76/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷³² *Ibid*, article 81/1, 2.

a comprehensive statement that covers all privileges, financial and rem, received by directors and members of committees. This statement must indicate the amounts received by directors in consideration of executive functions or created by their services, whether that is technical, advisory or administrative.⁷³³ In addition, such a report must include details of the highest compensation and remuneration paid by the company to the top five executives and the CEO and the chief finance officer, whether they are among the top five or not.⁷³⁴ Disclosing the remuneration of board members and key executives is compatible with OECD Principles as these consider it good corporate governance practice. This is something that has been adopted by an increasing number of countries.⁷³⁵

The AGM is the competent authority, in Saudi law, for defining the remuneration of audit committee members⁷³⁶ and approving the remuneration of the members of the nomination and remuneration committees.⁷³⁷ Moreover, the remuneration committee plays a pivotal role in preparing clear policies of compensation and remuneration for directors and top executives in accordance with the standards that should be built based on performance.⁷³⁸ However, the Saudi new Law of Companies adds another standard to such a policy related to the number of meetings attended by each director.⁷³⁹

The OECD Principles call for such policies to clarify the specific link between remuneration and firm performance including measurable standards and some conditions of payment for extra-board activities, which consider the longer-term interests of the firm and its shareholders. This assists shareholders to evaluate both the incentive schemes and the capability of the board logically, as well as to strike a balance between the costs and benefits.⁷⁴⁰

⁷³³ Ibid, article 76/4. See also article 93/a- 4 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷³⁴ Article 93/a- 4 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷³⁵ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles V/ a-4, at 44.

⁷³⁶ Article 101 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷³⁷ Article 64/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷³⁸ Ibid, article 62/2.

⁷³⁹ Article 76/2 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷⁴⁰ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles V/ a-4, at 44.

The correlation between director remuneration and firm performance has been adopted by the most developed countries, such the USA, the UK, Germany, Italy and Japan.⁷⁴¹ Also, there is a tendency in the European legislative approach to focus on the socio-legal perspective of director remuneration, which should be built on **three** norms: first, the duties of directors, particularly to consider the long-term interests of the firm, to avoid conflicts of interest and to manage risk soundly; second, the rights of shareholders to contribute to the management and enhance the long-term interests of the firm; finally, the rights of stakeholders to have a role in corporate governance.⁷⁴²

Saudi law restricts the policy of director remuneration through a conclusive framework and some specific rules. It also considers any determinations that violate its provisions as null and void. The law stipulates that remuneration which takes the form of a certain percentage of profits must not exceed 10% of the net profits of the company after deducting the reserves determined by law, the company's constitution or the AGM, as well as after distributing a dividend of not less than 5% of the company's capital to the stockholders.⁷⁴³ Furthermore, the Saudi new law sets a maximum limitation of the total amount that could be received by a director in all cases, including financial remuneration or rem privileges to not exceed 500,000 Saudi riyals per year, equivalent to US\$133,333.⁷⁴⁴

It will be recalled here that while the Saudi new law provides a new rule restricting the remuneration for a director to be limited to SR500,000, the same law provides a new section that includes 8 articles that place strict sanctions against convicted directors which may reach a fine of SR5 million and 5 years' imprisonment.⁷⁴⁵

Regardless of the size of the remuneration provided by the Saudi new law, it is difficult to set a single unified amount of the maximum remuneration for all directors regardless of size, value, needs, responsibilities and difficulties of the different firms they belong to. Such a limitation of the amount of remuneration may need to be reviewed,

⁷⁴¹ Aggarwal, R., and Ghosh, A. (2015). Directors' Remuneration and Correlation on Firm's Performance. *International Journal of Law and Management*, 57(5), at 378.

⁷⁴² Lee, J. (2012). Regulatory Regimes and Norms for Directors' Remuneration: EU, UK and Belgian Law Compared. *European Business Organization Law Review*, 13(4), at 635.

⁷⁴³ Article 76/2 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷⁴⁴ Ibid, article 76/3.

⁷⁴⁵ Ibid, articles 211 and 218.

particularly when taking into account the fact that the currency is subject to the risk of price changes and decline. This change may happen much faster than the ability of legislation to be amended, which takes a long time and needs to go through several legal procedures. Moreover, there is a need to clarify this limitation applied in all cases, as expressed by the new law,⁷⁴⁶ to explain if this even covers the executive directors who have additional responsibilities much more than just attending meetings. This may assist in avoiding any possibility of misunderstanding.

When the director's remuneration package has been designed, it is important to take into account its capability to retain and attract a good calibre of directors. It is, in general, true that linking a part of the director's remuneration with the company's profits and the performance to enhance the firm's business is a good idea. However, it should be recognised that it may differ from one company to another and is subject to a number of factors such as the firm's size, the ownership structure, the kind of industry and the competition between companies in attracting good directors.⁷⁴⁷

On a different note, English law requires quoted companies to prepare a separate annual report of directors' remuneration. Moreover, the Enterprise and Regulatory Reform Act 2013 adopts a stronger, clearer link between pay and performance to promote better engagement between companies and shareholders in quoted companies. It adopts some rules to empower shareholders to hold companies accountable through binding shareholder votes on a company's general policy for annual directorial remuneration.⁷⁴⁸ The Companies Act 2006 emphasises the information that must be given in the company's reports and annual accounts including all directors' benefits and remuneration, whatever form they may take. Thus, the Companies Act 2006 stipulates some detailed examples, such as payments for loss of office and payments by third parties for services provided to a person as director or in any capacity while he or she is a director.⁷⁴⁹

⁷⁴⁶ Ibid, article 76/3.

⁷⁴⁷ Aggarwal, R., and Ghosh, A. (2015). Directors' Remuneration and Correlation on Firm's Performance. *International Journal of Law and Management*, 57(5), at 379.

⁷⁴⁸ Sections 79(3) and 79(4) of the Enterprise and Regulatory Reform Act 2013, amending the Companies Act 2006 by inserting a new section 439A (Quoted companies: members' approval of directors' remuneration policy). See also, Petrin, M. (2015). Executive Compensation in the UK: Past, Present, and Future. *The Company Lawyer*, 36(7).

⁷⁴⁹ Sections 412, 420 of the Companies Act 2006.

More examples of these kinds of remuneration can be found in the UK Code such as pension contributions and earnings received by an executive director by virtue of working as a non-executive director elsewhere. All of these remunerations should be regulated by the remuneration committee through a proper policy and be included in the remuneration report.⁷⁵⁰ Disclosing membership of other boards and the remuneration that came from them enables shareholders to assess the experiences, possible pressures, the sufficiency of time and potential conflicts of interest which affect the director's performance. This level of transparency may be more important than restricting the number of board memberships that can be held by the same director.⁷⁵¹

The UK Code draws attention to the long-term success of the company, which should be promoted through well-designed long-term incentive schemes for directors that are approved by shareholders.⁷⁵² The schemes of performance-related remuneration should be based on transparent elements that reflect the time commitment and responsibilities. This includes non-financial metrics, creating a balance between fixed and performance-related remuneration and taking into account the position of the firm compared to other companies.⁷⁵³ Beyond that, the UK Code requires the remuneration committee to include some provisions in such schemes that would enable the firm to stop paying remuneration or recover amounts paid in certain cases for the violations of a director.⁷⁵⁴

The new Saudi CGR draws attention to some important points that shall be considered when establishing the remuneration policy. It shall be consistent with the company's long-term strategy, objectives and level of risk that may be faced by a director, as well as considering the position, responsibilities, educational qualifications and practical experience required to attract and retain talented professionals. The practices of other companies in this regard should be taken into account. Moreover, the policy shall consider situations and cases of suspending or reclaiming remunerations.⁷⁵⁵

⁷⁵⁰ Sections d/1.2 and d.1.4 of the UK Corporate Governance Code 2016.

⁷⁵¹ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI/e-3, at 60.

⁷⁵² Sections d/1 and d.2.4 of the UK Corporate Governance Code 2016.

⁷⁵³ *Ibid*, sections d/1, d/1.3 and schedule A.

⁷⁵⁴ Section d/1.1 of the UK Corporate Governance Code 2016.

⁷⁵⁵ Article 62 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

5.3.6 Conclusion

This section discussed the role and relationships of the board of directors with its members and meetings which impact on administrating and overseeing the company's business. The findings and recommendations can be summarised by the points below:

- The new Saudi Law of Companies 2015 expanded the power of the board of directors and removed obstacles that may prevent the board from fulfilling its duties. However, this broad power needs to be understood in relation to the fact that it is contained by the right of shareholders and principal investors to prevent or provide some restrictions to these powers.
- There are two essential elements of the fiduciary duty of the board of directors: the duty of care and the duty of loyalty for the company as one integral entity which has interests in the long term. These duties need to be clarified further in the Saudi CGR to avoid restricting them in some procedural issues such as disclosing conflicts of interest or following relevant laws.
- Exercising an independent and objective judgment is one of the pivotal duties of a director. Independence in exercising an objective judgment needs to be understood in the light of the personal role and the individual responsibility of each director to gain the proper information, express his opinions objectively in the boardroom and serve the interests of the company in the long term. Such a broad definition of 'independence' needs to be considered in Saudi legislation in the light of the English context.⁷⁵⁶
- The board of directors must document its meetings and record them in signed minutes, including the number of meetings attended by each individual director and all deliberations, votes and resolutions that happened in the meeting. It may be useful for Saudi legislators to consider some of the measures adopted in England such as taking minutes of all proceedings at meetings of the boards and having them authenticated and kept for at least ten years.⁷⁵⁷ This would mean that even

⁷⁵⁶ Section 173 of the Companies Act 2006. And section b of the UK Corporate Governance Code 2016.

⁷⁵⁷ Section 248 of the Companies Act 2006.

unresolved concerns or a proposed action about the running of the company would be recorded.⁷⁵⁸

- The company secretary is another central position in the board of directors that needs to be occupied by an expert to avoid the board committing an unintentional fault and ensuring compliance with applicable laws, policies and standards. English law requires some conditions to be met for those occupying such an important position in order to ensure that the company takes all reasonable steps to select a secretary with the correct experience and knowledge.⁷⁵⁹ Those conditions are necessary in the Saudi context and need to be compulsory in order to give the board of directors sufficient ability to discharge their duties and improve their internal corporate governance, which may assist to counterbalance the weaknesses in the local environment.
- Directors, particularly non-executive ones, should aim to access accurate, relevant and timely information to fulfil their responsibilities independently and objectively. To do this, they need to make contact with the company's major actors such as key managers, the internal auditor, the company secretary and key shareholders. Every individual member needs to do his best and prepare himself to fulfil his responsibilities and to ensure his effective contribution. On the other hand, there is a need to develop the content and the manner of submission of the documents that are sent to all directors with the meeting agenda.
- There is a need to review the limitation set by Saudi law of the total amount that could be received by a director in all cases.⁷⁶⁰ It is difficult to set a single unified amount of the maximum remuneration for all directors regardless of size, value, needs, responsibilities and difficulties of the different firms they belong to.

⁷⁵⁸ Section a/4, 3 of the UK Corporate Governance Code 2016.

⁷⁵⁹ Section 273(2) of the Companies Act 2006.

⁷⁶⁰ Article 76/3 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

5.4 The Committees of the Board of Directors

In order to assist the board to engage with its responsibilities effectively and to improve the work environment, the company needs to establish a number of specialist committees in accordance with its requirements and circumstances.⁷⁶¹ These committees, particularly where there is a potential for conflicts of interest, can increase the possibility for company affairs to be tackled objectively and independently, as well as to increase adherence to the law, relevant bylaws and policies. These committees, however, will not reduce the collective responsibility of the board of directors and the individual responsibility of its members.⁷⁶²

According to Saudi law, it is compulsory for a joint stock company to set up three committees to be named the “Audit Committee”,⁷⁶³ the “Nomination Committee” and the “Remuneration Committee”.⁷⁶⁴ The new Saudi CGR recommends that companies form another two committees, namely the “Risk Management Committee” and “Corporate Governance Committee”.⁷⁶⁵ Except for the audit committee,⁷⁶⁶ the board of directors is responsible for forming all its committees, appointing their members, and defining the jurisdictions and duties of each committee.⁷⁶⁷ Moreover, the board should also approve the bylaws of all its committees and lay down the general procedures, the tenure of both permanent and ad hoc committees, the powers delegated to them and the manner in which their activities can be monitored by the board of directors periodically. On the other hand, these committees should notify and report to the board their activities, findings and decisions with complete transparency.⁷⁶⁸

The Saudi CGR requires the company to appoint a sufficient number of non-executive members to certain committees as their objectivity is vital to the company. These committees are usually concerned with activities that might involve conflicts of interest, such as reviewing the integrity of the financial reports and the deals concluded by the

⁷⁶¹ Article 50 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁶² Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI/e, at 57-59.

⁷⁶³ Article 104 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷⁶⁴ Articles 61, 64 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁶⁵ Ibid, articles 70, 95.

⁷⁶⁶ Article 101 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷⁶⁷ Article 50 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁶⁸ Ibid, articles 50/2, 53/c.

company, nominating the membership of the board, appointing the management and determining remuneration.⁷⁶⁹ It is allowed for the board of directors to appoint persons other than board members, whether shareholders or otherwise, provided that the chairmen of the committees mentioned are independent directors.⁷⁷⁰ In addition, each committee, within the scope of its powers, can seek assistance from any specialists or experts, whether internal or external, provided that this is included in the minutes of the committee meeting.⁷⁷¹ However, the new CGR prevents the chairman of the board from being the chairman of any of the committees mentioned in the CGR.⁷⁷² Furthermore, with the exception of members of the committee, no member of the board or the executive management may attend the meetings of a committee without an invitation from that committee to listen their opinions or advice.⁷⁷³ Nevertheless, the new CGR requires the chairmen of each committee to attend the AGM to answer shareholders' questions.⁷⁷⁴

According to the last published report of the CMA in Saudi Arabia, the independent members in audit committees accounted for 41.5% of total audit committees' seats in listed firms. Data also show that non-executive members represented 18% and almost 40.5% of audit committees' membership was formed from non-board members. Likewise, the committees of nomination and remuneration in listed companies was where independent, non-executive and non-board members accounted for the greatest number of seats with 93% of total seats, whereas executive members occupied only 7% of total seats.⁷⁷⁵

5.4.1 Audit Committee

It is argued that the importance of the audit committee has been increasingly recognised after a series of successive financial collapses. It became one of the primary

⁷⁶⁹ Ibid, article 52/a.

⁷⁷⁰ Ibid, article 51/b.

⁷⁷¹ Ibid, article 52/b.

⁷⁷² Ibid, article 51/c.

⁷⁷³ Ibid, article 53/a.

⁷⁷⁴ Ibid, article 50/5.

⁷⁷⁵ See the Capital Market Authority in Saudi Arabia, Annual Report 2016, at p. 84, 85.

mechanisms of good corporate governance as it assists the board of directors to carry out its obligations and facilitates the oversight function of internal and external auditing and accounting.⁷⁷⁶

Unlike the old Saudi law of companies, which did not provide any specific provisions about a company's committees, the new Law of Companies 2015 allocates a separate section containing four articles that set out the provisions of the audit committee. It stipulates that the audit committee shall be formed by a resolution from the AGM and must comprise between three to five members, provided that none of them belongs to the executive board members. The resolution shall also define its jurisdictions and duties, standards of its work and remuneration of its members.⁷⁷⁷ The report of this committee has the same requirement as the reports of directors and auditor, and the financial statements. They must be approved at the AGM and have copies filed at the Ministry of Commerce and the Capital Market Authority (CMA) for listed companies.⁷⁷⁸ Moreover, sufficient copies of this report must be made available for shareholders at the company's main headquarters at least ten days before the date of the AGM.⁷⁷⁹

The new Saudi CGR provides several provisions that give the audit committee further independence. It prevents the chairman of the board and any other person who works in or has worked in the company's finance department, or in the executive management or for the company's external auditor during the preceding two years from being a member of the audit committee.⁷⁸⁰ Moreover, the new CGR requires that one of its members be specialised in finance and accounting.⁷⁸¹ The last point will make the committee more likely to discharge its duties, which are crucial, it is also more compatible with the UK Corporate Governance Code and global standards.⁷⁸²

⁷⁷⁶ Alzeban, and Sawan. (2015). The Impact of Audit Committee Characteristics on the Implementation of Internal Audit Recommendations. *Journal of International Accounting, Auditing and Taxation*, 24, at 61.

⁷⁷⁷ Article 101 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷⁷⁸ Ibid, article 128.

⁷⁷⁹ Ibid, article 104.

⁷⁸⁰ Articles 51/c, 54/d of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁸¹ Article 54/a of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia. This also compatible with

⁷⁸² Section c/3.1 of the UK Corporate Governance Code 2016.

The audit committee is concerned with monitoring the company's business. Therefore, it has the right to access the company's records and documents as well as to request any clarification or statement from the members of the board of directors or executive management. It may also request that the board of directors call an AGM if it is faced with hindrances from the board of directors or executives as well as if the company has suffered from substantial damage or losses.⁷⁸³

The audit committee must convene at least four meetings per financial year and must also meet periodically with the company's external and internal auditors.⁷⁸⁴ The audit committee shall review and give its opinion about the effectiveness and the integrity of the financial statements, the accounting policies of the company, reports and notes provided by the auditor. It shall also prepare an annual report on its view of the adequacy of the internal control system in the company including the activities of such committee and decisions have taken within its competence.⁷⁸⁵ The audit committee has the initial responsibility to make recommendations to the board for appointment, reappointment, dismissal and the remuneration of external auditors in order to prepare them to be approved by the shareholders at the AGM.⁷⁸⁶

According to the new Saudi legislation, the audit committee is no longer considered merely a board committee like the other committees that are formed and controlled by the board of directors. The new Saudi CGR goes further, stipulating that:

"If a conflict arises between the recommendations of the audit committee and the Board resolutions, or if the Board refuses to put the committee's recommendations into action as to appointing or dismissal the company's external auditor or determining its remuneration, assessing its performance or appointing the internal auditor, the Board's report shall include the committee's recommendations and justifications, and the reasons for not following such recommendations".⁷⁸⁷

The provisions mentioned above may give the audit committee a stronger position and further independence, in particular, over appointing and removing the members of such a committee by the AGM. This can be considered a pivotal addition in the new Saudi Law of Companies which, to some extent, may enable the audit committee to play a

⁷⁸³ Article 103 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁷⁸⁴ Article 57 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁸⁵ Ibid, article 104.

⁷⁸⁶ Article 55/c of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁸⁷ Article 56 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

partial role like a supervisory board in the two-tier model which consists of the non-executives exclusively and aims to monitor the management board of executives.

In comparison, the UK Corporate Governance Code gives the board of directors the job of forming the audit committee. Moreover, it does not prevent the company chairman from being a member of the audit committee; it only prevents him from chairing said committee. Nonetheless, this provision only applies to smaller companies.⁷⁸⁸

Alzeban and Sawan argue that there are **four** characteristics of the audit committee that ensure a high quality of performance, higher implementation of the audit committee recommendations and more effective risk management. Such characteristics are: greater independence than other committees, a higher level of expertise of its members in its working scope, a greater number of members and a greater frequency of meetings.⁷⁸⁹

5.4.2 The Nomination and Remuneration Committees

The new Saudi CGR requires the board of directors to form two committees for nomination and remuneration functions that shall not involve executive directors. However, it allows a company to combine the remuneration and the nomination committees into one committee⁷⁹⁰ as had been required in the old CGR.⁷⁹¹ There are two main roles for these committees: nominating the potential directors for the upcoming period and laying down the policies and standards related to performance. And also, they are responsible for organising the remunerations of the board members and senior executives.⁷⁹² It is evident that these two functions are not related to each other and they may have different requirements and different members' skills to achieve their goals and focus on their specific duties. Hence, both the UK Code and OECD Principles deal with these two functions separately through allocating two independent

⁷⁸⁸ Section c/3.1 of the UK Corporate Governance Code 2016 and see also the following sections until c/3.8.

⁷⁸⁹ Alzeban, and Sawan. (2015). The Impact of Audit Committee Characteristics on the Implementation of Internal Audit Recommendations. *Journal of International Accounting, Auditing and Taxation*, 24, at 62, 69.

⁷⁹⁰ Article 50/7 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁹¹ Article 15/a, b of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia.

⁷⁹² Articles 61, 65 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

committees to be named the “Nomination Committee” and the “Remuneration Committee”.⁷⁹³

The regulations for the remuneration and nomination committees including their running, duties and rules for selecting their members, the terms of their membership and their remunerations shall be issued at the AGM, as per the board’s recommendation.⁷⁹⁴ Issuing such regulations from a higher authority gives these committees and their powers further protection from being restricted by the board and executive directors, and it is more compatible with the Saudi context where the power of shareholders needs to be maximised. In contrast, the UK Code and OECD Principles of Corporate Governance do not require the AGM’s approval for defining their role and the authorities delegated to them by the board of directors, as long as they have been disclosed and are available.⁷⁹⁵ This may be more consistent with the ultimate responsibility of the board for the activities of these committees and for appointing their members. However, the UK Code provides additional conditions and details that may support the independence of the nomination committee. It requires the majority members and the chair of such a committee to also be independent. Furthermore, it prevents the chairman from chairing the committee if the committee is dealing with the appointment of a successor to the chairman.⁷⁹⁶

The nomination committee plays a significant role in gathering human resources data about senior management in order to nominate the potential directors to be appointed at the AGM.⁷⁹⁷ It is recommended that the number of names presented to the AGM be greater than the number of available seats in order to give the AGM the flexibility required to select the board members from among those nominees.⁷⁹⁸ This function has a long-term influence that is either positive or negative over the company, which necessitates a careful consideration to put in place the policies and standards needed.

⁷⁹³ Section d/2 and b.2 of the UK Corporate Governance Code 2016. And see, Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles VI/d-4,5, at 54,55.

⁷⁹⁴ Articles 60/b, 64/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁹⁵ Section b/2.1 of the UK Corporate Governance Code 2016. And see, Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles II/ c-4, at 22-23.

⁷⁹⁶ Section b/2.1 of the UK Corporate Governance Code 2016.

⁷⁹⁷ Article 68 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁷⁹⁸ Article 66/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

Therefore, the Saudi CGR gives this committee a crucial responsibility to prepare an annual description and review that covers all skills, capabilities, qualifications and the time required for the membership of the board of directors.⁷⁹⁹ However, the board of directors has the ultimate responsibility for laying down explicit policies, standards and procedures for the membership of the board of directors, which must be approved by the general meeting of shareholders.⁸⁰⁰

An annual internal evaluation needs to be carried out by such a committee to discharge its role effectively. In doing so, it should review the structure of the board of directors, determine the strengths and weaknesses in the board of directors and ensure the continuance of the independence of the independent board members and the absence of any conflicts of interest. Moreover, it needs to provide appropriate recommendations on all these aspects.⁸⁰¹

This committee has a vital role to minimise the time and efforts and facilitate the procedures of the AGM to elect a balanced and qualified board. It improves the selection and the searching process through fully disclosing the experience and background of candidate members to be elected in accordance with their abilities and suitability for the company.⁸⁰²

5.4.3 Evaluation of the Board of Directors and its Committees

Self-evaluation is a significant means of ensuring good performance and implementation of internal and external laws and policies. It requires a high degree of transparency, openness, honesty and agreement on goals from every director, committee and support staff. Much time and effort needs to be taken, such as interviewing directors, talking with auditors and institutional investors and collecting accurate data, as well as analysing attendance records and minutes of board meetings and its committee. The roles and contributions of each individual director should be recorded in a personal profile, which should also include all relevant information such

⁷⁹⁹ Ibid, article 65. And see Section b/2.2 of the UK Corporate Governance Code 2016.

⁸⁰⁰ Article 22/3 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸⁰¹ Article 65 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸⁰² Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles II/ c-4, at 22-23.

as experience, education, professional background and interpersonal abilities and skills which brought about his appointment.⁸⁰³

The UK Code provides useful points for assessing the board of directors' performance, its committees and its individual members to be recorded in an annual formal and rigorous report. This evaluation should include the extent that the board works together as a unit and any factor that has an impact on its effectiveness.⁸⁰⁴ Moreover, the senior independent director should command the non-executive directors to evaluate the performance of the chairman without ignoring the views of executive directors.⁸⁰⁵ The Code also requires the board of directors to arrange for the chairmen of the audit, remuneration and nomination committees to be known and available at the AGM to receive shareholders' questions.⁸⁰⁶ Beyond that, the UK Code stipulates that "evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company".⁸⁰⁷

According to the UK Code, this evaluation is not only for the purposes of inclusion in the annual report so that it is available for shareholders and considered by the AGM but is also to be used immediately by the chairman to improve board performance. The UK Code stipulates that "the chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors".⁸⁰⁸

Generally, the board of directors as a whole is a body that is responsible for initiating the board evaluation and ensuring compliance with corporate governance legislations and internal regulations and policies. Such assessment relies on a chairman and his core competencies as he is a person who leads its exercise and plays the key role in taking the initiative and encouraging actors to have a positive interaction with the evaluation processes. He is also able to delegate this function to the chairman of the board

⁸⁰³ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 439, 444, 449.

⁸⁰⁴ Section b/6 of the UK Corporate Governance Code 2016.

⁸⁰⁵ *Ibid*, section b/6.3.

⁸⁰⁶ *Ibid*, section e/2.3.

⁸⁰⁷ *Ibid*, section b/6.2.

⁸⁰⁸ *Ibid*, section b/6.

nomination committee.⁸⁰⁹ This fact does not prevent the hiring of some professional non-competitor bodies or individuals who may play a significant role in independent assessment. This could be provided by a firm specialising in board appraisal, institutes of directors and consultancies, a past chairman, an experienced independent consultant and superior chairman or director from the board of another firm.⁸¹⁰

In the Saudi context, the matter of assessment is still dealt with in a limited manner by disclosing information and providing reports even though a new CGR was issued in 2017. Saudi law requires the board of directors to provide an annual report to the AGM about its actions and the company's affairs. It also requires a statement to be given about the number of board meetings and the aggregate number of attendance of each board member as well as the board's recommendation on this issue.⁸¹¹ Moreover, the report must give a brief description of the main committees, including their names, jurisdictions, duties, names of their chairmen and members.⁸¹² Likewise, the audit committee shall provide an annual report about its activities, findings, decisions and its view about the company business within its competence.⁸¹³ There are also some assessment tasks related to the board business and its members that have been given to the audit and nomination committees, such as reviewing the structure of the board of directors, skills required for board membership and determining the points of strength and weakness in the board of directors.⁸¹⁴ Moreover, a listed company must disclose any punishment that has been imposed on it, any risks facing the company and any material differences in the operational results compared to the preceding year's results. The names of the companies of which any board member is a manager or a board member must also be disclosed.⁸¹⁵

It should be noted here that the assessment of the board of directors and its committees has received special attention in the new Saudi CGR issued in 2017, which features a part dedicated to supporting and assessing the board of directors and covers many points

⁸⁰⁹ Tricker, B. (2015). *Corporate Governance Principles, Policies and Practices* (3rd ed). Oxford: Oxford University Press, at 438, 448, 449.

⁸¹⁰ *Ibid*, at 439, 449.

⁸¹¹ Article 76/4, 5 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁸¹² Article 90/6 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸¹³ *Ibid*, article 91.

⁸¹⁴ Article 103 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And see article 65 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸¹⁵ Article 90/3, 9, 17, 20 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

mentioned above. However, all these provisions for assessment come as guiding articles, which means that they are not technically legislation and do not resolve the need to improve the corporate governance in the Saudi context in this regard. The new CGR stipulates that:

"the board shall develop, based on the proposal of the nomination committee, the necessary mechanisms to annually assess the performance of the Board, its members and committees and the executive management using key performance indicators linked to the extent to which the strategic objectives of the Company have been achieved, the quality of the risk management and the efficiency of the internal control systems, among others, provided that weaknesses and strengths shall be identified and a solution shall be proposed for the same in the best interests of the Company".⁸¹⁶

These procedures should cover individual assessments of the board members and be disclosed to all parties concerned in the assessment as well as attempting to improve the performance of the board through nominating competent professional staff able to improve the performance of the board or any other methods available.⁸¹⁷ Moreover, a periodic assessment of the performance of the chairman of the board should be carried out by non-executive directors. They should consider the opinions of the executive directors and the chairman of the board should not be present while the matter is being discussed.⁸¹⁸ The new CGR also recommends that the board of directors receive an assessment of its own performance from a competent third party every three years.⁸¹⁹

⁸¹⁶ Article 41/a of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸¹⁷ Article 41/b, c, d of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸¹⁸ Article 41/f of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸¹⁹ Article 41/e of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

5.5 The Company Auditor

5.5.1 The Company Auditor in Saudi Law

External audit is a vital mechanism of good corporate governance that protects the rights of shareholders and stakeholders, and at the same time helps its leaders not to commit mistakes. According to Saudi law, the company must have one auditor or more, who must be appointed by the AGM from the observers authorised to work in Saudi Arabia. The AGM shall also determine their remuneration and their work tenure which can be repeated provided that the total duration does not exceed five consecutive years. The auditor can be changed by the AGM at any time without prejudice to their right for compensation if the change occurred at an improper time or for an unacceptable reason.⁸²⁰

In order to carry out his duties, the auditor has the right to access the company's books, records, data and other documents all the time and to request further explanations. The board chairman must facilitate the work of the auditor. Otherwise, the difficulties faced shall be recorded by the auditor in his report submitted to the board of directors. If this is not resolved by the board, he must request a general assembly to be convened to consider this matter.⁸²¹ Moreover, the law requires the auditor to attend the AGM, receive the shareholders' queries and answer their questions in light of company interests.⁸²²

The board of directors must submit their annual report which must include the financial position and the statements of the firm to the auditor at least 45 days before the AGM.⁸²³ Likewise, the auditor must prepare his report, in accordance with generally accepted auditing standards, and submit it to the AGM to be read in the meeting before ratifying the financial statements and the report of the board of directors. This report must cover **three** main subjects: his opinion on the extent of the integrity of the financial statements and accounts of the company, violations of the provisions of law or the internal bylaws provisions of the company; and the attitude of the company administration in enabling

⁸²⁰ Article 133/1 of the Law of Companies 2015 in the Kingdom of Saudi Arabia

⁸²¹ Ibid, article 134.

⁸²² Ibid, article 96.

⁸²³ Ibid, 126/2.

him to obtain the information needed.⁸²⁴ Jurisdiction authorities, such as the Ministry of Commerce and Capital Market Authority, must also receive copies of the auditor's report.⁸²⁵

The auditor is also responsible for preparing a special report when the board chairman informs the AGM about any transactions and contracts in which a director has a personal interest.⁸²⁶ Moreover, he must immediately inform the chairman when company losses amount to half of its capital.⁸²⁷ He also has the right to request to call for an AGM or EGM to be convened and call them himself after 30 days if the board has not responded to his request.⁸²⁸ The duties and responsibilities of the auditor cover all financial matters that the company may face including capital increasing or capital reduction and liquidation of the company.⁸²⁹

To ensure the independence of the auditor, Saudi law prevents the auditor from participating in the foundation of the company, board membership and from doing any technical, administrative or consultative work for the company. This includes being a relative to fourth class or a partner to one who occupied these functions.⁸³⁰ Moreover, the law gives the shareholders who represent at least 5% of the capital the right to ask the Jurisdiction authority to order an inspection of the company if they had found anything suspicious in the acts of the auditor or the members of the board of directors.⁸³¹ With the law, the auditor can be asked for compensation for damage that occurs to the company, the shareholders or others because of errors made by him in the performance of his work or if he broadcasted to others the secrets of the company.⁸³² In addition, there are also strict sanctions against convicted auditors which may reach a fine of SR5 million and 5 years' imprisonment.⁸³³

⁸²⁴ Ibid, article 134.

⁸²⁵ Ibid, article 126/4.

⁸²⁶ Ibid, article 71.

⁸²⁷ Ibid, article 150.

⁸²⁸ Ibid, article 90.

⁸²⁹ Ibid, articles 138, 144, 209.

⁸³⁰ Ibid, article 133/2.

⁸³¹ Ibid, article 100.

⁸³² Ibid, article 136/1,2.

⁸³³ Ibid, articles 211, 218.

It will be recalled that the work of the auditor is linked with the functions of the audit committee which has the task of reviewing the firm's financial statements, the internal control system and the accounting policies. It is also responsible to review the notes of the auditor and pursue the implementation of the corrective measures about them, as well as provide their own report about all of these matters to the AGM.⁸³⁴ Beyond that, the audit committee is the body that recommends the individuals appointed, dismissals and the remuneration of the auditor. Moreover, it shall meet with the auditor periodically, review his plans and its activities and verify his independence.⁸³⁵

There are, in fact, overlapping responsibilities between the auditor and the board of directors and its committees, which should be integrated to ensure the integrity of the financial and accounting procedures. Hence, there is an increasing need for cooperation and interactions among the four components of corporate governance: board of directors, management, internal audit and external audit. Moreover, it is important for them to coordinate the linkages of internal and external audit to enhance the effectiveness of the auditing function and the reliability of financial reports.⁸³⁶ This may also reduce the cost and time of audit work and yield useful information for all parties of corporate governance. It should be taken into account that the nature of the linkages between audit mechanisms are significantly affected by environmental factors, legal system and the techniques and approaches used, which are inadequate in developing countries.⁸³⁷

5.5.2 Company Auditor in English Law and Global Standards

A parallel approach can be found in English law, but with more detail. The UK Companies Act 2006 provides detailed provisions about disclosure of the terms of an auditor appointment, his services and his report, fixed remuneration, and the right to

⁸³⁴ Article 104 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁸³⁵ Articles 55/c-1, 57 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸³⁶ Mihret, Dessalegn Getie, and Admassu, Mengistu Amare. (2011). Reliance of External Auditors on Internal Audit Work: A Corporate Governance Perspective. *International Business Research*, 4(2), at 67.

⁸³⁷ Ibid, at 68.

remove him and resign as well as the matter of voiding the provisions protecting auditors from liability.⁸³⁸

In the English context, for example under *Caparo Industries plc. v. Dickman*, there is no liability for the company auditor that would arise in respect of any negligent misstatement as long as there is no special relationship or assumption of responsibility.⁸³⁹ Therefore, there is no duty of care from the auditor that would be owed to potential investors with regard to their investment decisions since the necessary degree of proximity between the parties is absent.⁸⁴⁰ The Saudi new Law of Companies 2015, in contrast, states that the external auditor "shall be liable to compensate the Company, the shareholders or third parties for the damages resulting from errors it commits in the course of its engagement."⁸⁴¹

Appointing the directors and the company's auditors is the main role of shareholders in governance to ensure that an appropriate governance structure is in place.⁸⁴² Therefore, the UK Code of Corporate Governance 2016 emphasises the duty of the directors and the audit committee to maintain an appropriate relationship with the auditor. This is to ensure the independence and objectivity of the external auditor as well as the effectiveness of the audit process in accordance with relevant professional and regulatory requirements.⁸⁴³

The audit committee should explain in the annual report how auditor objectivity and independence are safeguarded and disclose the length of tenure of the current auditor and when the last tenure occurred, as well as any non-audit services provided by the external auditor.⁸⁴⁴ Moreover, the committee should provide a description of the approach taken to assessing the effectiveness of the external audit and recommending the appointment, reappointment and removal of the external auditor.⁸⁴⁵ Thus, such a

⁸³⁸ Sections 489-532 of the Companies Act 2006.

⁸³⁹ For further cases that support this legal principle see, *James McNaughton Paper Group v Hicks* [1991] 1 All ER 134; *Customs and Excise v Barclays Bank Plc* [2006] UKHL 28; *West Bromwich Albion v El Safty* [2006] EWCA Civ 1299.

⁸⁴⁰ *Caparo Industries plc. v. Dickman* [1990] 2 AC 605.

⁸⁴¹ Articles 36/2, 218 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. See also, Article 82/3 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸⁴² Section c/3 of the UK Corporate Governance Code 2016.

⁸⁴³ *Ibid*, section c and c/3.2.

⁸⁴⁴ *Ibid*, section c/3.8

⁸⁴⁵ *Ibid*.

committee should hold the primary and ultimate responsibility in this recommendation function which needs to be accepted by the board of directors. If it does not accept it then it should explain in the annual report why it takes a different position.⁸⁴⁶ This rule gives the audit committee further power and independence over its duties, something adopted by the Saudi new CGR issued in 2017.⁸⁴⁷

The OECD Principles provide some measures to improve the independence of the auditor and to promote their loyalty to the firm to exercise due professional care rather than anyone else who may interact with their work. These measures can be summarised by the points below:

- The auditor should work under a framework of principles that remove him from threats to his independence, such as self-interest, self-review, familiarity, advocacy and intimidation. This may be done by a combination of policies and procedures that include prohibitions, restrictions and disclosures.⁸⁴⁸
- Restricting or banning non-audit works that the auditor may undertake for his audit client because such services might significantly impair their independence. Furthermore, due to the disclosure of payments that the external auditor has received, any skewed incentives that resulted from non-audit services may be addressed. A tighter regulatory approach can be adopted to deal with this issue through setting a fixed percentage of non-audit income that can be gained from a certain client.⁸⁴⁹ Brandon indicates that there is a negative effect on judgments and decisions of the external auditor when he provides consulting services to the firm and such services may not help improve the functioning of the audit committee.⁸⁵⁰
- Limiting the auditor's work tenure and the mechanism of compulsory rotation of auditors are useful ways to support auditor independence.⁸⁵¹

⁸⁴⁶ Ibid section c/3.7

⁸⁴⁷ Article 56 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸⁴⁸ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles V/c, at 47,48.

⁸⁴⁹ Ibid.

⁸⁵⁰ Brandon, D. (2010). External Auditor Evaluations of Outsourced Internal Auditors. *Auditing: A Journal of Practice and Theory*, 29(2), at 170.

⁸⁵¹ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles V/c, at 47,48.

- Ensuring the competence of the audit profession and promoting compliance with its standards and other relevant laws and regulations may create a great opportunity to exercise due professional care. This can be achieved by making the auditor subject to the discipline of an oversight body of auditors which regulate its membership through an adequate charter based on quality of implementation and ethical standards. Such a situation allows a company to examine the auditors before appointing them as their qualifications and experiences have been registered and confirmed.⁸⁵²

It should be noted that external auditors play a pivotal role in a weak governance environment where legal institutions, the quality of law enforcement and the investor protection laws are inadequate.⁸⁵³ However, the company can independently improve their own governance through selecting a high-quality auditor who is particularly keen to protect his reputation as the cost of hiding misconduct is very high for him. This can also be done through adopting many other means that ensure improved transparency and high disclosure quality.⁸⁵⁴

Maximising firm-level governance will assist the company to counterbalance the weaknesses in the country's legislation or in its enforcement. Moreover, employing a high-quality auditor may mitigate the negative impact of the lack of accounting information caused by a weak legal system. They may also fulfil a strong governance function in such environments.⁸⁵⁵

⁸⁵² Ibid.

⁸⁵³ Hossain, M., Lim, C., and Tan, P. (2010). Corporate Governance, Legal Environment, and Auditor Choice in Emerging Markets. *Review of Pacific Basin Financial Markets and Policies*, 13(1), at 92.

⁸⁵⁴ Ibid at 97- 98.

⁸⁵⁵ Ibid at 99.

5.6 Stakeholders

5.6.1 Determination of Stakeholders

The term ‘stakeholder’ can be defined as “any person who has an interest in the company, such as shareholders, employees, creditors, customers, suppliers, community”.⁸⁵⁶ In other words, it covers “any group or individual who can affect or is affected by the achievement of the organisation’s objectives”.⁸⁵⁷ This includes any types of relationships that need to be considered by managers such as business partners, employees and the parties mentioned above, who deserve to obtain any kind of benefit and avoid risks as they can also affect the firm, whether in processes or outcomes.⁸⁵⁸ They all form part of the whole picture of the company by representing a different part such as a firm’s capital, its infrastructure, human capital commitments or providing a different level of services to it.⁸⁵⁹ The board of directors has two levels of duties towards them: a contractual and a moral duty to ensure the long-term success.⁸⁶⁰

This research aims to discuss listed companies, which have dispersed ownership and generally have large capital and labour inputs as well as a wide impact on different external parties and sectors. The particular nature of the listed company raises the importance of finding a balance between liability, control and ownership to create integrated relationships between key actors in the light of the major purpose of the company. Therefore, it is difficult to consider all the interests of a variety of levels of stakeholders who have a stake or interest in a firm.⁸⁶¹ Hence, the discussion in this chapter will focus on the key groups of stakeholders and their main interests provided that there is no conflict with each other.

⁸⁵⁶ Article 1 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸⁵⁷ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, ISSN: 1450-2889 Issue 4, at 91.

⁸⁵⁸ Ibid.

⁸⁵⁹ Hill, C., and Jones, T. (1992). Stakeholder- Agency Theory. *Journal of Management Studies*, 29(2), at 133.

⁸⁶⁰ Freeman, E., and McVea, J. (2001). A Stakeholder Approach to Strategic Management. *Darden Business School Working Paper*, No. 01-02, at 19, Can be downloaded from the Social Science Research Network Electronic Paper Collection at: http://papers.ssrn.com/paper.taf?abstract_id=263511, accessed on 22/5/2016.

⁸⁶¹ Ibid, at 11.

As discussed earlier, shareholders have an asset specificity, and therefore, they have fundamental rights such as disposition with respect to shares, a share of the distributable profits, attending the AGM and voting on its decisions, supervision of the board of directors' activities and filling in responsibility claims against board members.⁸⁶² However, this does not qualify them to control the firm on their own or to acquire special consideration over all other stakeholders who may be more involved and affected by the firm's risks,⁸⁶³ particularly when taking into account the ability of shareholders to sell their shares at any time.⁸⁶⁴ The firm is not only its capital but also includes complicated assets that should be considered such as intellectual rights, moral rights, secrets and employees' experiences, and its power and role in a society, which may impact the local environment, the quality of life and surrounding industries.

It should be noted that dealing with the interests of different parties and the diversity of a firm's priorities is not a zero-sum game.⁸⁶⁵ Therefore, creating value for all parties assists the company to broaden capabilities and cooperation in its activities and to reduce the probability of any kind of conflict.⁸⁶⁶ It also drives the company to improve the management, business environment and relationships for the long-term success.⁸⁶⁷ Moreover, these actors can play a useful role in facilitating good corporate governance and enhancing internal control mechanisms.⁸⁶⁸

⁸⁶² See part 2 "Rights of Shareholders" of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia, articles 4 to 15.

⁸⁶³ Freeman, E., and McVea, J. (2001). A Stakeholder Approach to Strategic Management. *Darden Business School Working Paper*, No. 01-02, at 18, Can be downloaded from the Social Science Research Network Electronic Paper Collection at: http://papers.ssrn.com/paper.taf?abstract_id=263511, accessed on 22/5/2016.

⁸⁶⁴ Fontrodona, J., and Sison, A. (2006). The Nature of the Firm, Agency Theory and Shareholder Theory: A Critique from Philosophical Anthropology. *Journal of Business Ethics*, 66(1), at 36.

⁸⁶⁵ Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), at 235.

⁸⁶⁶ Beleya, P., Raman, G., Ramendren, C., and Nodeson, S. (2012). Independent Directors and Stakeholders Protection: A Case of Sime Darby. *International Journal of Academic Research in Business and Social Sciences*, 02(04), at 429.

⁸⁶⁷ Freeman, E., and McVea, J. (2001). A Stakeholder Approach to Strategic Management. *Darden Business School Working Paper*, No. 01-02, at 10, Can be downloaded from the Social Science Research Network Electronic Paper Collection at: http://papers.ssrn.com/paper.taf?abstract_id=263511, accessed on 22/5/2016.

⁸⁶⁸ Goergen, M. (2010). *Corporate Governance and Complexity Theory [electronic resource]*. Cheltenham, UK: Edward Elgar, at 4-5.

5.6.2 The Relationship with Stakeholders in Saudi Law Compared to English Law and Global Standards

Starting from the importance of taking into account the interests of stakeholders mentioned above, the first part of the Corporate Governance Regulations in Saudi Arabia clearly refers to this aim. It introduces itself as a regulation that provides rules and standards to ensure the protection of the rights of both shareholders and stakeholders in joint stock companies listed in the exchange, as well as to ensure the management's compliance with the best governance practices.⁸⁶⁹

In addition, Saudi CGR provides a guiding article that requires the board of directors to establish written policies regulating the relationship with stakeholders in order to protect their respective rights and maintain good relationships with each other, as well as regulating the company's social contributions. This policy should cover mechanisms for indemnifying the stakeholders, settlement of complaints or disputes with them, protecting the confidentiality of information related to them and dealing with any case that contravenes their rights under the law and their respective contracts. In addition, the board of directors should regulate the relationship of the company's executives and employees with stakeholders through setting out a code of conduct that is compatible with proper professional and ethical standards. The board should also supervise this code and lay down appropriate procedures that ensure good compliance.⁸⁷⁰

Unlike the above guiding provisions provided by the new Saudi CGR 2017 and the new Saudi Law of Companies 2015, which is silent on this matter, section 172 of the Companies Act 2006 provides a clear and strong formulation to take into account the interests of stakeholders and compel directors to consider the company's stakeholders. It stipulates that

“a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to: ... the interests of the company's employees, ... the need to foster the company's business relationships with suppliers, customers and others, ... the impact of the company's operations on the community and the environment”⁸⁷¹

⁸⁶⁹ Articles 2 and see 22/4 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸⁷⁰ Ibid, see the guiding article 83.

⁸⁷¹ Section 172(1) of the Companies Act 2006.

It is difficult to deny that the new Saudi CGR features a specific section for stakeholders including several articles that would regulate conflicts of interest between all parties and ensure the protection of stakeholders' rights.⁸⁷² However, there is a significant difference between merely protecting the rights of all parties and considering those parties as the vital actors who play a part in building the company's success.

In a similar manner, the OECD Principles cover six aspects that impact on corporate governance. One of these principles is the role of stakeholders including individual employees in corporate governance.⁸⁷³ According to this principle, the framework of corporate governance should recognise, respect, protect and consider the rights of stakeholders under the law and their respective contracts. Stakeholders should be encouraged to take part in creating and developing wealth, jobs and sustainable enterprises through active cooperation with the corporation. In order to do so, they and their representative bodies should be eligible to gain relevant, sufficient and reliable information in a timely and regular way. The company should also ensure that they can communicate freely without fear of losing their rights when they express their concerns about unethical or illegal practices to the board of directors.⁸⁷⁴

The general conclusion that can be drawn from most legal scholars, judges and legal systems is that the interests of various stakeholders and the need to create a fair balance in controlling the firm in the light of its general interests are now recognised.⁸⁷⁵

5.6.3 Employees

5.6.3.1 Employees in the Saudi Context

Employees can be considered as one of the most important stakeholders as they impact greatly on the company and vice versa. Despite the fact that the products and the value of the company rely, to great extent, on employees' level of practice, they are the

⁸⁷² See part 7 "Shareholders" of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia, articles 83 to 85.

⁸⁷³ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles IV/c, at 38.

⁸⁷⁴ Ibid.

⁸⁷⁵ Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), at 230, 231.

weaker party in terms of the ability to claim their rights or complain against the company. This is particularly the case in developing countries where employees may have their rights compromised for doing so and there are no effective civil institutions to support them. The logical solution, therefore, is for them to receive further protection from the board of directors and the rules of corporate governance.

The modern company is not only physical and financial assets owned by shareholders but is also composed of portable knowledge productions owned by employees. They are the human capital of the company and provide time, skills, ideas and experiences,⁸⁷⁶ as well as their role in creating innovations and keeping the secrets of the company. Moreover, they bear the risks as shareholders and, like them, are certainly affected by management decisions but have fewer opportunities for survival. Thus, the role of employees deserves to be appreciated and they should be entitled to payment in exchange for bearing risks.⁸⁷⁷

The relationship between the board of directors and employees needs further attention in the Saudi context due to the particular nature of the political, legal and economic environment in Saudi Arabia that was discussed in detail in chapter three. The Saudi political and legal environment does not support the democratic principles and institution-building that successful corporate governance depends on. There is also a lack of institution-building that might help in raising the confidence of judicial recourse, disclosure levels and rights protection. This is very different to developed countries such as England where there are independent and strong trade unions.⁸⁷⁸ This situation needs to be considered by regulations related to corporate governance and the rules that control internal management.

The Saudi economy has **two** major characteristics that create challenges for employees and the labour environment. The first is that the current Saudi economy is dominated by the public sector which also owns a high percentage of the majority of blue chip companies listed on the market. Consequently, the majority of the national labour force in Saudi Arabia works in the government sector, which creates serious problems for the

⁸⁷⁶ Fontrodona, J., and Sison, A. (2006). The Nature of the Firm, Agency Theory and Shareholder Theory: A Critique from Philosophical Anthropology. *Journal of Business Ethics*, 66(1), at 36-37.

⁸⁷⁷ Ibid.

⁸⁷⁸ Cernat, L. (2004). The emerging European corporate governance model: Anglo-Saxon, Continental, or still the century of diversity?. *Journal of European Public Policy*, 11(1), at 150, 152.

government. These include whether that is in terms of cost of expenditure (over 50% of the budget) or in terms of the unemployment rate for the national labour force (which has reached 11.5%).⁸⁷⁹ The government has sought to solve this problem by encouraging the corporate sector to take on the national labour force as much as possible. This requires appropriate legal rules and incentives that encourage the national labour force to work in companies and also ensure their rights' protection and their contribution to national development goals. The second challenge is the new Saudi vision which has sought to make rapid structural reforms to the Saudi economy. It announced two main mechanisms for doing so: directing 95% of the new national labour force to the private sector, and setting up a privatisation programme that aims to involve most government functions, public agencies and state-owned companies.⁸⁸⁰ This also necessitates a review of the relationship of the corporate sector with the national employees and the relevant rule of corporate governance.

5.6.3.2 Improving the Role of Employees in the Saudi Context

Saudi corporations are not subject to any legal enforcement or compliance that gives employees a right to participate in strategic management decisions or to have any representative form. However, no system of corporate governance can operate in isolation from the effect of companies' actions on the wider groups of various stakeholders, especially employees. Therefore, it is important to review the Saudi system of corporate governance in order to protect the rights of employees and activate their role in good corporate governance.

There are several ways and international practices that can be applied through the board of directors in the Saudi context. One of the most effective ways is the scheme of participatory management; this involves labour and employee involvement in strategic management decisions. This can be borrowed from the continental European tradition

⁸⁷⁹ Saudi Arabian Monetary Agency, (2016). Financial Stability Report 2016, at 12. available at http://www.sama.gov.sa/en-US/EconomicReports/Financial%20Stability%20Report/Financial%20Stability%20Report%202016_en.pdf

⁸⁸⁰ See the official website of Saudi Arabia's Vision for 2030, P45, available at: <http://vision2030.gov.sa/en/node>, accessed on 21/10/2016. For more details and statistics, see chapter three.

of corporate governance where employees in firms of a certain size have the right to elect some members of the supervisory body or directors. Such a scheme has been adopted by Austria, Denmark, Luxembourg and Sweden, and to some extent Finland and France. Likewise, in German law, corporations that have more than 2000 employees must make up half of the supervisory board of employee representatives and one third of them in firms with between 500 and 2000 employees.⁸⁸¹

It may be objected that the domination of representatives of major shareholders over the board of directors is common, even in Germany where employees have the greater representation in the board.⁸⁸² Moreover, the duty of the board of directors that requires directors to act in a way that promotes the success of the company for the benefit of its members as a whole including the interests of the company's employees, should be seen hierarchically. In other words, the interests of the company's shareholders are to be regarded more highly than those of its employees.⁸⁸³ However, the goal of employees' representatives, in fact, is not to dominate the board but to give their perspectives, assist the board in reaching the right decision and highlight their concerns so that they are taken into account, which may affect the company in the long-term.

Another useful practice is to give employees a role in corporate governance in an advisory capacity on certain issues as suggested by the supervisory body. This is one of the means of creating employee participation in decision-making without the negative impact on shareholder influence.⁸⁸⁴

There is another practical way to enhance the participation of employees in corporate governance, which is by encouraging various vehicle types of employee stock ownership. This could be stock or employee pension funds, which may maximise the role of labour entities such as trade unions and works councils and encourage further involvement in corporate governance.⁸⁸⁵ Owning shares gives employees an

⁸⁸¹ Goergen, M., Manjon, M., and Renneboog, C. (2008). Is the German System of Corporate Governance Converging Towards the Anglo-American model?. *Journal of Management and Governance*, 12(1), at 50.

⁸⁸² Ibid.

⁸⁸³ Keay, A. (2012). *The enlightened shareholder value principle and corporate governance [electronic resource]*. Oxford: Routledge, at 92.

⁸⁸⁴ Weil, G., and Manges, L. (2002). *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States*, European Commission, Final report and Annexes, Weil, Gotshal and Manges, at 32.

⁸⁸⁵ Ibid, at 34.

opportunity to be represented in the AGM and also influence its decisions including electing directors. It is also the case that they have more expertise in company affairs and are more interested in attending meetings than any other group of minority shareholders.

OECD Principles provide another suggestion to deal with this case, and is one that has been adopted by many countries. They establish safe-harbours and facilitate the procedures to receive complaints of employees and their representatives confidentially through direct access to an independent board member. This method has often been supported and encouraged by laws or principles and sometimes been assigned to the audit committee or an ethics committee as the contact point. In addition, the internal auditor can play this role provided that direct access to the board is maintained. This function can also be done through modern communication channels. This is also important for company reputation, the potential risks and the financial position, which are significantly affected by unethical or illegal behaviour of corporate executives including abuse in transactions with employees. Therefore, taking the concerns of employees and other stakeholders into account is part of internal controls that maximise the advantage of the company and its shareholders' interests.⁸⁸⁶

The new Saudi CGR issued in 2017 partly deals with the role of employees in the matter of providing comments and reporting non-compliant practices. It requires the audit committee to find a way that enables employees to confidentially provide their observations related to any inaccuracies in the company's reports and to adopt appropriate follow-up procedures with the board.⁸⁸⁷ The board of directors should also develop policies and facilitate procedures that can be followed by stakeholders for submitting complaints or reporting any violations against the board. This is because the conduct and practices of senior management affect these parties and others, so they should be able to voice their concerns. Confidentiality can be ensured by facilitating direct contact with an independent member of the audit committee as well as allocating a telephone number, an email address, an employee or a specialised committee to receive and address stakeholders' complaints or reports.⁸⁸⁸ However, all of these

⁸⁸⁶ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles IV/e, at 39.

⁸⁸⁷ Article 58 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁸⁸⁸ *Ibid*, article 84.

procedures aim to protect the interests of stakeholders including employees and to tackle their complaints and comments without giving them a serious opportunity to contribute to decision-making.

It can be argued that the Saudi legislature has not yet aimed to give employees any legal support entitling them to participate in strategic management decisions or to have any form of representation. Unlike the majority of articles in the new CGR, which are mandatory, it includes some guiding articles such as those that recommend that a company set up programmes for developing and incentivising the participation and performance of its employees. These programmes should include forming committees to hear employees' opinions about issues that are subject to important decisions and establishing a scheme to grant its employees a stake in company profits or shares and setting up a separate fund for pension programmes.⁸⁸⁹

It should be noted here that this issue has also been the topic of extensive debate in England. A public consultation has been launched in the UK to discuss measures and options for giving more of a voice to employees and customers in the boardroom. The UK government launched a review of corporate governance in November 2016. This Green Paper asks for views and provides some options on executive pay; giving more of a voice to employees, customers and suppliers in large private businesses. It also welcomes other suggestions to help address the challenges of corporate governance. The aim of this is to strengthen the UK's corporate governance framework and to deliver an economy that works for everyone, as well as building on current strengths and encouraging companies to do business in the UK.⁸⁹⁰

The Green Paper provides some suggestions within a unitary board system that could improve the link between the boardroom and the workforce and other stakeholders.⁸⁹¹ These include the establishment of one or more stakeholder advisory panels, which

⁸⁸⁹ Ibid, article 85.

⁸⁹⁰ See United Kingdom: Government launches Review of Corporate Governance. (2016, November 30). Mena Report, at 10. Available at: <https://www.gov.uk/government/consultations/corporate-governance-reform>, accessed on 7/2/2017. See also, the government response to the green paper consultation published on 27.8.2017. Available at: <https://www.gov.uk/government/consultations/corporate-governance-reform>, accessed on 31.8.2017.

⁸⁹¹ Ibid.

could be invited to full board meetings or to board committees to offer input on relevant issues. Appointing designated non-executive directors as formal representatives for employees and other stakeholders is another option that could articulate the specific perspectives of stakeholders and bring their concerns to the boardroom.⁸⁹² Moreover, the paper states that there should be higher expectations for large companies to engage with employees and other stakeholders and to have flexibility to tailor their communication channels to. This could have gone further by appointing individual stakeholder representatives to company boards.⁸⁹³

The role of stakeholders is also emphasised in the Third Report of Session 2016–17 of the Business, Energy and Industrial Strategy Committee. It recommends the promotion of more effective measures that give more of a voice to stakeholders in long-term decision making.⁸⁹⁴ The report recommends that companies in the UK should be required to facilitate the engagement of stakeholders by selecting the appropriate means and to report on the steps they have taken.⁸⁹⁵ It provides a number of options that can raise the contribution of the stakeholders:

- Requiring the board of directors to prepare specific and accurate reports that explain how they have dealt with all different stakeholder interests including their impact in financial decisions.⁸⁹⁶ The report recommends that the Financial Reporting Council revise the UK Corporate Governance Code to include a section that requires companies to provide annual reports detailing how they are engaging with stakeholders.⁸⁹⁷
- Encouraging firms to communicate digitally with stakeholders throughout the year.⁸⁹⁸
- Giving employees the right to be represented on the board of directors to bring a different perspective to the board as well as being represented on remuneration committees to ensure commitment to fair pay.⁸⁹⁹

⁸⁹² Ibid, at 37-38.

⁸⁹³ Ibid, at 41.

⁸⁹⁴ UK Parliament Business, Energy and Industrial Strategy Committee. (2017). *Business, Energy and Industrial Strategy Committee 3rd Report. Corporate Governance Volume 1. Report*, HC 702, at 59.

⁸⁹⁵ Ibid, at 25.

⁸⁹⁶ Ibid, at 60.

⁸⁹⁷ Ibid, at 25.

⁸⁹⁸ Ibid, at 61.

⁸⁹⁹ Ibid, at 64- 66.

- Establishing stakeholder advisory panels to establish a formal framework for the board of directors to obtain the views of stakeholders, including employees. This has the potential to create a useful forum to produce a meaningful dialogue to assist a company in developing its policies and strategy as well as in alerting it to potential problems and tackling them.⁹⁰⁰

5.7 Conclusion

This chapter discussed the possibility of reforming Saudi law in terms of the roles and relationships of the board of directors with the main actors in light of corporate governance in English law and global standards. The research provided several suggestions to reform Saudi legislation in this area which can be summarised by the following points:

- A company, especially a listed company, is not merely an amalgam of physical and financial assets but also relies on multiple factors of production which are dependent on each other, such as money, time, skills, ideas and experiences that deserve to be appreciated equally. This leads to a comprehensive view of the different actors who own a firm, including capital, management and labour, and who are all entitled to a rent in exchange for bearing risks. Moreover, these actors can play a useful role in facilitating good corporate governance and enhancing internal control mechanisms. There is a significant difference between merely protecting the rights of all parties and considering those parties as actors who play a vital part in building the company's success.
- There is a need to increase the efficiency of the AGM as it is an essential firewall and a useful tool for shareholders to practise their rights and protect their interests in the Saudi context. In order to achieve this, the board of directors should boost efficient communication by facilitating attendance of shareholders, obtaining information and allowing questions and debates. This can also be done by activating the exercise of voting rights, whether in person or by proxy, which assists the

⁹⁰⁰ Ibid, at 25.

company to monitor the managers effectively and to pass well-informed resolutions.

- The chapter recommends that the company should take into consideration the shareholders' local culture when communication technology is used. Hence, adopting both methods – physical and electronic – for holding the AGM may prevent the board of directors from avoiding face-to-face dialogue and direct accountability, as well as over-controlling the meeting and ignoring questions that are being asked.
- It is important for the Saudi context for measures to be adopted to improve the independence of the board members, its committees and the company auditor, and to give their powers further protection from being restricted by the chairman of the board or executive directors. Moreover, the measures should facilitate accessing the information required and promoting the loyalty of these actors to the firm to exercise due professional care rather than anyone else who may interact with their work. This may be done by a combination of policies and procedures that include prohibitions, restrictions and disclosures.
- It is important to review the Saudi system of corporate governance in order to protect the rights of employees and activate their role in good corporate governance. Employees can be considered one of the most important stakeholders as they impact greatly on the company and vice versa. They are the weaker party in terms of the ability to claim their rights or complain about the company, and they are deeply affected by board decisions but have fewer opportunities for survival. This is particularly the case in Saudi Arabia where employees may have their rights compromised and there are no effective civil institutions to support them. This is equally the case because of the characteristics of the current economy. The future announced plan creates serious challenges for employees and the labour environment, as well as the government.

Chapter six

Conclusion

6.1 Introduction

This research has reviewed the legislation relating to the board of directors in listed companies under the corporate governance system in Saudi Arabia and the extent to which such legislation affects its composition and relationships with the main parties in the company. In seeking to achieve the stated research aims, this thesis has used a comparative study with both English law and global standards and assessed Saudi legislation's compatibility with them in this respect. This has been conducted in a manner that matches the particularity of the legal and economic environment and the nature of listed companies and supervisory bodies in Saudi Arabia.

6.2 The Research Question Addressed

The main question of this research was: "To what extent is it possible to reform the legislation related to the board of directors in listed companies in Saudi Arabia in the light of English law and global standards, taking into account the local political, economic and legal environments which significantly impact the board of directors?".

The developing nature of the political, economic, judicial and legal environment in Saudi Arabia negatively impact on corporate governance in listed companies. Moreover, as in other developing countries, there is a shortage of independent media, strategies for combating corruption, civil institutions and democratic principles that successful corporate governance depends on.⁹⁰¹ This situation draws attention to the importance of internal entities of corporate governance and the centrality of the role of the board of directors in safeguarding the interests of different shareholders and stakeholders. Hence, the research used English law and global standards to study the options for reforming Saudi legislation related to the board of directors, which would allow it to meet the standards of corporate governance and achieve their purpose.

The objective of this research was firstly to clarify the Saudi environment that impacts on the board of directors and to identify loopholes and flaws in Saudi law that relate to the composition of the board of directors and its role and relationships with the main

⁹⁰¹ See chapter three, section entitled "The political and legal environment in Saudi Arabia".

actors. Then, the intention was to make some recommendations and suggest some solutions that would contribute to enriching the respective laws by suggesting more details, flexibility or enforceability, thus reforming and developing them.

The research answered the main question by discussing the sub-questions determined in the introduction of this research in light of English law and global standards. It dealt with the pivotal factors of the Saudi environment affecting the board of directors and its composition and relationships in the Saudi context. These sub-questions include:

- What are the concepts and principles of corporate governance that affect the board of directors? What are the theories and models that explain the relationship between the board of directors and the company? To what extent are these theories and models compatible with those in Saudi Arabia and able to achieve the objectives of corporate governance in the Saudi context?

To answer these questions, the research discussed the importance, concepts and major principles of corporate governance. Moreover, it explored the major corporate governance theories which affect the role of the board of directors such as agency theory, stakeholder theory, stewardship theory and so on. This was in order to assist understanding of the role of the board of directors and its relationships with shareholders, stakeholders and the company as a whole. It then went on to explore the most prominent models of corporate governance used worldwide that affect the role of the board of directors and to describe the main characteristics of each of them. The research discussed to what extent these theories and models are compatible with those in Saudi Arabia and able to achieve the objectives of corporate governance in the Saudi context.⁹⁰² The thesis also discussed comparative law and legal transplantation and the importance of considering the local environment when evaluating transplanted rules and finding useful rules and solutions from other systems.⁹⁰³

- To what extent are Saudi political, legal and economic environments compatible with the requirements that affect the role of the boards of directors in discharging

⁹⁰² See chapter two.

⁹⁰³ See chapter one, section entitled “Comparative law and legal transplantation”.

their duties and the success of corporate governance in light of English law and global standards?

The thesis highlighted the unique environment in Saudi Arabia in terms of the political, legal and judicial aspects, which have some anomalous characteristics and create challenges in corporate governance which significantly influence the role and relationships of the board of directors in listed companies. This is especially the case with judicial authority.⁹⁰⁴ Moreover, the research clarified the structure of the Saudi economy and listed companies, as well as the major features of the recent trend set out in Saudi Arabia's Vision for 2030 which is towards rapid privatisation.⁹⁰⁵ The thesis discussed the impacts of these environments and trends on the corporate sector and the practices of corporate governance, and provided some suggestions that may help in tackling some problems which have arisen from such an environment. The thesis has also defined the major features of the new Saudi Law of Companies, issued in 2015, and the new Corporate Governance Regulation, which recently issued in 2017. The thesis has dealt with all of the relevant changes in the new law and regulation. It has also clarified the extent of the improvement in corporate governance resulting from them as well as clarifying those aspects related to the thesis that require further reform.

- To what extent are the composition of the board of directors in Saudi Arabia and its types of membership compatible with English law and global standards of corporate governance? Which international experiences in this regard are more appropriate to the Saudi context and capable of achieving the objectives of corporate governance in it?

The thesis discussed this in depth and provided a number of suggestions to reform Saudi law related to the composition of the board of directors in light of English law and global standards. This includes the appointment of the board of directors and its tenure, as well as its structure, types and size. Moreover, it studied the most common, traditional models of boards of directors, which are the one-tier system and the two-tier system, to discover their main features that may be appropriate to the Saudi context and capable of facilitating the mechanisms of corporate governance needed. It also

⁹⁰⁴ See chapter three, section entitled "The judicial authorities related to companies' sector".

⁹⁰⁵ See the official website of Saudi Arabia's Vision for 2030, at 45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016. See also, chapter three.

discussed the diversity of board membership and the role of executive, non-executive, dependent and independent directors. The provision of shadow directors received substantial attention as did female representation on boards of directors.⁹⁰⁶

- How can Saudi law be reformed in terms of the roles and relationships of the board of directors with the main actors in light of corporate governance in English law and global standards?

The research provided several suggestions to reform Saudi legislation in this area. It discussed the relationship of the board of directors with shareholders, the role of the Annual General Meeting in this regard and the great importance of the AGM in the Saudi context. The relationship of board of directors with its meetings and members was the subject of wide debate in the thesis, including the boundary of its powers, information needed, and the effective contribution and remuneration of board members and top executives. The research also discussed the committees of the board of directors, such as audit committee and nomination and remuneration committee, as well as evaluating the performance of the board of directors and its committees. Moreover, there were two sections, dealing firstly with the role and relationships of the board of directors with the company's auditor and secondly with the role and relationship with stakeholders especially employees who should have a further consideration in the Saudi context compared to global standards and practices.⁹⁰⁷

In this final stage of the study, it is contended that the research questions have been answered and the fundamental issues in the thesis have been clarified.

⁹⁰⁶ See chapter four.

⁹⁰⁷ See chapter five.

6.3 The Research's Contribution

Corporate governance is in its infancy in Saudi Arabia, where the first legislation dealing with this issue was published in 2006. Despite several studies that have discussed corporate governance in Saudi Arabia, there have not been enough of these in this area. This study dealt with corporate governance through **four** key aspects: board of directors, listed companies, Saudi environments and English law and global standards. It started with the Saudi legal, political and economic environments in order to study the corporate governance needs in listed companies that related to the board of directors compared with the corporate governance in England and global standards. To the best of my knowledge, no study has discussed this issue from this perspective within the scope and targets of this research.

Moreover, this research is one of the first studies to comment on the new Law of Companies published in Saudi Arabia on 4 December 2015 and which superseded the 1965 law on the subject. This new law provides many different provisions related to corporate governance, and it is designed to meet the contemporary needs of the company sector and create a motivating environment for companies to increase their contribution to the national economy. It also tackles the shortcomings of the obsolete law and the dispersed decrees that tried to amend it.

Discussion on the new direction found in the Saudi Vision for 2030 issued in 2016, when this thesis was well underway, is another contribution of this study. This governmental initiative can be considered a major, historical turning point that could have a substantial impact on the diversification of the economy, the culture of work and corporate governance practices. It aims to maximise the role of the private sector, increase economic liberalisation and create a comprehensive privatisation programme.⁹⁰⁸ This research discussed the vision in light of the essential characteristics of the current economy and corporate sector and provided some legal suggestions to deal with challenges that may arise from this trend related to the thesis scope.

It is worth noting that on the 13th of February 2017, when this thesis was in its final stages, a new version of the Corporate Governance Regulation (CGR) was introduced

⁹⁰⁸ See the official website of Saudi Arabia's Vision for 2030, at 45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016.

in Saudi Arabia. The new regulation has a massively higher number of articles than the superseded one. It has changed many provisions, which has impacted on numerous points that had been discussed by this thesis. Several rules had been criticised and some amendments and solutions had been suggested in this thesis which were subsequently tackled by the new CGR. However, the thesis dealt with all relevant changes and the shortcomings addressed by the new regulation. It also clarified the extent of the improvement in corporate governance that resulted from the new regulation and those aspects related to the thesis that require further reform.

Several amendments have been suggested to improve the relevant legislation in Saudi Arabia, and the research has also provided some possible solutions for a number of specific problems existing in the Saudi context.⁹⁰⁹

⁹⁰⁹ See section 6.5 “The Main Recommendations for Reform”.

6.4 Summary of the Findings

6.4.1 Theories and Models of Corporate Governance in Saudi Arabia

There are numerous corporate governance theories and models which arise from different theoretical perspectives, whether they be political, cultural, ethical, social, institutional or economic. Some of them seek to serve particular aspects of corporate governance while others may be formed as a result of a reaction to and the tackling of some problems and needs in corporate governance. Each of the theories has its relative merits and some have feasible elements that can be applied to contribute to governance improvements in different environments and circumstances.⁹¹⁰ Therefore, studying the main theories is essential to understand the concepts and principles of corporate governance, the particular nature of a joint stock company and the role of the board of directors. This is in addition to understanding the boundaries of the relationships between various groups in a firm and the importance of finding a comprehensive balance between liability, control and ownership.

Both English and Saudi legislation deem the firm (not its shareholders) to be the principal and the board of directors as autonomous fiduciaries and mediating hierarchs who act on behalf of the interests of the whole corporation. They also recognise various stakeholders as team members who have claims, needs and rights.⁹¹¹ Hence, the board of directors and the firm have a unique relationship which can never be described as an agent-principal relationship between the board and shareholders exclusively.⁹¹²

Despite the fact that there is worldwide agreement on some fundamental principles of corporate governance, this have never removed the crucial differences between the most famous systems, i.e. the Anglo-Saxon and the Continental European ones. These

⁹¹⁰ Kiel, G., and Nicholson, G. (2003). Board Composition and Corporate Performance: How the Australian experience informs contrasting theories of corporate governance. *Corporate Governance: An International Review*, 11(3), at 201.

⁹¹¹ Section 172 of the Companies Act 2006. And see articles 83- 85 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁹¹² Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), at 231.

are based on a different host of institutional, legal and cultural barriers firmly rooted in the two doctrines.⁹¹³

The model adopted in Saudi Arabia is much closer to the Anglo-Saxon model and more in harmony with its general theory as it aims to generate a fair return for shareholders. Like this model, Saudi legislators adopted the unitary board of directors and do not provide the option of a two-tier model. The Saudi system also does not support the bank-oriented system which creates long-term dominant ownership. Furthermore, there are no regulations that support any form of employee representation or participation in decision-making. However, this system supposes that there exists a legal infrastructure with strict regulations on integrity of disclosure, advanced capital markets with institutional settings and a well-functioning stock market.⁹¹⁴ These requirements may therefore be difficult to replicate in a developing country such as Saudi Arabia.

By contrast, like the Continental European model in Germany and France, the Saudi legal system, including the corporate governance system, is based on civil law. It also contains numerous rules that protect and regulate rights and interests of stakeholder groups, as well as providing some limitations on CEO power. Unlike the Anglo-Saxon model, the legal and economic environments in Saudi Arabia to some extent boost the state's role, ownership and control over the corporate sector. The government in Saudi Arabia dominates most labour and financial services as well as business sectors. The structure of many large joint stock companies is dominated by state ownership. This environment to some extent boosts the state's role and control over the corporate sector.⁹¹⁵ Some of the principles of the Continental European model may, therefore, be useful in developing corporate governance in the Saudi context.

Listed companies which have dispersed ownership and generally impact on different internal and external parties need good governance to ensure that they are being run well and their managers are responsible and accountable. This points to the importance of the constant review of the theories, models, principles, practices and processes of

⁹¹³ Goergen, M., Manjon, M., and Renneboog, C. (2008). Is the German system of corporate governance converging towards the Anglo-American model?. *Journal of Management and Governance*, 12(1), at 65-66.

⁹¹⁴ Cernat, L. (2004). The emerging European corporate governance model: Anglo-Saxon, Continental, or still the century of diversity?. *Journal of European Public Policy*, 11(1), at 149-151.

⁹¹⁵ See chapter three, section "The public joint stock companies in Saudi Arabia".

corporate governance according to the real needs and culture in each country, as well as continual changes of the internal and the external environments.⁹¹⁶ Thus, there is no need to search for the best theory or system to imitate blindly. Instead, the real need is to introduce significant legal protection for investors and achieve the firm's goals successfully.⁹¹⁷ Furthermore, it is important to develop the internal mechanisms and external regulatory environment and state agencies to combat corruption.⁹¹⁸

6.4.2 The New Law of Companies in Saudi Arabia

On 4th December 2015, the new Law of Companies was published in Saudi Arabia, which superseded the previous law issued in 1965 and gave existing companies a one-year time limit to comply with its new rules.⁹¹⁹ This law was designed to meet the contemporary needs of the company sector and create a motivating legal environment for them to increase their contribution to the national economy. It also tackles the shortcomings of the obsolete law and the dispersed decrees that tried to amend it. The new law removes several barriers and restrictions to the growth of the company sector. It also includes numerous rules that enhance the good practices of corporate governance. On the one hand, the new law reduces the costs and the procedures for the establishment of a firm. For instance, it minimises the statutory reserve capital and the capital required for establishing a public company. Also, the number of members required to set up a joint stock company has been reduced.⁹²⁰ According to this law, a single person who meets certain conditions can set up a company.⁹²¹ Moreover, the new law gives modern communications technology a vital role as it allows companies to maximise shareholder participation by holding the meetings of general assemblies via modern means of communication. The website of the Ministry of Commerce becomes adequate on its own for a firm to advertise itself and publish its Memorandum of

⁹¹⁶ Abdullah, H., and Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Euro Journals Publishing, Middle Eastern Finance and Economics*, Issue 4, at 88,94. available at <http://www.eurojournals.com/MEFE.htm>, accessed on 12/3/2015.

⁹¹⁷ Shleifer, A., and Vishny, R. (1997). A Survey of Corporate Governance, *Journal of Finance*, 52(2), at 739. Available at: <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.1997.tb04820.x/full>, accessed on 12/3/2015.

⁹¹⁸ Pettet, B., Lowry, J., and Reisberg, A. (2009). *Pettet's Company Law; Company and Capital Markets Law* (3rd ed.). New York: Pearson Longman, at 137.

⁹¹⁹ Articles 224- 226 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁹²⁰ Ibid article 54.

⁹²¹ Ibid article 55.

Association electronically. Those simplified rules may encourage Saudi businessmen to modify their institutions to shape firms and to encourage family companies, which receive greater attention in the new law, to become joint stock companies.⁹²²

On the other hand, the new law provides some simplifications to shareholder participation and further protection of their rights. It makes several principles of corporate governance compulsory rather than remaining optional or being considered soft law. For example, it prevents the position of the chairman of the board of directors and any other executive position in the company from being combined.⁹²³ Moreover, it forces companies to adopt a cumulative election method in appointing members of the board of directors. It also gives any shareholder the right to attend an AGM regardless of the number of shares he holds⁹²⁴ rather than at least 20 shares required by the previous law.⁹²⁵ The new law minimises the loss ratio of capital of a company which necessitates an extraordinary meeting of the shareholders within a prescribed time period to solve the problem or the company will be dissolved by force of law. This rate of loss was 75% of the capital whereas it is only 50% in the new law⁹²⁶, which is consistent with the case in the UK.⁹²⁷ There are also strict sanctions of imprisonment and fines stipulated by the new law which act as a strong warning to the board of directors or any company parties not to breach the provisions of this law or provide false data and so on.⁹²⁸

The tendency toward further streamlining the company sector can be observed in the new Law of Companies as it removes several barriers and reduces the costs and procedures previously imposed on companies. For example, according to the new law, the percentage of shareholder representation in the AGM must reach one quarter or more of the company's capital value to be valid. If the percentage is lower, the law gives the company the right to convene another AGM within a month, regardless of the percentage of shareholders represented then. In addition, this alternative meeting can be held only one hour after the essential AGM provided that this alternative meeting has been mentioned in the statement of calling and the company constitution allows this

⁹²² Ibid article 13, 86/3.

⁹²³ Ibid article 81.

⁹²⁴ Ibid, article 86/1.

⁹²⁵ See the previous Law of Companies 1965 in the Kingdom of Saudi Arabia, article 88.

⁹²⁶ Ibid article 95, 150. And article 86/3 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁹²⁷ See section 656(1) of the Companies Act 2006.

⁹²⁸ Articles 211, 218 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

action.⁹²⁹ This is unlike the old law which stipulated that the meeting may not be valid if attended by shareholders representing less than one half of the company's capital. If that was the case, the alternative meeting could not be held on the same day.⁹³⁰

On the subject of the board of directors, there is a tendency to expand the power of the board of directors in the new Saudi Law of Companies 2015 and to remove obstacles that may prevent the board from fulfilling its duties. Hence, unlike the old Saudi Law of Companies, the new law allows the board to contract loans whatever their tenures and release the debtors of the company from their liabilities. Furthermore, the board of directors becomes eligible to sell or mortgage the real property or the place of business of the firm. The board of directors no longer needs upfront permission to do these actions from the AGM or company's constitution, as long as they did not provide any specific provisions in this regard.⁹³¹ Beyond that, the new Saudi law binds the company to all the acts performed by the board of directors even if these acts are outside the limits of its competence, except if the beneficiary party is acting *mala fide*.⁹³²

It is worth noting that this broad power of the board of directors needs to receive further consideration from the shareholders and the principal investors given that they still have the right to prevent or provide some restrictions to these powers. They can make some of the above actions be subject to their approval at the general meeting. Moreover, they can require the board to call an extraordinary general meeting (EGM) to amend the articles of association and add some rules that restrict the powers of the board.⁹³³

To facilitate the fulfilment of the duties of the board of directors, the new Saudi law allows the board of directors to adopt resolutions by submitting them to the directors individually as long as there is no request in writing from any director asking to convene the board to deliberate on such resolutions.⁹³⁴ It also allows a company to insert in its constitution the authority for a director who cannot attend a meeting to ask another director to vote/act on his behalf.⁹³⁵

⁹²⁹ Ibid, article 93.

⁹³⁰ See the previous Law of Companies 1965 in the Kingdom of Saudi Arabia, article 91.

⁹³¹ Article 75/2 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. See the old Law of Companies 1965 in the Kingdom of Saudi Arabia, article 73.

⁹³² Article 77 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁹³³ Ibid, articles 75/2, 88, 90.

⁹³⁴ Ibid, article 84.

⁹³⁵ Ibid, article 83/3.

Even though the new Saudi Law of Companies gives the board of directors extensive powers to achieve the company's objectives,⁹³⁶ it provides detailed rules to ensure that there are no abuses or any personal gain for a director whether directly or indirectly from the transactions or contracts made on the company's account.⁹³⁷ The CGR requires the company to clarify the responsibilities of the board of directors in the articles of association. Furthermore, it provides many details about those duties and responsibilities.⁹³⁸

Unlike the old Saudi law of companies which did not provide any specific provisions about a company's committees, the new Law of Companies 2015 allocates a separate chapter includes four articles that regulate the provisions of the audit committee. It stipulates that the audit committee must be formed by the AGM from non-executive board members which also defines its jurisdictions and duties, standards of its work and remuneration of its members.⁹³⁹ The report of this committee has the same requirement as the reports of directors and auditor, and the financial statements.⁹⁴⁰

This may give the audit committee a stronger position and further independence, in particular over appointing and removing the members of such a committee by the AGM. This can be considered a critical addition to the new Saudi Law of Companies as, to some extent, it may enable the audit committee to play a partial role, like a supervisory board in the two-tier model which consists of non-executives exclusively and aims to monitor the management board.

6.4.3 The New Corporate Governance Regulations in Saudi Arabia

On the 13th of February 2017, the new Corporate Governance Regulation (CGR) was published in Saudi Arabia, superseding the previous regulation issued in 2006. Numerous provisions have been changed, many shortcomings tackled and copious details provided. The key changes and characteristics of the new CGR can be summarised as follows:

⁹³⁶ Ibid, article 75.

⁹³⁷ Ibid, articles 71,72,73.

⁹³⁸ Articles 21 to 31 of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁹³⁹ Article 104 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

⁹⁴⁰ Ibid, article 128.

- The new CGR has been issued to respond to the changes in the new Saudi Law of Companies 2015 by providing a number of details and explanations for the provisions of the new Law of Companies. Unlike the old CGR which is not harmonised with the new law and is in conflict with some of its provisions.⁹⁴¹
- Unlike the previous CGR, which comes under the approach of "comply or explain" for all listed companies,⁹⁴² the provisions of the new CGR are compulsory for all listed companies, except a small number of guidance articles.⁹⁴³
- The number of parts and rules in the new CGR massively exceeds the number in the old version. There are twelve parts in the new CGR containing 98 articles, containing copious details compared to only 5 parts, including 19 articles in the old one.
- The new CGR provides some forms and schedules for disclosing remunerations and obliges listed companies to prepare their remuneration documents accordingly.⁹⁴⁴

This new CGR can be considered a quantum leap in corporate governance legislation in Saudi Arabia, which will improve corporate governance practices and contribute towards meeting the standards of good corporate governance. However, the thesis has mentioned several points that need to be covered by the new CGR and has provided numerous suggestions to improve its rules. One of the key reforms that may enhance the benefits of new CGR would be to make some of its guidance articles compulsory or at least that they come under the principle of comply or explain.

6.4.4 Key Environmental Factors that Affected Corporate Governance in Saudi Arabia

The research found that the board of directors is greatly affected by political, legal and judicial systems, and the cultural environment, as well as the prominent characteristics

⁹⁴¹ Many of relevant new provisions are discussed in the chapters four and five of this thesis.

⁹⁴² Article 1/c of the Corporate Governance Regulations 2006 in the Kingdom of Saudi Arabia. A number of articles from the old CGR had become mandatory by way of various decrees from the Capital Market Authority.

⁹⁴³ Article 1/c of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁹⁴⁴ Ibid, article 93/b. See also the forms and schedules at 69.

of the capital market and the relations between the government and corporate sector. It highlighted that the Saudi environment has **three** main factors that significantly affect the corporate governance and the board of directors, especially in listed companies: the state authority, the structure of the Saudi economy and the new trend in the Saudi Vision for 2030.

First, the state apparatus, in general, consists of judicial, executive and regulatory authorities but there is no separation between them in Saudi Arabia ⁹⁴⁵ as they are all held by the Council of Ministers which is presided over by the king. In other words, the king is the final authority for all these bodies.⁹⁴⁶ Legislation is issued through royal decree or the decree of the Council of Ministers which is presided over by the king. There is also broad power for a minister in issuing bylaws and legal decrees in their ministry and interpreting legislation. The judicial authority and its administrative affairs are managed by the Minister of Justice. Moreover, the semi-parliament members are appointed by the king, not through public elections. Beyond that, the listed companies fall under the supervision of the Capital Market Authority which has its own jurisdiction and is not subject to the jurisdiction of commercial courts.⁹⁴⁷

The second factor is the structure of the Saudi economy which relies on oil and many petrochemical products that are controlled or run by a limited number of state-owned companies.⁹⁴⁸ The public sector and government expenditure has been the main engine for the economy and has dominated most economic activities,⁹⁴⁹ including the company sector which depends on government tenders or on providing services to it.⁹⁵⁰ This situation has created several problems in the governance of the public sector and in the

⁹⁴⁵ Article 44 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

⁹⁴⁶ Ibid.

⁹⁴⁷ See chapter three, the political, economic and legal environment in Saudi Arabia affecting corporate governance.

⁹⁴⁸ Ministry of Finance of Saudi Arabia, (2015). Ministry of Finance statement about the national budget for 2016, available at <https://www.mof.gov.sa/en/docslibrary/Budget/Documents/2016.pdf>. See also, General Authority for statistics in Saudi Arabia, (July 2016). Saudi Arabia's exports of goods and non-oil imports in January 2016, available at: <http://www.cdsi.gov.sa/en/1282>, accessed on 18/8/2016.

⁹⁴⁹ Saudi Arabian Monetary Agency, (2016). Financial Stability Report 2016, at 7, 43. available at http://www.sama.gov.sa/en-US/EconomicReports/Financial%20Stability%20Report/Financial%20Stability%20Report%202016_en.pdf, accessed on 18/8/2016.

⁹⁵⁰ Elasrag, H., (2014). Unemployment and Job Creation in the GCC Countries (Arabic), *MPRA Paper No. 54600*, at pp 4-13, available at <http://mpra.ub.uni-muenchen.de/54600>, accessed on 18/8/2016.

unemployment rate for the national labour force which reached 11.5%.⁹⁵¹ Moreover, the ownership and control of Saudi listed companies appears to be highly concentrated in the state and its founding families. The ten biggest companies of the Saudi market represent almost half of the Saudi market value. The ownership of these companies is concentrated in the hands of the government.⁹⁵² Governmental institutions are among the major shareholders of more than 30% of listed companies,⁹⁵³ and 39% of the Saudi stock market is accounted for by only three governmental organisations.⁹⁵⁴

The third factor is the Saudi Vision for 2030 which was issued in 2016 by the new king who wished to follow a different agenda and put in place a new leadership group. This could be considered a major historical turning point that may have a broad impact on the diversification of the economy, the culture of work and corporate governance practices. Its target is to maximise the role of the private sector in the long-term and increase economic liberalisation.⁹⁵⁵

There is a strong trend to create a comprehensive privatisation programme that involves most public agencies and state-owned companies in order to slash government waste, increase the rate of transparency and counter corruption. Moreover, there is a real push to solve the current governmental problem of unemployment by raising the rate of nongovernment jobs in the private sector to employ the majority of the national labour force.⁹⁵⁶ When this Vision is linked to the current legal and political environment, it

⁹⁵¹ Saudi Arabian Monetary Agency, (2016). Financial Stability Report 2016, at 11. available at http://www.sama.gov.sa/en-US/EconomicReports/Financial%20Stability%20Report/Financial%20Stability%20Report%202016_en.pdf, accessed on 18/8/2016.

⁹⁵² According to the updated on 18.8.2016, the total market value of those ten companies is SAR 822.8 billion, See the official website of The Saudi Stock Exchange (Tadawul) <https://www.tadawul.com.sa/wps/portal/tadawul/home>, accessed on 18/8/2016.

⁹⁵³ According to the report of Major Stake Holder as the updated on 18.8.2016, See the official website of Saudi Stock Exchange (Tadawul) available at: <https://www.tadawul.com.sa/wps/portal/tadawul/markets/reports-%26-publications>, accessed on 18/8/2016.

⁹⁵⁴ See Saudi Stock Exchange (Tadawul), Weekly Stock Market Ownership and Trading Activity Report, Week Ending 18 August 2016, at 10. Available at: <https://www.tadawul.com.sa/wps/wcm/connect/66aeb048-f719-479c-b002-c5962c5ac08f/3.+Weekly+Trading+and+Ownership+By+Nationality+Report+4-18-2016.pdf?MOD=AJPERES>, accessed on 18/8/2016.

⁹⁵⁵ See the official website of Saudi Arabia's Vision for 2030, at 45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016.

⁹⁵⁶ See the official website of Saudi Arabia's Vision for 2030, P45, available at: <http://vision2030.gov.sa/en/node>

raises concerns about the ability to move forward in those programmes safely in this situation whilst maintaining the rights of shareholders and stakeholders and ensuring the success and diversification of the economy, as well as solving employment problems.⁹⁵⁷

6.4.5 The Relationship with the Main Actors under Corporate Governance

A company is not merely an amalgam of physical and financial assets, but is also composed of its human capital which own the portable knowledge productions. They may be affected more than shareholders by management decisions as they have less opportunities for survival through merely selling their shares.⁹⁵⁸ The modern company, especially a listed company, relies on multiple factors of production which are dependent on each other, such as money, time, skills, ideas and experiences that deserve to be appreciated equally. This leads to a comprehensive view of the different actors who own a firm, including capital, management and labour, and who are all entitled to a rent in exchange for bearing risks.

It should be noted that dealing with the interests of different parties and the diversity of a firm's priorities is not a zero-sum game.⁹⁵⁹ Therefore, creating value for all parties assists the company to broaden capabilities and cooperation in its activities and to reduce the probability of any kind of conflict.⁹⁶⁰ It also drives the company to improve the management, business environment and relationships for long-term success.⁹⁶¹

⁹⁵⁷ The Economist magazine, 9 Jan 2016, The Saudi blueprint, available at: <http://www.economist.com/news/leaders/21685450-desert-kingdom-striving-dominate-its-region-and-modernise-its-economy-same?cid1=cust/ednew/n/n/n/2016017n/owned/n/n/nwl/n/n/ME/email>, accessed on 18/8/2016.

⁹⁵⁸ Fontrodona, J., and Sison, A. (2006). The Nature of the Firm, Agency Theory and Shareholder Theory: A Critique from Philosophical Anthropology. *Journal of Business Ethics*, 66(1), at 35,36.

⁹⁵⁹ Heracleous, L., and Lan, L. (2012). Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective. *Journal of Management Studies*, 49(1), at 235.

⁹⁶⁰ Beleya, P., Raman, G., Ramendren, C., and Nodeson, S. (2012). Independent Directors and Stakeholders Protection: A Case of Sime Darby. *International Journal of Academic Research in Business and Social Sciences*, 02(04), at 429.

⁹⁶¹ Freeman, E., and McVea, J. (2001). A Stakeholder Approach to Strategic Management. *Darden Business School Working Paper*, No. 01-02, at 10, Can be downloaded from the Social Science Research Network Electronic Paper Collection at: http://papers.ssrn.com/paper.taf?abstract_id=263511, accessed on 22/5/2016.

Moreover, these actors can play a useful role in facilitating good corporate governance and enhancing internal control mechanisms.⁹⁶²

The UK Companies Act 2006 takes a broad view when determining the board's duty to promote the success of the company for the benefit of its members as a whole. It stipulates that this must consider the interests of the company's employees; the relationships with suppliers, customers and others; the community and the environment that may be impacted by the company's operations; the company's reputation for following high standards of business conduct; and the fairness between members of the company.⁹⁶³ There is a significant difference between merely protecting the rights of all parties and considering those parties as actors who play a vital part in building the company's success.

In a similar manner, the OECD Principles emphasises that the framework of corporate governance should involve stakeholders in creating and developing wealth, jobs and sustainable enterprises through active cooperation with the corporation. In order to do so, they and their representative bodies should be eligible to gain relevant, sufficient and reliable information in a timely and regular fashion. The company should also ensure that they can communicate freely without fear of losing their rights when they express their concerns about unethical or illegal practices to the board of directors.⁹⁶⁴

6.4.6 The Authority Responsible for Disputes of Listed Companies in Saudi Arabia

One of the most important issues studied by this research is the competent authority responsible for disputes of listed companies in Saudi Arabia, which works outside the jurisdiction of the commercial courts. This also applies to the appeals panel of these disputes. The listed companies in Saudi Arabia are subject to the CMA and the jurisdiction of the Committee for the Resolution of Securities Disputes (CRSD)

⁹⁶² Goergen, M. (2010). *Corporate governance and complexity theory [electronic resource]*. Cheltenham, UK: Edward Elgar, at 4-5.

⁹⁶³ Section 172 of the Companies Act 2006

⁹⁶⁴ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles IV/c, at 38.

established by the CMA which also has the authority to issue regulations and rules.⁹⁶⁵ The law gives the CMA the power to determine wrongful acts, investigate disputes, subpoena witnesses, order the production of evidence and file a lawsuit before the CRSD which is established by the CMA.⁹⁶⁶ This means that the CMA in some cases plays the roles of legislator, claimant, inspector, jury and judge at the same time.

It should be noted that the Saudi law does not deem the members of these committees to be judges and considers their resolutions to be administrative decisions rather than judicial verdicts.⁹⁶⁷ This is the case despite the fact that the CRSD and the appeals panel are carrying out judicial functions and they have the full authority to punish anyone violating the law with fines, imprisonment, suspension of trade, seizure of property, travel bans and so on, according to the set conditions.⁹⁶⁸ However, this does not mean that they have the legal qualifications and independence which the members of the judicial authority have.

The unusual factors above may create an atmosphere of uncertainty about the credibility of litigation in the Saudi capital market. These may have serious negative effects not only on Saudi companies and the relationships with their board members but also on attracting foreign investors. Such a situation goes against the current strong trend towards privatisation and maximising the role of the corporate sector in Saudi Arabia, which needs to improve regulations, the judicial system, the environment of the market economy and measures of protection for the rights of all parties.

This thesis pointed to the reason for this unacceptable situation. It arose from long-term disagreements between politicians and scholars of Shari'ah about enacting laws and their codification and about dealing with the needs of civil society in the modern state. This has resulted in a number of rules being borrowed from transnational law which conflict with Shari'ah teachings such as those on the stock market and banking sector. These in fact conflict with the Judicial Law and the applicable main legislations in Saudi Arabia that emphasise the role of Shari'ah. The research also suggested some solutions to deal with this dilemma.⁹⁶⁹

⁹⁶⁵ Article 5/a of Capital Market Law 2003 in the Kingdom of Saudi Arabia.

⁹⁶⁶ Ibid, article 25/a

⁹⁶⁷ Ibid, article 25/ b, c.

⁹⁶⁸ Ibid, article 57/c, 59.

⁹⁶⁹ See chapter three, section entitled "The judicial authorities related to companies' sector".

6.5 The Main Recommendations for Reform

The internal corporate structure including the board of directors is one of the central aspects that needs to be considered when reviewing the corporate governance system in the Saudi context. The board of directors is the most important internal corporate institution for representing shareholders and coordinating the interactions within company boundaries, for regulating the relationships between the different constituencies and for enacting bylaws and corporate policies. Therefore, it is of utmost importance to consider the composition, roles and key relationships of the board of directors carefully when reviewing corporate governance legislation.

The research has found several useful rules in England legislation and global standards which may assist in reforming Saudi legislation related to the board of directors. The research, therefore, provides a number of suggestions in this regard that can be found in the relevant chapters in the thesis. These suggestions can be summarised and divided into the points below.

6.5.1 The Composition of the Board of Directors

- There are some provisions in Saudi law in this area that need to be reviewed, such as those relating to the board size, conditions and the tenure of directorships. There are some details and differences in England where the different circumstances of firms are considered and a distinction is made between large and small companies. This distinction may be useful for the Saudi context.⁹⁷⁰

- It is recommended that Saudi law should be more flexible, similar to some European countries, in allowing the adoption of either of the two models of the board of directors, the unitary system and the two-tier system, in order to give firms an opportunity to select which one is more suitable for their needs and circumstances. Adopting the two-tier model is considered a typical option or solution for numerous specific situations such as state-owned firms and the process of privatisation, family

⁹⁷⁰ See chapter four the research suggested that there are six points in Saudi law need to be revised in light of English law.

companies, large multinational corporations with several branches and in mergers between two companies. Moreover, because this model maximises the role of the board of directors, it may seem more beneficial in developing countries where many obstacles prevent the shareholders' associations from playing their role.⁹⁷¹

- Saudi law places all the ultimate responsibilities on the board of directors⁹⁷² and has not provided any legislation to deal with shadow directorships. Therefore, the research strongly recommends adding proper rules to Saudi legislation to deal with shadow directors to prevent them from interfering. This will keep pace with increased global legislative developments and best practices of international corporate governance, as well as to maximise the firms' economic benefits through improving corporate management. There is an urgent need for such legislation, especially in developing countries where a culture of participation, transparency and accountability is lacking in many respects. Moreover, the political structure in some of these countries creates the perfect environment for shadow director practices where class divisions persist, and power, money and influence are concentrated in the hands of certain groups in society.⁹⁷³

6.5.2 The State Authorities and Legal Environment in Saudi Arabia

- It is strongly recommended that Saudi Arabia should develop its legal and economic environments and judicial systems to meet the needs of modern capital markets and the corporate sector. This relates in particular to the Vision for 2030 issued in 2016 which aims to maximise the role of the private sector, increase economic liberalisation and create a comprehensive privatisation programme.⁹⁷⁴ In order to achieve the desired results, slash government waste and counter corruption, the vision needs to meet global standards of directorship and ensure good practices of corporate governance principles. Most principles of good corporate governance are

⁹⁷¹ See chapter four, section entitled "The types of boards of directors in light of the Saudi context".

⁹⁷² Article 78 of the Law of Companies 2015 in the Kingdom of Saudi Arabia. And see article 21/b of the Corporate Governance Regulations 2017 in the Kingdom of Saudi Arabia.

⁹⁷³ See chapter four, section entitled "The shadow directorship in Saudi Arabian law".

⁹⁷⁴ See the official website of Saudi Arabia's Vision for 2030, P45, available at: <http://vision2030.gov.sa/en/node>, accessed on 18/8/2016.

built on three supreme values: accountability, transparency and probity, which represent some of the essential concepts of a democratic system.⁹⁷⁵ Therefore, the use of corporate governance mechanisms may pay considerable dividends in democratic countries compared to undemocratic ones.

- Both politicians and Islamic scholars should work together to end the stalemate between them which has brought into being several administrative committees that have a judicial jurisdiction. They should create an atmosphere of mutual trust and find a solution that ensures that all kinds of disputes including securities disputes will be covered by the structure of judicial authority. The research suggests that this problem can be solved by two methods.

First, policy-makers could recognise and comply with the law they have enacted that emphasises that all legislation must be formulated in accordance with the principles and the sources of Shari‘ah.⁹⁷⁶ The law also imposes on the courts the exclusive application of the provisions of Islamic Shari‘ah.⁹⁷⁷ On the other hand, Shari'ah scholars could be more proactive and respond to the requirements of development and economic needs, and also be more harmonised with the global commercial system and international agreements. Moreover, improving judicial authority, qualifying programmes, curriculums and judges' competence so that they are qualified and have sufficient experience to deal with the cases filed before semi-judicial committees is another area that needs to be looked at. This solution is more appropriate considering the recent trend clearly stipulated by the Saudi law issued in 2007, which gives commercial courts jurisdiction over all authorities of the commercial judiciary and aims to abolish the current administrative judicial committees over time.⁹⁷⁸

The second way is to improve these semi-judicial committees, transforming them into authentic courts with all their powers, authority and independence. The existence of these semi-judicial committees that are run in the same location and legal environment

⁹⁷⁵ Garratt, B. (2003). *Thin on Top Why Corporate Governance Matters and how to Measure and Improve Board Performance* (1st ed.). London: Nicholas Brealey Publishing, at 3.

⁹⁷⁶ Article 1, 46, 55 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia. And article 2 of Law of the Shura Council in the Kingdom of Saudi Arabia.

⁹⁷⁷ Article 48 of Basic Law of Governance 1992 in the Kingdom of Saudi Arabia.

⁹⁷⁸ Section 8 of the Operational Mechanism of Judicial law, available at the official website of Supreme Judicial Council: <https://iservices.scj.gov.sa:9113/home/pdflist>), accessed on 18/8/2016.

points to a problem with names and not actual practice. Therefore, the problem can be solved by these committees having the same characteristics and procedures of the courts regardless of the name they are given. It should be noted by both politicians and Islamic scholars that the unfairness, abuse and neglect of rights that may arise from the current situation of vesting some judicial functions on administrative committees are in much greater conflict with both Shari'ah teachings and the Basic Law of Governance.⁹⁷⁹

6.5.3 The Relationship of the Board of Directors with the Main Actors

- There is a need to increase the efficiency of the AGM as it is an essential firewall and a useful tool for shareholders to practise their rights and protect their interests. In order to achieve this, certain things need to be in place in the AGM. The first is efficient communication which could be boosted by facilitating attendance of shareholders, obtaining information and allowing questions and debates. The second is effective exercise of voting rights whether in person or by proxy, which determines the fate of the management team. These will assist the company to monitor the managers effectively and to pass well-informed resolutions,⁹⁸⁰ especially in Saudi listed companies where ownership and control are highly concentrated in the State and its founding families.⁹⁸¹ This includes simplifying accessing the information related to the issues that will be discussed in the AGM and allowing questions to be received in advance of the AGM.⁹⁸²
- The new Saudi law allows the AGM to be held through modern means of communication.⁹⁸³ The research recommends that the company should take into consideration the shareholders' local culture and the extent that communication technology is used. Hence, adopting both methods – physical and electronic – for holding the AGM may prevent the board of directors from avoiding face-to-face

⁹⁷⁹ See chapter three, section entitled “The judicial authorities related to the company sector, suggested reform”.

⁹⁸⁰ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders’ Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 765- 767.

⁹⁸¹ The World Bank, February 2009, Report on the Observance of Standards and Codes (ROSC), Country Assessment, Kingdom of Saudi Arabia, p1, 4.

⁹⁸² Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles II/ c-3, at 23.

⁹⁸³ Article 86/3 of the Law of Companies 2015 in the Kingdom of Saudi Arabia.

dialogue and direct accountability as well as over-controlling the meeting and ignoring questions that are being asked.⁹⁸⁴

- It is important for the Saudi context to adopt measures to improve the independence of the board members, its committees and the company auditor, and to give their powers further protection from being restricted by the chairman of the board or executive directors. Moreover, the measures should facilitate accessing to the information required and promote the loyalty of these actors to the firm to exercise due professional care rather than anyone else who may interact with their work. However, they should work under a framework of principles that safeguard them from threats to independence such as self-interest, self-review, familiarity, advocacy and intimidation. This may be done by a combination of policies and procedures that include prohibitions, restrictions and disclosures.⁹⁸⁵

- Self-evaluation, which should be done by the board of directors, is a significant means of ensuring good performance and implementation of internal and external laws and policies. It requires a high degree of transparency, openness, honesty and agreement on goals from every director, committee and support staff. Much time and effort needs to be taken, such as interviewing directors, talking with auditors and institutional investors and collecting accurate data, as well as analysing attendance records and minutes of board meetings and its committees. The roles and contributions of each individual director should be recorded in a personal profile which should also include all relevant information such as experience, education, professional background and interpersonal abilities and skills which brought about his appointment.⁹⁸⁶ This fact does not prevent the hiring of some professional non-competitor bodies or individuals who may play a significant role in independent assessment. This could be provided by a firm specialising in board appraisal, institutes of directors and consultancies, a past chairman, an experienced

⁹⁸⁴ Samat, N. and Ali, H. (2015). A Legal Perspective of Shareholders' Meeting in the Globalised and Interconnected Business Environment. *Procedia - Social and Behavioral Sciences*, 172, at 768.

⁹⁸⁵ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles V/c, at 47.

⁹⁸⁶ Tricker, B. (2015). *Corporate governance principles, policies and practices* (3rd ed). Oxford: Oxford University Press, at 439, 444, 449.

independent consultant and superior chairman or director from the board of another firm.⁹⁸⁷

- Employees can be considered as one of the most important stakeholders as they impact greatly on the company and vice versa. They are the weaker party in terms of the ability to claim their rights or complain about the company, and they are deeply affected by board decisions but have fewer opportunities for survival. This is particularly the case in Saudi Arabia where employees may have their rights compromised and there are no effective civil institutions to support them. Moreover, the characteristics of the current economy and the future announced plan create serious challenges for employees and the labour environment, as well as the government. Therefore, it is important to review the Saudi system of corporate governance in order to protect the rights of employees and activate their role in good corporate governance.

The research discusses several solutions that can be borrowed from the continental European tradition of corporate governance where employees in firms of a certain size have the right to elect some members of the board of directors.⁹⁸⁸ Another useful practice is to give employees a role in corporate governance in an advisory capacity on certain issues as suggested by the board of directors. Encouraging various vehicle types of employee stock ownership may maximise the role of labour entities and gives employees an opportunity to be represented in the AGM and also influence its decisions including on electing directors.⁹⁸⁹ Improving the procedures to receive complaints of employees and their representatives confidentially through direct access to an independent board member, the audit committee or an ethics committee as the contact point would also be a major improvement. This function could also be done through modern communication channels.⁹⁹⁰

⁹⁸⁷ Ibid.

⁹⁸⁸ Goergen, M., Manjon, M., and Renneboog, C. (2008). Is the German system of corporate governance converging towards the Anglo-American model?. *Journal of Management and Governance*, 12(1), at 50.

⁹⁸⁹ Weil, G., and Manges, L. (2002). *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States*, European Commission, Final report and Annexes, Weil, Gotshal and Manges, at 32-34.

⁹⁹⁰ Organisation for Economic Co-operation and Development. (2015). *G20/OECD Principles of Corporate Governance*, Paris: OECD Publishing, Principles IV/e, at 39.

6.6 Possibilities for Further Research

Corporate governance in the Saudi context has many different aspects that need to be tackled by critical studies, including the role of the board of directors. Given its limited size and timescale, this research was unable to cover some important issues related to the board of directors of Saudi listed companies. There are also other issues partly discussed by this research which need further study to improve corporate governance in the Saudi context.

Some of these are related to the relationship of the board of directors with the CEO and internal company bylaws of corporate governance, as well the relationship with profitable and non-profitable entities and international observing bodies of corporate governance. Measures that ensure the quality of law enforcement constitute another aspect that needs to be studied alongside provisions related to breaches of corporate governance rules, negligence and abuse.

Challenges that may arise from the strong trend towards privatisation in Saudi Arabia and the role of the board of directors in this context are the other significant topics that need to be considered in depth by further studies in the light of corporate governance standards. A good privatisation programme could play an important role in improving corporate governance and contribute to re-evaluating of a number of significant issues, such as standards of transparency, probity, accountability and the culture of directorship. However, there is a need to improve regulations, the judicial system, the environment of the market economy and measures of protection for the rights of all parties to avoid negative effects on both the public and the corporate sectors in Saudi Arabia.

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