Chapter (3)

Corporate Governance and Its Role of Disclosure

3-1. Introduction:

The mechanism of corporate governance is considered to be one of the main mechanisms of the knowledge economy which enjoyed strong international attention by organizations and scientific and professional institutions (Demirag et al., 2000). This is because, on the one hand, corporate governance plays a vital role in sparing companies from exposure to negative situations, e.g. insolvency, bankruptcy, financial and administrative failure. On the other hand, it also exercises a great influence in maximizing the value of a company in the market, and ensures its survival, viz, the continuation and growth in the world of business internationally, regionally and locally (Reed, 2002). Therefore, business environment witnesses a hectic race, on both the global and the local levels, towards the adoption of the concept of corporate governance as part of the economic reform programs in every country for the purpose of improving economic and social performance at the macro level (Alashmawi, 2005). Eventually, the efforts and concerns of business organizations in different world countries vary in terms of the application of this concept depending on how an organization considers its importance in emphasizing the well-being and general financial and administrative performance of the organization, and also in maximizing the benefits for each of the owners of property rights, the stakeholders, the minority and also other parties concerned with and having interests in various sectors.

A study (Dave, 2003) has revealed that most of the companies in developed countries showed an inclination towards the implementation of the principles of corporate governance in a manner faster than that of national institutions in developing countries, whose financial and administrative structures are characterized by remarkable declination and significant deterioration in the degree of disclosure and transparency mainly due to deficiencies in the application of principles of corporate governance. Indicating the maximal benefit of the concept of corporate governance at the micro level, a study (Ronnie, 2001) has stipulated that, as an approach to declaring the extent of justice and fairness in the exercise of authority among opposing parties, companies should maintain transparent disclosure of the group of determinants, both accounting and non-accounting, in their various reports.
Interest in corporate governance has increased immensely, and this can be manifested by the tendency towards adopting this concept by many developed economies as well as the economies of some developing countries which have gained momentum during the past few decades, especially in the aftermath of the economic and financial crises experienced by a number of countries in Eastern Asia, Latin America, and Russia in the nineties of the twentieth century, which is not too far from what has been witnessed in the US lately which lead to the collapse of a number of American multinationals and business tycoons in 2002. Given the continuing increase in the concept of corporate governance, a good number of international institutions and organizations have shown keenness on shedding light on this concept through close study, analysis and investigation. A good example of these organizations can be represented by International Monetary Fund (IMF), World Bank, and the Organization for Economic Cooperation and Development, which issued in 1999 the principles of corporate governance, which is concerned with the assistance of each of the member states, and non-members of the Organization, to develop legal and institutional frameworks for the application of corporate governance in all companies, public or private, whether current or non-current capital markets, by providing a number of guidelines to strengthen corporate governance, enhance the efficiency of monetary stock-markets, and stabilize the world economy as a whole. The last point in particular has received support from World Organization of Securities Administrators in May 2002, which affirmed the importance of adopting the principles of corporate governance.

In the light of what has been discussed and stated above, this chapter is designed to shed light on a number of pillars essential to the concept corporate governance, hence providing a better understanding of the concept and its implications. Among such pillars is the emergence of corporate governance, its aspects and objectives, the principles of Organization for Economic Cooperation and Development (OECD), the principles of the Basel Committee, the parties concerned with the application of corporate governance. In addition to that, the discussion also extends to provide an outlook of the effectiveness of corporate governance, its determinants, and finally the role of disclosure and transparency in promoting corporate governance.
3-2. Nature of Corporate Governance

3-2-1. The Emergence of Corporate Governance and Development:

If one takes a look at the economic literature of corporate governance, one can but find that Berle and Means Company is the first to address the issue of the separation of ownership from management. In 1932, the company published a study titled “The Modern Corporate and Private Property” in the United States. The study can be seen as the seed of the growth of, and the source of the light that came later to be shed on the types of problems that can occur when ownership is separated by the company’s management and control. For example, how is it possible to enable the financiers to make sure that the directors of the company would not squander the capital of the company or the funding that they are willing to invest in the company? How can bankers make sure that the members of the Board of Directors of the company do not exploit their position and misuse authority and power in ways that may not serve the interests of the organization or its financiers? (Berle and Means, 1932). Later, in 1976 and 1980, Jensen and Meckling (1976) and Fama (1980) drew attention to the implications of the Agency issue and the inevitability of conflict between management and owners in the event of dismissal as a result of negative practices that can have a detrimental effect on the company and industry in general. In this connection, William (1978: 78) proposed that the mechanisms for sound corporate governance can come to fill such a gap in such a way that can multiply the value of the project and at the same time induce a state of equilibrium between all the concerned parties in the company (Nanka-Bruce, 2011: 28).

Here, it can be said that the need for corporate governance stems from the separation of ownership and management in public shareholding companies. Investors generally seek to invest their capital in income-generating enterprises in order to ensure returns on the investment so that they can enjoy their profits later, but many do not find the time or the necessary expertise to run the company. As a result, investors employ experienced people who have expertise in administration so as to run the company’s day-to-day business, putting in mind the general goals of increasing the company’s profit and improving its performance over the long term (Center for International Private Enterprise, 2005). But the main concern or obstacle in this regard is that the appointed managers or administrators are not the owners of the company and thus will not often bear the brunt of the loss of investment and loss of profits in case of failure or company collapse. For instance, there is the possibility that managers and/or administrative may
sometimes unscrupulously take decisions or actions that may reduce the value of the investments of shareholders, or may pay less attention than required otherwise to monitor the operations of the company’s internal activities, or may be too venturous especially when there is competition and they feel that their positions are at risk, or may not be inclined to take a certain measure of risk necessary for enhancing the company’s returns and performance especially if they feel that their routine positions stable. They may also turn against any attempts at constructing mergers by shareholders of different companies, despite potential long-term interest, and instead confine their activities to failing investments which they know how to manage although they are not profitable. Managers may also run illicit activities and secretly embezzle money from the company, i.e. the shareholders’ money (Tirole, 2005). All such possible scenarios can negatively affect the company’s financial and administrative performance and, conversely, highlight the need to apply sound corporate governance.

With regard to its emergence, corporate governance, however, was not as much in demand as it is now, perhaps largely after the recent collapse of several giant businesses and multinationals, and the breakout of financial scandals in some companies (particularly American companies). Thorough investigations into such cases have enabled legislative and jurisprudential boards and committees to identify some of the causes of such business failures and attribute them to lack of financial control and monitoring, and illegal contributions such as bribes, for example. This in turn led the law enforcement agencies in the United States to issue Anti-Corruption Act in 1977, which set forth specific, carefully moulded, rules, and put in effect the process of reviewing the system of internal control in companies (Qubbaja, 2008).

This was followed by the emergence of a number of proposals by the Commission on Stock Exchange in the United States to regulate the disclosure of the types of internal financial control. In 1985, after the occurrence of a number of financial collapses in the savings and loans, Treadway Commission was founded mainly to identify and determine the major causes of under-representation of facts in financial reports, and make recommendations about reducing the possibility of future re-occurrence. In its report issued in 1987, Treadway Commission stressed the need for a sound regulatory environment, independent committees for audit, and more objective internal auditing based on the dire need for clear disclosure of the extent of the internal control effectiveness.
The repercussions of the financial scandals and the collapse of companies that took place in the late eighties and early nineties of the last century, more attention was paid to corporate governance in England, leading shareholders and banks to feel concerned for their investments. As a result, London Stock Exchange constituted the Cadbury Committee in 1991, with a principal aim of setting up practice projects that would help companies identify and implement internal control so as to prevent huge losses in these companies (Wong, 2011: 15).

In October 1993, Rutteman Report appeared, which recommended the need to include reports of companies listed on the report of the internal control systems which a company applied to preserve the assets and equity of the company. In 1995, Greenbury Report came into existence, delineating the issue of allowances and remunerations of the members of a company’s board of directors. The report recommended the need to establish an awards committee consisting of at least three non-executive members of the board whose responsibility includes the revision and evaluation of regulations and principles according to which allowances and awards are specified so that allowances and remunerations are commensurate with the responsibilities and subsequent performance of the awardees.

Since 1999, there has been an agreement reached between Organization of Economic Cooperation and Development (OECD) and World Bank regarding the enhancement of mutual cooperation and dialogue with reference to corporate governance in response to the increasing demands by the countries willing to adopt and strengthen corporate governance in their economic paradigm. There is a unanimous international conviction that sound corporate governance is considered a cornerstone in market development in the long run.

It is observed that the U.S. economy has been exaggerating profits as a result of the excesses of some large companies in maximizing their profits. The evidence of this is manifested by the collapse of gigantic companies such as Enron, Qwest, and Xerox. However, the shock ensuing from the collapse of Ernon Company did not galvanize the U.S. pecuniary markets only to receive a fresh shock, i.e. the collapse of WorldCom Company, the second largest telecommunications company in the world. This company collapsed overnight without any prior warning, resulting in a state of disorientation in financial statements users due to the consequent lack of confidence in published financial statements, honesty and integrity of auditors, and increase in the expectations gap between the users of these financial statements and the auditors (Alhalmi, 2009).
Again, in 2002, the world of finance witnessed yet other scandals, that is, the collapse of many organizations, including the Global and Crossing, Olive Koiconekshn, Merck Pharmaceuticals, Merrill Lynch, and stepped Stewart. Reasons of the collapse of these giants have been deduced, including tampering with and abusing accounts, fraud and accounting errors, hidden internal information, deception, and lack of integrity and work ethics of organizations’ administrations and international audit offices, e.g. Arthur Andersen and Price water house Coopers. As a result of that, the community lost confidence in management, regulatory, and accounting systems, affecting investment decisions in the stock exchange markets of America and other countries (Juma’a & Refa’i 2003: 154).

In the wake of financial collapses of giant U.S. companies in 2002, the Sarbanes-Oxley Act was issued, focusing on the role of corporate governance in the eradication of financial and administrative corruption faced by many companies through the activation of the function exercised by non-executive members of the administrative boards of companies, and stressing the need that the majority of board members be constituted from non-executive members, yet with a clear definition of their responsibilities in the board of directors or in its committees such as audit committees, remunerations committees and finance committees (Sarbanes-Oxley, 2002).

Regarding the Organization for Economic Cooperation and Development (OECD), the OECD council requested the OECD in 1998 to work in conjunction with national governments of the members of the organization and other international organizations and the private sector to put up a set of principles and guidelines for corporate governance. Moreover, by making extensive use of the expertise and efforts of a number of non-OECD-member states as well as the World Bank, International Monetary Fund, the business sector, and other parties involved in the subject matter, the principles of corporate governance were issued in 1999, representing the basis on which countries and companies can rely on as they develop the foundations for the application of the concept of corporate governance (Solomon, 2006: 42). In 2004, Member States of the Organization for Economic Cooperation and Development (OECD) approved a revised version of the principles, which included several amendments to the principles of 1999.

In emerging markets, the practice of sound corporate governance is more challenging than it is in developed markets. This is because the density of ownership falls in the hands of a few shareholders, the market is either small or non-existent, and the legal frameworks and tools
mandatory for companies to practice corporate governance are weak. However, a number of emerging markets have tried a range of measures to promote the practice of corporate governance (Elnaggar, 2006).

Internationally, the U.S. Securities (SEC) convicted in 2001 the former Executive Director of the Sunbeam Company, which was involved with Arthur Anderson Firm in setting up fake projects costing shareholders billions of dollars. In the same year, the U.S. Securities convicted the same company for committing grave professional mistakes and issuing misleading audit reports, and fined Arthur Andersen a sum of $7 million as civil penalty. This is apart from the scandals of Enron Corporation, WorldCom Corporation and Xerox Corporation. Such incidents eventually led to the low level of professional ethical conduct of auditors, and the lack of confidence of users of financial statements in the published financial statements and the integrity of auditors, thus widening the expectations gap between the users of the published financial statements and auditors. Eventually, as a result of these financial landslides created an atmosphere of mistrust between the financial statements users and the function performed by the auditors. Hence, the auditors became obliged to prove their ethical and professional independence, complete impartiality, and adherence to the ethics of professional conduct (Abu Zer, 2006).

Besides, as a result of such landslides in the American giant companies and other global companies, a sense of doubt and mistrust took over the users of financial statements regarding the role played by management and auditor. This electrical atmosphere necessitated urgent redressing and handling, starting with the fact that auditors should apply and adhere to laws and regulations. However, it takes a lot of time and efforts to restore and rebuild a relation based on trust between the parties, and it is not easy to set up laws to control sensitive issues such as transparency and integrity. Therefore, there is an absolute necessity for commitment to the implementation of the principles and ethics of professional conduct alongside the adherence to laws and regulations.

These financial scandals led the American press, the Congress, the Judiciary Apparatus, and the American society as a whole to search for the intrinsic roles that boards of administration, auditing committees, upper administration, and internal and external auditors can play in corporate governance, since sound corporate governance stipulates for all such parties to shoulder some part of the responsibility, i.e. by providing confirmation regarding the
efficiency of performance, adherence to law and regulations, trust in fiscal and financial reports, improvement of the financial performance of an organization, and preserving a reasonable and acceptable level of risk-taking if duties are fulfilled objectively and honestly (Tone at the Top, 2002).

WorldCom Company confessed that as a result of misleading accounting system and failing to disclose some things, it had exaggerated its declared profits substantially, i.e. by nine billion U.S. dollars. The misleading accounting practices of this company had been designed in order to maximize profit in a misleading way to comply with the requirements of the Stock Exchange in order to support its share prices in the financial market (Dahmash & Abuzer, 2003).

In May 2002, the European Council issued recommendations, indicating that there were previous recommendations to ignore the obligation of a chartered auditor to check a matter if related to financial, commercial, employment, or any other issue which a rational third party may infer as a relationship that would affect or impinge on the independence and impartiality of the legal inspector or auditor. In addition, there were also detailed recommendations, such as the requirement or condition that the audit fees should be sufficient to cover the work necessary to check, and to prevent intense speculation regarding low auditing fees. However, did not prevent auditors from accepting the recommendations of advisory work (Abuzer, 2006).

After the collapse of Enron Corporation, Patricia Hewitt (the then Minister of State in the United Kingdom) announced, early in 2002, the establishment of a joint coordination group to look after auditing and accounting issues, stipulating that effective systems of financial reporting, legislation and auditing in the United Kingdom had been meticulously reviewed. The topics that were presented for discussion include the following:

1. Appropriateness of existing standards of professional conduct to check the bodies and professional associations in order to ensure the independence of auditors, particularly if they provide adequate protection where the auditors also provide other non-audit services to their clients.

2. Availability of possible requirements for obligatory succession of auditors, or re-tendering for the audit of the company.

3. The need for a more detailed disclosure in the accounts for the company’s fees paid to auditors for audit and other non-audit services.
Based on the above, there came global advocacy for the application of the principles of corporate governance in organizations, whether targeted or not-for-profit, in order to preserve continuity of organization, encourage investment, and improve the role played by each of the board of directors and senior management, and various committees, and internal and external auditors, and increase the independence of each of these parties so as to achieve self-censorship and corporate governance (Juma’a, 2004).

Accordingly, the council of the international boards of accounting and auditing standards of the International Federation of Accountants (IFAC) (International Federation of Accountants) focused on the need to reflect the idea of corporate governance and its relationship with the continuity of organizations. To emphasize that, Article 23 of the International Accounting Standard No. 1 of the International Accounting Standards Board (IASB), entitled “Presentation of Financial Statements” states the following: “When preparing financial statements management should assess the capacity of the organization to continue … “ (IASB, 2001: 98; IFRS, 2009).

Again, it is stated in Article 17 of the International Auditing Standard (ISA.570) of the International Auditing and Assurance Standards Board (IAASB), entitled “Going Concern”, that the auditor must evaluate the management’s estimate of the organization’s capacity to provide continuity.

Besides, the Council of Auditing Standards and International Warranty passed International Standard on Auditing No. 260, entitled “Communications with Those Charged with Governance”. Among the essential issues here are as follows: (IAASB, 2009):

- Changes in accounting policies.
- Lawsuits.
- Cases that raise significant doubt regarding the organization’s ability to provide continuity.
- Cases of material weaknesses in internal control.

As a result of financial collapses, and in line with developments in international accounting and auditing standards and their implications as reflected in the internal audit profession, The Institute of Internal Auditors (IIA) developed standards and code of conduct the internal audit profession to address the new environmental variables (IIA, IASB, 2003), i.e.,

1. Corporate Governance.
2. Information Technology.

In addition, there has been a tremendous interest by societies, governments, and international organizations in tackling such issues as mismanagement of organizations, financial scandals, the increasing violation of values and ethics, the tendency to hold managers and professional accountants responsible for their social and ethical conduct, and the other environmental and social issues such as pollution, security and illicit payments and so on.

Since 1980 until now, the principles and applications of corporate governance have undergone several changes and modifications. The boards of directors have become more independent, and institutional investor more active. Also, they began to attract increasing attention as a result of massive management failure, and loss of investor confidence in the corporate governance system, which has extended to the business schools that strongly criticized the landslides and asked what kind of accounting standards applied and the prevailing ethics in business organizations (Alkhafaji, 2003, pp.288-289). Therefore, the Organization for Economic Cooperation and Development (OECD) showed more and more interest in the subject of corporate governance. In 1999, OECD handed down the principles of corporate governance, the most important of which were the rights of equity shareholders and how to redress them, the role of stakeholders in governance, the responsibilities of the board of directors, and the issues of disclosure and transparency.

In Asia, where independent and qualified members constitute a minority in the boards of directors of companies, worked the Society of Securities Investors in Singapore decided to work in collaboration with companies in the face of the phenomenon through the appointment of board members who were independent and by cooperation with the financial directors for the sake of improving the practice of corporate governance in the companies in which they invest. In China, the Organization of Securities forced the firms to change external auditors every five years. The same took place in Hong Kong, Thailand and India. Prior to the release of Sarbanes Oxley, experts of the Monetary Authority of Singapore and Hong Kong offered solutions to the issues of corporate governance in the banking sector. In 2000, Hong Kong issued a guide requiring banks to commission audit committees composed of non-executive directors, provided that they be independent, in order to promote the principles of transparency and independence of the auditor. Likewise, Singapore took some measures obligating banks to follow sound corporate governance practices, e.g. separation of financial and non-financial businesses, and
replacement of auditors every five years. In Malaysia, the government started to work on the application of Islamic values and regulations, while also benefiting from values of some other religions, to urge workers to follow these teachings in an attempt to establish a behavioural model that could lead to transparency and accountability; otherwise, violators could be met with management policies to discipline them.

3-2-2. Global Corporate Governance:

There is, as yet, no generally applicable global corporate governance model. Corporations work within the parameters set by national laws and regulations, and the economic goals and expectations of shareholders and other stakeholders. The basic principles found in good corporate governance systems include transparency, accountability, fairness and responsibility, put into practice by a combination of statutory rules and self-regulation in the form of Codes of Best Practice. The foundation of corporate governance is disclosure: this encourages the confidence and trust required by all stakeholders. There has been some measure of convergence in corporate governance practice internationally, resulting from the standards being required by international investors and capital markets. There are also initiatives by the World Bank and the Organization for Economic Co-operation and Development (OECD) to provide a theoretical and analytic framework.

In particular, in April 2004, the OECD published a revised version of its Principles of Corporate Governance, and in April 2005, it announced the launch of a Business Sector Group to give practical guidance to board members trying to improve corporate governance. It is proposed that the Group will produce a boardroom guide to the OECD Principles of Corporate Governance, including concrete examples and advice on how board members can put good corporate governance into practice, notably in the absence of detailed or prescriptive regulation.

On 1st December 2006, the OECD took a further step towards facilitating the use of the OECD Principles of Corporate Governance by releasing a Methodology for Assessing Implementation of the OECD Principles. The Methodology can be used by independent assessors and, for self-assessments, by national authorities. It will also be used by the World Bank under its Review of Standards and Codes programmed.

In September 2008, the OECD announced the launch of a drive to raise the standards of corporate governance as good corporate governance has been recognized during the current financial markets turmoil as ‘one of the keys to healthy financial markets’. Part of this work will
involve ‘strengthening’ the implementation of the OECD’s Principles of Corporate Governance. The OECD plans to meet with representatives of governments, regulators, industry and other interested parties to discuss the lessons for corporate governance that need to be learnt from the financial crisis. Following these discussions, the OECD intended to publish a statement of its findings and recommendations after the meeting of its corporate governance steering group on 19 and 20 November 2008.

The United Nations is also helping to develop more of a global corporate governance environment through the publication, in April 2006, of its ‘Principles for Responsible Investment’, a set of voluntary guidelines aimed to encourage investors to address environmental, social and governance concerns (Turner, 2009:p11).

3-2-3. Definition of Corporate Governance:

The business literature has defined corporate governance in different ways and from different perspectives. Some authors define corporate governance from a regulatory perspective as “the system of laws, rules, and factors that control operations at a company” (Gillan and Starks, 1998) Others define it from the point of view of corporate governance participants and the related constraints of dealing with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer and Vishny, 1997). Yet others view corporate governance as more than merely the relationship between the company and its capital providers, by focusing on the broader aspects of stakeholders. In the areas of law and economics, corporate governance investigates how to secure and motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational design, and legislation. Corporate governance can also be defined in the context of the agency theory, as a process designed to align interests of management (agent) with those of shareholders (principals), and to hold management accountable to the company’s equity owners (Marnet, 2008: 28).

In essence, corporate governance is a legal concept used to describe corporate oversight accountability and the balance of power that exists among shareholders, management, and directors. The legal definition of corporate governance focuses on the enforcement of shareholders’ rights, stating that “the field of corporate governance is concerned with the rules and principles that regulate the power relationship among owners (shareholders), directors, and managers” (Goodman and Schwartz, 2004). Thus, corporate governance defines shareholders’
rights and their enforcement and the fiduciary duties of the company’s directors and officers to its shareholders. State laws have traditionally provided the definition and enforcement of shareholders’ rights. Nonetheless, federal laws and regulations (SOX, SEC rules), through proxy rules and public filings, have significantly influenced the enforcement of shareholders’ rights. Institutional investors have used the federal proxy rules in an effort to shape and improve corporate governance practices at individual companies. Thus, from a legal point of view, corporate governance is influenced by state and federal laws as well as regulations and the listing standards of national stock exchanges.

In practice, effective corporate governance can be described as a vigorous set of checks and balances that establish responsibilities, require accountability, and enforce consequences. In this context, the term “corporate governance” refers to the company’s decision-making and control processes as determined by its board of directors. Thus, it can be more narrowly defined as the extent of a company’s compliance with applicable laws, rules, regulations, standards, and best practices or it can be more widely defined as a company’s relationship with a wide range of corporate governance participants, including the board of directors, management, auditors, legal counsel, financial advisors, regulators, standard setters, shareholders, and other stakeholders. Clearly, therefore, corporate governance is a process affected by legal, regulatory, contractual, and market-based mechanisms and best practices to create substantial shareholder value while protecting the interests of other shareholders. (Zabihollah, R. 2007)

Corporate governance can also be defined as the process of supervision and control intended to ensure that the company’s management acts in accordance with the interests of shareholders (Parkinson, 1994). The governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries (Tricker, 1984). The governance of an enterprise is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership and control. It incorporates the trusteeship of assets, their management and their deployment (Cannon, 1994).

Corporate governance can also be viewed as the relationship between shareholders and their companies and the way in which shareholders act to encourage best practice (e.g., by
voting at AGMs and by regular meetings with companies’ senior management). Increasingly, this includes shareholder ‘activism’ which involves a campaign by a shareholder or a group of shareholders to achieve change in companies (The Corporate Governance Handbook, 1996).

According to Keasey and Wright (1993), corporate governance can be manifest as the structures, process, cultures and systems that engender the successful operation of the organization. It can be broadly considered as the system by which companies are directed and controlled (The Cadbury Report, 1992). More specifically, corporate governance is the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity (Jill, S & Aris, S 2004).

Corporate governance has been defined by Monks and Minow (2001) as the relationship between the number of parties and participants that leads to determine the direction and performance of the organization. Monks and Minow (2001) have identified the main parties and participants, i.e. shareholders, management, and board of directors.

According to the Institute of Internal Auditors (IIA, 2002), corporate governance is known as operations done through the procedures used by the representatives of the stakeholders to provide supervision of the risks and management by the administrator, and control the risk of the organization by ensuring adequacy of controls to avoid this risk, leading to a direct contribution to the achievement of the objectives and conservation of the values of the organization. One should take into account that the performance of corporate governance activities is the responsibility of the stakeholders in the organization, to achieve the Agency’s effectiveness (Stewardship). The former definition refers to the identification of stakeholders and means of surveillance and control of the organization accomplishing mutual objectives of the organization to a large extent.

According to former World Bank president, J. Wolfensohn, the idea of corporate governance is about justice, transparency, accountability and responsibility (Mathiesen, 2002). Corporate governance deals with the ways of a system which reassures financiers of a company to get a big payoff on their investment (Shleifer & Vishny, 1997), whereby the system is the direction and control of business organizations. Since corporate governance determines the structure of the distribution of duties and responsibilities among the different participants in the company, such as the board of directors, managers, and other stakeholders, to contribute and to
establish rules and provisions to make decisions for the company; hence, corporate governance can be seen as the means to provide a company with the appropriate structure necessary for the achievement of the company’s development objectives and goals, and the tools for performance monitoring (OECD, 1999).

It is hoped that the above-mentioned views and definitions of corporate governance are comprehensive enough to shed light on the concepts, goals and incentives, management, supervision, and structure. It is also noted that the principles of corporate governance and accounting activities can be applied to organizations that are pro-profit and those non-profit organizations alike, especially, for example, those not-for-profit organizations which want to rule effectively through their representatives and effectively acquire and use available resources to achieve the special needs of the community.

Regardless of these different definitions of corporate governance, this concept still needs to develop and re-examined in terms of its fitness to cope with the events that toppled over huge U.S. corporations such as Enron, WorldCom and Xerox (and also in other countries) to avoid future re-occurrence of such collapses. Corporate governance works primarily on a combination of laws and regulations and oversight; for example, with reference to the World Bank, the aim of ensuring compliance by the Bank, and compatibility with the objectives of the Bank, and safety standards in general. In addition, it provides a mechanism for linking the interests of shareholders, and other relevant bodies, the World Bank, in order to enhance its performance.

What is primarily significant to mention here is that corporate governance has succeeded in attracting the attention of the large number of individuals and community organizations because it is a significant phenomenon of economic health for organizations and society in general, despite the obvious lack of precise or unanimous definition, a situation which perhaps springs from the fact that corporate governance could cover more than the areas of economics and business per se.

3-2-4. Objectives of Corporate Governance:

Good corporate governance helps in supporting performance, increasing competitiveness, attracting investment for companies, and improving the economy in general through the following means (Maureen, 2004):
1. Strengthening transparency in all transactions and business processes, and procedures for accounting, financial auditing, as can be to adjust the elements of corruption at any stage.

2. Improving and developing the company’s management, and assisting managers and the governing council to build a sound strategy, and ensure that decisions or merger control are based on a sound footing, so as to raise the efficiency of performance.

3. Avoiding banking crises due to their impact on the local economy.

4. Strengthening public confidence in the success of the privatization process while ensuring the best return on state investments, allowing more jobs and an overall increase in economic development.

5. Ensuring a fair deal for shareholders, employees, creditors and other parties with interests in particular in the event of a corporate bankruptcy.

Thus, corporate governance aims to achieve many things including:

1. Control and follow up performance.

2. Improve the efficiency and effectiveness of companies.

3. Find the appropriate structure, which is determined through the company’s goals, and means to achieve those goals, and improve performance.

4. Review and dictate amendments of the laws governing the performance of companies.

5. Clarify and not to confuse the tasks and responsibilities of line managers, and functions of the board of directors and the responsibilities of its members.

6. Evaluate the performance of senior management, and strengthen accountability, and raise the degree of confidence.

7. Enable companies to obtain financing on the part of a larger number of local and foreign investors, and through building and raising confidence in the companies.

8. Entangle the possible participation of shareholders, employees, creditors and lenders to serve as observers for the performance of companies.

9. Avoid accounting and financial problems, providing grounds to strengthen and stabilize the activity of companies and their impact on economy, and serving as a means to prevent future banking collapses and reinforce domestic as well as global capital markets, thus assisting in the achievement of development and economic stability (Darwish, 2003).
10. Stand as a device for economic efficiency in general, both at the micro level and the macro level.

3-2-5. Significance of Corporate Governance:

It can be said that the importance of corporate governance is mainly manifest in the following areas:

1- With reference to the socio-political and legal systems: legal There is a kind of mutual interaction and influence between economy and administration on the one hand and the socio-political and legal circumstances of a particular place at a particular time on the other. Each derives from and is affected one way or the other by one another. In this kind of relationship, economic governance works to enhance the interaction of all these areas in a positive way. If applied to a company with dexterity, with a guarantee to involve economic, administrative, socio-political and legal factors efficiently, corporate governance can increase the value of the company and create an atmosphere of competitiveness in the market as a whole, enabling companies to attract sources of funding for local and global expansion and growth. In this way, corporate governance enables companies to create new job opportunities, lower the impact of unemployment, and contributes towards stabilization of not only financial markets but also the whole country, and not only at the local level but also globally. This is a corollary of the fact that companies affect and are affected by the economic, social and political aspects of the public life, and good performance in companies entails more jobs, more income and better living standards. Thus, companies through their commitment and good performance can broaden the context of well-being and progress of a society. Here, the impact of corporate governance in this area should be highlighted, i.e. through the help of state administration in achieving the aspirations of the citizens by responding to their needs and necessities properly and efficiently, particularly in the areas of poverty alleviation and the promotion of human rights and establishing the dictates of justice. In particular, the relationship between corporate governance and the legal system is of prime importance. This is because the legal system is deemed to be the guarantor and the principal safety valve of implementing sound corporate governance through the provision of standards of disclosure, transparency and integrity.

2- Corporate governance represents an efficient and effective system of standards and contemporary practices of investment resources available to organizations, reflecting the
progress of management, and responding to the requirements of stakeholders by making use of appropriate mechanisms to achieve the desired goals of the organization and project with transparency (Atef, 2003). The cross [Levitt] in his book) Take on the street] describes this situation saying: “We have turned slogan investor to flee to survive”. That is to say, an investor would sell the shares he owns and leave the company – i.e. escape – or sells his shares owned by leaving the company - escape - if he sees that the company’s management is incompetent or that the work of the company’s administration and management follows mechanisms that are ineffective or devoid of ethical professional conduct. By contrast, things can be turned upside down and this negative outlook can be changed very rapidly thanks to corporate governance and its mechanisms, as an attempt to reform the company’s management and give the company the necessary momentum to achieve success and survive in the competitive world of business (Levitt, 2002).

3- Corporate governance can operate as a basis of variables that affect strategic management in determining the organization’s objectives and strategic direction, given their importance in a company’s perspective (Johnson & Scholes, 1997). This view tallies with [Hitt]’s opinion: “The governance of the organization and curricula had a significant impact on the patterns of strategies formulated and implemented [Hitt, Ireland and Hoskisson, 2009]. Witt and Meyer (2002) also indicate the impact of governance on the formulation of the organization’s purpose, pointing out that the primary function of governance is to influence the formulation of the organization’s mission and the declaration and delivery of the basic principles that will guide its activities and overall performance. One of the major objectives of an organization is the development of priorities between claimants by the longer part of the job Drafting, The Governing Council can perform this task through the comparison between the most appropriate options strategy. On this basis, Morck and Steier (2004) indicate the vital role of the governing body in identifying the strategic direction and performance of an organization, i.e. by following a successful decision-making strategy that can protect the organization’s resources and its investments, and within an appropriate degree of oversight and flexibility on the part of the managers, who are supposed to be possessed of special qualifications, such as understanding and intelligence in order to adapt their ways to the environment and circumstances surrounding them and fulfil their goals, accordingly.
4- Corporate governance can impact on the strategy of improving audits in general by the implementation and oversight function effectively, with the strategic direction of the strong, ensure effective oversight and scrutiny of strategic and financial support by reducing the discrepancy between what is an object and what should be in the interests of all parties [Julie, 2001; Atef, 2003].

3-2-6. OECD Principles of Corporate Governance:

The OECD Principles of Corporate Governance were originally developed in response to a call by the OECD Council Meeting at Ministerial level on 27-28 April 1998, to develop, in conjunction with national governments, other relevant international organizations and the private sector, a set of corporate governance standards and guidelines. Since the Principles were agreed in 1999, they have formed the basis for corporate governance initiatives in both OECD and non-OECD countries alike.

Moreover, they have been adopted as one of the Twelve Key Standards for Sound Financial Systems by the Financial Stability Forum. Accordingly, they form the basis of the corporate governance component of the World Bank/IMF Reports on the Observance of Standards and Codes (ROSC).

The OECD Council Meeting at Ministerial Level in 2002 agreed to survey developments in OECD countries and to assess the Principles in light of developments in corporate governance. This task was entrusted to the OECD Steering Group on Corporate Governance, which comprises representatives from OECD countries. In addition, the World Bank, the Bank for International Settlements (BIS) and the International Monetary Fund (IMF) were observers to the Group. For the assessment, the Steering Group also invited the Financial Stability Forum, the Basel Committee, and the International Organization of Securities Commissions (IOSCO) as ad hoc observers.

In its review of the Principles, the Steering Group has undertaken comprehensive consultations and has prepared with the assistance of members the Survey of Developments in OECD Countries. The consultations have included experts from a large number of countries which have participated in the Regional Corporate Governance Roundtables that the OECD organizes in Russia, Asia, South East Europe, Latin America and Eurasia with the support of the Global Corporate Governance Forum and others, and in co-operation with the World Bank and
other non-OECD countries as well. Moreover, the Steering Group has consulted a wide range of interested parties such as the business sector, investors, and professional groups at national and international levels, trade unions, civil society organizations and international standard setting bodies. A draft version of the Principles was put on the OECD website for public comment and resulted in a large number of responses. These have been made public on the OECD website.

On the basis of the discussions in the Steering Group, the Survey and the comments received during the wide ranging consultations, it was concluded that the 1999 Principles should be revised to take into account new developments and concerns. It was agreed that the revision should be pursued with a view to maintaining a non-binding principles-based approach, which recognizes the need to adapt implementation to varying legal economic and cultural circumstances. The revised Principles contained in this document thus build upon a wide range of experience not only in the OECD area but also in non-OECD countries.

1-Ensuring the Basis for an Effective Corporate Governance Framework:

The corporate governance framework should 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.

A. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

B. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

C. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

D. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

2-The Rights of Shareholders and Key Ownership Functions:

The corporate governance framework should protect and facilitate the exercise of shareholders’ rights.

A. Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information
on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.

**B.** Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorization of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

**C.** Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

2. Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

3. Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated. Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.

4. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

**D.** Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

**E.** Markets for corporate control should be allowed to function in an efficient and transparent manner.

1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors
understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

2. Anti-take-over devices should not be used to shield management and the board from accountability.

F. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

1. Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

2. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

G. Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

3-The Equitable Treatment of Shareholders:

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same series of a class should be treated equally.

1. Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.

2. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.

3. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.

4. Impediments to cross border voting should be eliminated.
5. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

B. Insider trading and abusive self-dealing should be prohibited.

C. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

4- The Role of Stakeholders in Corporate Governance:

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

A. The rights of stakeholders that are established by law or through mutual agreements are to be respected.

B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

C. Performance-enhancing mechanisms for employee participation should be permitted to develop.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

E. Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

F. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

5- Disclosure and Transparency:

The corporate governance framework should 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.

A. Disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.
2. Company objectives.
3. Major share ownership and voting rights.
4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.
5. Related party transactions.
6. Foreseeable risk factors.
7. Issues regarding employees and other stakeholders.
8. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.

B. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.

C. An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

D. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.

E. Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.

F. The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

6- The Responsibilities of the Board:

The corporate governance framework should 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.

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.
B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should apply high ethical standards. It should take into account the interests of stakeholders.

D. The board should fulfill certain key functions, including:
   1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
   2. Monitoring the effectiveness of the company’s governance practices and making changes as needed.
   3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
   4. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.
   5. Ensuring a formal and transparent board nomination and election process.
   6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
   7. Ensuring the integrity of the corporation’s accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
   8. Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective independent judgment on corporate affairs.
   1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party
transactions, nomination of board members and key executives, and board remuneration.

2. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.

3. Board members should be able to commit themselves effectively to their responsibilities.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

3-2-7. Standards of the Basel Committee on Banking Supervision:

Basel Committee on Banking Supervision, the World (Basel Committee) Developed for the Basel Committee in 1999, special instructions for governance in banking and financial institutions, a focus on the following points (BIS, Basel Committee on Banking Supervision 2010):

1. The corporate values, codes of conduct and other standards of appropriate behaviour and the system used to ensure compliance with them.

2. A well-articulated corporate strategy against which the success of the overall enterprise and the contribution of individuals can be measured.

3. The clear assignment of responsibilities and decision-making authorities, incorporating a hierarchy of required approvals from individuals to the board of directors.

4. Establishment of a mechanism for the interaction and cooperation among the board of directors, senior management and the auditors.

5. Strong internal control systems, including internal and external audit functions, risk management functions, independent of business lines, and other checks and balances.

6. Special monitoring of risk exposures where conflicts of interest are likely to be particularly great, including business relationships with borrowers affiliated with the bank, large shareholders, senior management, or key decision-makers within the firm (e.g. traders).

7. The financial and managerial incentives to act in an appropriate manner offered to senior management, business line management and employees in the form of compensation, promotion and other recognition.

8. Appropriate information flows internally and to the public.
Given the important financial intermediation role of banks in an economy, the public and the market have a high degree of sensitivity to any difficulties potentially arising from any corporate governance shortcomings in banks. Corporate governance is thus of great relevance both to individual banking organizations and to the international financial system as a whole, and merits targeted supervisory guidance. The Basel Committee on Banking Supervision published initial guidance on corporate governance in 1999, with revised principles in 2006. The Committee’s guidance assists banking supervisors and provides a reference point for promoting the adoption of sound corporate governance practices by banking organizations in their countries. The principles also serve as a reference point for the banks’ own corporate governance efforts (Greuning & Bratanovic, 2009:46).

Subsequent to the publication of the Committee’s 2006 guidance, there have been a number of corporate governance failures and lapses, many of which came to light during the financial crisis that began in mid-2007. Drawing on the lessons learned during the crisis, the Committee’s document, Principles for enhancing corporate governance, sets out best practices for banking organizations. The key areas where the principles have been strengthened include: (1) the role of the board; (2) the qualifications and composition of the board; (3) the importance of an independent risk management function, including a chief risk officer or equivalent; (4) the importance of monitoring risks on an ongoing firm-wide and individual entity basis, (5) the board’s oversight of the compensation systems; and (6) the board and senior management’s understanding of the bank’s operational structure and risks. The principles also emphasize the importance of supervisors regularly evaluating the bank’s corporate governance policies and practices as well as its implementation of the Committee’s principles. The final version of this paper was released in October 2010 (BIS, Basel Committee on Banking Supervision 2010).
3-2-8. Parties Concerned on the Application of Corporate Governance:

There are four main parties which influence and get influenced by the proper application of the rules of corporate governance, and which determine to a large extent the success or failure in the application of these rules. The following Figure (2) illustrates these parties:

![Diagram showing Parties concerned with the Application of Corporate Governance]

**Figure (2): Parties concerned with the Application of Corporate Governance**

1- **Shareholders:**

They provide the capital for by way of their ownership of shares in return of obtaining appropriate profit for their investments. In a way, they constitute the main source of magnifying the value of the company in the long run. In other words, the sustainability and continuation of a company depends mainly on their existence in the company. However, if the returns of the company are not enticing or at least meaningful, investors may either withdraw their investments and leave the company in search of other projects that are more profitable or at least lose the desire to expand the activities of the company (Hussein, 2005: 48). Generally speaking, a necessary step to accomplish shareholders’ goals is that of proper selection, that is, of competent boards of directors and members of senior management who can lead the company
in an effective way and set it aboard within the parameters of the rules, regulations, policies and objective set for the company beforehand.

2- **Board of Directors:**

They are the representatives of the shareholders as well as other parties, such as stakeholders. The board of directors is responsible for the selection and appointment of executive managers who are entrusted with the authority of the daily management within the purview and control of the board of directors. In addition, the board of directors shall draw the general policies of the company and the mechanisms to safeguard the rights of shareholders.

The framework of corporate governance must provide strategic orientation for the corporation, maintain effective control of the senior executive management, and ensure accountability on the part of the management to the corporation and its shareholders. This means that members of the board of director should work on the basis of comprehensive information database, in good faith, with great caution, and on behalf of the institution and its shareholders. Moreover, the board of directors must firmly believe in compliance with the laws in force, taking into account the treatment of shareholders must take place on an equal basis, exercising the authority vested in them with a substantial sense of objectivity and fairness, and never sparing any effort to search for vital and precise information in a timely manner (UAB, 2003).

3- **Management:**

The company’s management is responsible for increasing the profits of the company and enhancing its value. In addition, it is the company’s management’s responsibility to maintain disclosure and transparency in the information being disseminated to shareholders (Solomon, 2006: 18). Typically, a company’s management stands as a link between the board of directors and the other parties dealing with the company. That is because it is the responsibility of the company’s management to carry out the board of directors’ recommendations, strategies and objectives. Therefore, extreme care must be taken while choosing the members of the management and administration because they are ultimately in charge of implementing the wishes of shareholders and the board of directors. In order to make sure that the members of management and administration carry out their duties effectively, it is imperative for the board of directors to set a proper mechanism for the follow-up process of the management’s
performance, and compare the performance achieved against objectives set, and prepare necessary ad-hoc or alternative plans whenever required.

4- Stakeholders:

These are a group of parties that have a vested interest in the company, such as customers, creditors, suppliers, workers, and staff. It should be noted that these parties have interests that may be conflicting and different in some cases. Creditors, for example, are interested in the company’s ability to pay while workers and employees are concerned with the company’s sustainability and ability to continue (Center for International Private Enterprise, 2005 (a): 22). These parties are important in the equation of the network of relationships of/within the company since each of them performs a task that is essential for the company to produce and provide goods and services, and without them neither the administration nor even the board of directors or the shareholders can achieve the strategies of the company. In short, the stakeholders are the necessary cogs in the whole machine of the organization.

Customers and clients are the party which buys the product or service, without whom there is no reason for the existence of a company or organization. This is a fact that the board of directors must take into consideration and must hereby ensure proper organizational administration and performance that can win customers’ satisfaction. In other words, customer’s satisfaction must be the rule number 1 in the organization’s policy and the organization’s administration must in no way overlook this thump rule. Otherwise, customer’s dissatisfaction is but an indication of absence of capable administrative system, or organizational mismanagement and administration’s inability to run the organization properly and set it on the right track (Kabaqah, 2008).

The suppliers constitute the party which provides the company with the necessary raw materials, goods and other services. So the company depends entirely on the efficiency of these suppliers to supply materials, goods and services in a timely manner and with adequate quality and any delay in delivery of such materials and services, for otherwise any inconvenience in supplies is expected to result in delays in production processes in the company, and therefore negatively affect customer service.

With regard to funders and creditors such as banks, financial organizations, and all parties that give the company credit facilities, including suppliers who grant the company grace periods to pay due amounts owed by the company as a result of services or materials received by or sold
to the company, the company should deal with these parties with the utmost care and precision. Misleading information for donors may cut off future funding lines, which negatively affects the company’s business and future plans (Hussein, 2003: 18).

**3-2-9. Determinants of Corporate Governance:**

For companies, organizations and even countries to benefit from the features of corporate governance practices, there should be a number of determinants that ensure proper application of corporate governance. Determinants of corporate governance are of prime importance for their capacity to increase confidence in national economies and to activate and enhance the role of capital markets to mobilize savings on the one hand, and higher rates of investment returns on the other hand. In addition, these determinants help in the protection of the rights of small investors and encourage the private sector and organizations to grow and raise their levels of competitiveness. (Solomon, 2006: 19):

**3-2-9-1. External Determinants:**

The term “external determinants” refers to the overall investment climate in a state and includes the laws regulating the economic activity within which companies operate. These may differ from one country to another. These are:

A. The existence of laws and regulations that govern the business markets, such as company laws, the laws of capital and the laws relating to bankruptcy, competition, and counter-monopoly.

B. The existence of a financial system which ensures good availability of appropriate funding for projects, and which encourages companies to expand on the basis of national and international competition.

C. The efficiency of regulatory bodies and organs, such as capital market authorities, stock exchange, i.e. by exercising tighter control on the companies, verifying the accuracy and integrity of the information and financial statements published by companies, and meting out appropriate measures and sanctions in case a company fails its commitment or breaches the law.

D. The role of non-governmental organizations in ensuring the commitment of its members’ behaviour, ethically as well as professionally, so as to maintain dynamic efficiency of the market. These non-governmental organizations include, for example, associations of accountants and auditors, lawyers’ syndicates, unions, and other concerned institutions, such as
those related to credit rating and financial consulting. The importance of external determinants emanates from the fact that their presence ensures the implementation of laws or rules that warrant good management of a company and reduce the discrepancy between the social returns and private returns (Baltic International Center for Economic Studies, 2005).

3-2-9-2. **Internal Determinants:**

Internal determinants refer to rules and methods applied within companies and include the development of proper administrative structures that describe how decision-making takes place within the company, and the appropriate distribution of powers and duties among the parties concerned with the application of the concept of corporate governance, such as the board of directors, management, shareholders and stakeholders in such a way that leaves no room for conflict of interests between these parties but rather leads to the achievement of the interests of investors in the long term (Sulaiman, 2006: 20).

It must be noted that these determinants, whether internal or external, are influenced by a range of other factors associated with the culture of the state, the political system, the economic status, and the educational and intellectual level among individuals and members of the community. That is to say, corporate governance is only a part of a greater magnitude of the economic environment within which companies operate, and includes, for example, macroeconomic policies and the degree of competition in product markets and markets for productive factors. The framework of corporate governance depends also on the legal, regulatory, and institutional environment as well as factors of work ethics and a company’s awareness of the environmental and social interests of the communities where the company operates and which can have an impact on its reputation and success in the long term.

As a matter of caution during the application of these principles, one must take into account the culture of the state and the associated political, economic, legal and cultural systems. This is because the investors’ awareness of these factors is so important that the ability of investors to exercise their rights in companies in which they have shares is largely influenced by the circumstances that prevail in the state (Center for International Private Enterprise (a), 2005: 42).
3-2-10. Rules of Corporate Governance:

There are a number of intrinsic rules that constitute the pillars of corporate governance, including:

1- **Transparency:**

Transparency is a touchstone for trust, integrity and objectivity in the company’s management procedures and proper disclosure in a timely manner. This pertains to all important issues related to the company, such as the financial status, performance, property rights, and corporate governance. A cornerstone of corporate governance in particular and proper management in general, transparency ensures the delivery of accounting information and disclosure of financial and non-financial statements in such a way that guarantees correct, complete and clear information to all concerned parties, hence allowing them to prepare a meaningful analysis on the operations of the companies or corporations and the economic grounds of each operation.

2- **Accountability:**

Accountability is used here to refer to the principle of holding accountable those who make decisions in the company or organization, and those who carry out work that involves decision-making, for the results of their decisions and actions with regard to the interests of the company and shareholders. Accountability also involves the necessity to create proper, cost-efficient and practical mechanisms to achieve decisions made.

3- **Responsibility:**

Responsibility as a rule of corporate governance is intended to mean the availability of an organizational structure that clearly identifies points and levels of authority and accountability. It is the yardstick of holding accountable the board of directors and decision-makers for their liability towards the company and shareholders. This is apart from the existence of an effective system of internal control. A company operates within the parameters of a framework of regulations and laws that are reviewed periodically, of course alongside an effective system of professional and ethical conduct (Rihawi, 2008).

4- **Clarity:**

Clarity is related to financial statements and disclosure. Because the preparation of financial statements and reports is the responsibility of the management of a company, the board of directors of the company should take the necessary measures to ensure that clarity,
transparency and fairness of these statements and reports are well maintained. To do so, the administration, through the audit committee, should carry out a thorough inspection that can bring about an overall understanding of the financial statements and reports.

5- **Independency:**

Independency is considered here to mean a mechanism that reduces or eliminates conflict of interests, such as the domination of the board of directors by an authoritarian or overbearing company president or shareholder. This mechanism starts with the pattern and methods of forming councils, appointing committees, up to the selection of an independent, qualified, competent external auditor who can carry out the required auditing task with care, precision and professionalism, providing external assurances of the that the financial statements and the current performance truly represent the standing of the company.

6- **Audit Committee:**

Often, this kind of committees is composed of independent members of the board of directors and exercises its monitoring role in order to enhance the effectiveness and efficiency of the internal and external auditors. It also ensures that internal and external auditors are independent of influences by the management, and reports on that, and also follows up the implementation of these reports to make sure that the company’s management implements the recommendations the reports contained (CIPE, 2003).

7- **Justice:**

This ensures equal treatment of all shareholders including minority and foreign shareholders and the inclusion of special provisions for the protection of minority shareholders in the statute of the company. It also involves recognition and disclosure of the rights of all parties with vested interests as set by law (Accountants directory 23/6/2006; CIPE, 2003).

3-2-11. **Negative Aspects of the Absence of Corporate Governance:**

Some studies suggest that there are many negative aspects, difficulties and constraints in the absence of corporate governance of companies. Perhaps the most conspicuous of these aspects are financial and administrative default, financial and administrative failure, financial and administrative corruption, financial unit risks, credit risks, technical risks, absence of strategic vision for companies, incompetent accounting disclosure, weakness of internal control systems, low level of performance in company management, etc.
The reasons behind the necessity for the application of corporate governance in the companies are as follows (Fakhra, et al., 2003: 216):

**A.** Global investing requirements of corporations require a high level of governance in order to orient their investments.

**B.** The occurrence of cases of bankruptcy and financial default caused by mismanagement, and the abuse of authority caused the general public to put pressure on legislators to take measures to protect their interests.

**C.** The tendency towards privatization necessitated the development of criteria to ensure the integrity of public enterprises being privatized.

**D.** The need to pay attention to aspects of professional ethics and conduct in such a manner as to warrant the protection of the interests of members of society, especially in the sectors that affect many segments of society such as environmental issues, public health and public safety.

**E.** The larger the number of shareholders, the weaker their ability to organize the work of the company and monitor its performance is.

**F.** It plays an essential role in the protection of the rights of small shareholders and other parties related to the company against any possible complicity between senior management and big shareholders in the company in order to realize their own interests at the expense of marginalizing others.

**G.** Corporate governance is also needed to cope with the absence of a clear definition of the responsibilities of the board of directors and executive managers vis-à-vis stakeholders and shareholders.

In an attempt to remedy such negative aspects that leading to insolvency and collapse of joint stock companies which, in turn, can shake the confidence of clientele, two studies (Ceouch, et al., 1999; Egan, 1997) emphasized the need to make the necessary efforts to develop and rebuild client’s confidence in the professions of accounting and auditing in particular. The studies also accentuate the importance to reconsider the regulatory frameworks, the contemporary scientific approaches, and the structures of programs and activities of companies so as to maintain the systems of accountability and monitoring and support the functions of disclosure and transparency, and also stipulate for the independence and
impartiality of the external auditor, hence reducing the direct dominance of the boards of directors of companies in the process of managerial decision-making (Ahmad, 2003: 493).

3-2-12. The Concept of Effective Corporate Governance:

Availability of funding is essential to the sustainability of firms in market economies, but it depends on efficient allocation of resources through intermediaries in the financial markets for the purposes of investment and productivity. The process of allocation of funds depends on the returns expected by investors, in addition to their belief in and view of the level of corporate governance of the companies where they invest and the sustainability of these companies. These provisos can generally be evaluated by analyzing the relationship between returns and risk. In addition to that, the degree of investor’s confidence relies greatly on a wide range of legal, legislative and organizational factors that ensure the protection of investments (Oledo, 2006).

Based on these grounds, corporate governance comes to deal with the ways in which: (1) financiers get reassured of returns on their investment, (2) funders can retrieve some of the profit from managers, (3) investors get assured that managers will not squander or waste the money they invest in the company, (4) it is possible to make sure that the company does not invest in failed projects, and (5) it becomes possible for financers to monitor the performance of managers (Shleifer & Vishny, 1997). In order to achieve these goals, the structure of corporate governance should be characterized by the following (Jensen & Meckling, 1976):

1. The ability to give assurance that the agent takes decisions that correspond to the contract which was established between the agent and the owner (shareholders), to ensure the continuation of significant flow of capital to fund the company, and to reduce the effects of information asymmetries between managers and providers of capital which may result in loss of wealth of lenders (financiers).

2. The ability to protect the interests of shareholders and reduce financial and administrative manipulation and tackle cases of fraud and dupery which are intended to plunder tangible or intangible resources and funds of the company.

Fox and Heller (2006) recognize the effectiveness of corporate governance as a set of activities that aim to maximize the wealth obtained from real operations of the company in
addition to the distribution of wealth between the shareholders proportionately. Klapper and Love (2003) maintain that companies have different levels of effectiveness of corporate governance due to the impact of external as well as internal factors. These factors, according to Himmelberg et al. (1999), consist in the composition and structure of the company’s assets and growth opportunities. With regard to the composition of assets, it is easier to control fixed assets (tangible) compared to intangible assets, i.e. it is more difficult to misappropriate or embezzle fixed assets compared to the liquid or intangible one. So, it is better for the companies that have a high level of intangible assets to adopt a more efficient level of corporate governance. In respect to growth opportunities, moreover, a company with good growth opportunities must exercise a high level of corporate governance so that it can reach to an optimal structuring of capital so as to reduce the cost of funding.

3-3. Corporate Governance in Arab Countries:

Many Arab countries have recently shown an increasing interest in the application of the concept of corporate governance, especially after the financial collapses that affected the financial community of many countries in the world. Corporate governance in the Arab countries resembles that governance in many countries with developing and emerging economies, especially in that there is a big gap between these countries and industrialized countries as far as the application of the principles of corporate governance is concerned. In spite of the increasing interest in corporate governance, developing countries have hard time providing the conditions and atmosphere which facilitate the proper application of corporate governance principles in such a way that leads to the promotion of investment in these countries and attract foreign. A number of international bodies and organizations, however, have extended a hand to work to establish in the Arab States the principles of corporate governance issued by the Organization for Economic Cooperation and Development (OECD). For instance, the Global Corporate Governance Forum, in collaboration with the Centre for International Private Enterprise (CIPE) and many of those interested in the concept of corporate governance in many Arab countries, organized a series of conferences, seminars, publications to promote the application of corporate governance applications and to develop recommendations for the proper application of these principles in a manner that is commensurate with the economic, cultural and political conditions and implications of the contemporary Arab region (Omran et al, 2008: 34-36) and that would encourage the availability of a suitable environment for the
application process, and raise awareness among individuals, investors and decision-makers regarding the important role played by corporate governance at the corporate level and the national economy in general (Solomon, 2006: 224). Unfortunately, save petroleum industry in some countries, the Arab States have miserably failed to attract foreign and domestic investments necessary to address the problems of demographic and economic upswings, the causes of which have been attributed by a number of studies in the developing and Arab countries to the weak structures of corporate governance in these countries (Saidi, 2004: 223).

Generally speaking, the weaknesses of corporate governance in most Arab States can be said to have emanated from the following (Musa, 2003: 61; Union of Arab Banks, 2005: 62):

1. The failure of boards of directors of companies in many of these countries to work in unison on behalf of shareholders, specifically the interests of minority shareholders and providing protection for these interests.

2. The extremely limited participation of minority shareholders in the processes of decision-making and monitoring due to many obstacles raised by entering and major shareholders.

3. The poor standards of disclosure and transparency, which form an obstacle to minority shareholders and lenders to share control over companies.

4. The weakness of the legal protection necessary to preserve the interests of small shareholders.

5. The nominal nature of the principle of separation between ownership and management (domination), for substantial owners are either members of the board of directors of companies or they are the one who appoints members of the board of directors.

6. The weakness of the basis of credit assessment by creditors so that the lending institutions tend to rely on guarantees and not on a scientific basis to assess the projects or as per expected cash flows.

A number of factors have played an important role in the formation of the image of corporate governance in the Arab region and its institutions, i.e. (Union of Arab Banks, 2003: 40-32.):

1. Most of the major companies in the Arab states began as organizations run by families, and are still under the control of its founders or their hereditary successors.
2. During past periods, the governments of some of these countries played a key role in the development of some industries and in the transfer of resources to them as well as determining the degree of competition.

3. Since the nineties, most of these countries followed excessive policies of reform, financial and economic liberalization, and development of capital markets, but these markets are still underdeveloped by international standards.

4. The pervasiveness of corruption, negligence, bribery and lack of transparency.

5. The high number of small and medium enterprises in the Arab world compared to the big enterprises that find difficulty in implementing the standards of corporate governance due to the high cost of applying corporate governance.

6. The fact that the application of corporate governance ultimately depends on the cooperation between the public and private sectors, and the strength of the legislative authority to compel companies on the application. This implies that losing companies are expected to be received with deaf ears. But what has been noticed in the Arab world is the intervention of the authorities, often to help loss-making companies, which negatively affects the practice of good corporate governance.

7. Speculative investors’ stance against the implementation of reforms of corporate governance, being a stumbling block in their way, because they think that corporate governance may deprive them from the exploitation of information and weaken their profitability in the market, since they always seek to evaluate the investment in assets valued at less than the truth, and generate a great return in the short term.

8. Control of state-owned enterprises despite the fact that this characteristic does not conflict with the practice of good corporate governance.

9. Weak culture of corporate governance as well as the lack of training programs for the private sector to be supportive of change.

Despite efforts to restructure the Arab economies and regulate capital markets in the Arab world, these markets are still dominated by practices that are not regulated. In addition, negative aspects still pervades the Arab market, i.e. low level of liquidity, low level of disclosure and transparency, small magnitude or size of market, weak legal and legislative environment appropriate for investment, and ownership of significant proportions of companies by big investors, lack of commitment to corporate accounting standards while preparing financial
statements, low quality of financial statements and reports, and delays in the issuance of financial statements and reports. All these factors have accordingly impacted upon the application of the concept of corporate governance (Rchimi, 2004).

Although, in the nineties many companies in the Arab began the practice of granting shareholders the right to discuss the issues listed in the agenda of the board assembly, to investigate the actions and decisions of members of the board of directors, and to monitor the company’s performance, progress and financial position, a lot of companies are still subject to criticism regarding shareholders’ dissatisfaction with the stranglehold of major shareholders and the weakness of control and monitor systems (Shawky, 2002).

In the area of transparency and disclosure under which important and necessary information needed by the beneficiaries of the financial statements are provided, it is rare for shareholding companies in the Arab world to disclose within their annual reports details of the bonuses to board members and executive managers, or the criteria for financial performance which are the product of the exercise of corporate governance so that shareholders can make a comparison with other similar companies. In addition, it is also rare for such companies to offer disclosure of the scarcity of the expected risk factors (CIPE, 2005).

Since the concept of corporate governance has become a necessary requirement for the success and growth of capital market which, in turn, would contribute to the development of the national economy as a result of the success of the financial performance and management of companies, and in order to promote the principle of transparency, many Arab countries have passed governing laws (CIPE, 2005 (a): 31-41), e.g.,

1. Issuance and trade of stocks, defining the responsibilities and obligations of issuers and intermediaries on the basis of transparency.
2. Requirements for listing companies on the basis of transparency and disclosure standards.
3. Development of independent share registries.
5. Existence of a governmental body equipped with a number of independent, qualified experts and giving them the power to regulate the operations of securities.
6. Protection of stakeholders, and creation of cooperation necessary for the sustainability of financially sound companies.
7. Activation of the role of audit committees as one of the actors in the oversight and monitoring of the departments of private companies.

The following is a review of the evolution of conditions of corporate governance in some Arab countries. A study (CIPE, 2003) has divided Arab States into three groups:

**Group A:** This group includes the Arab countries that made efforts to help to implement programs of privatization and economic reform since the mid-eighties, namely Egypt, Jordan and Morocco. These three are among the countries which have the capacity to attract and import capital, and are recognized for their step of establishing stock exchange markets as a key tool for attracting investment in the medium and long term.

**Group B:** This Group includes the petroleum exporting countries, i.e. Gulf States, or State Members of the Gulf Cooperation Council (GCC). These countries managed to achieve stability in their economies due to high oil prices. They are among the countries which export capital. It is noticed that investment in these countries was limited in the past to citizens of the GCC countries, but since 2000 these countries have opened the door of investment for foreign capital.

**Group C:** This group includes the States that have economic instability caused by political turmoil, such as Palestine and Iraq, and the States that are still at the beginning of economic reform, such as Lebanon, Syria, Algeria, Sudan, and Yemen, where the markets of capital do not exist and if they do, the capital markets in these countries are relatively small.

In Jordan, for instance, the business environment involves the existence of relatively appropriate bases and foundations for the adoption of effective corporate governance due to the availability of suitable legislative environment, sound banking system, regulated capital market, standards of disclosure and transparency, international accounting standards, international standards of auditing, disclosure and transparency of the privatization process, property-rights protective milieu, sophisticated judicial system, and honest control over money laundering (Hanini, 2005). At the Special Conference of Corporate Governance, which was held in Amman on February 14, 2005 and was sponsored by the Securities Commission, the World Bank dealt with the state of corporate governance in Jordanian companies in particular by comparing the levels of corporate governance in Jordanian companies with their counterpart levels in OECD countries and the global average (World Bank, 2005), and the results were:
Jordan was superior to the world average in fifteen standards of the World Bank and was equivalent to industrial countries in one of them; yet there were areas that still needed to develop with regard to companies law, the rights of shareholders and the responsibilities of the members of the board of directors.

The regulatory environment witnessed great progress, the Authority of Securities was reinforced vide the Securities Act of 2002, and the Authority had actually begun the exercise of its powers in order to raise the level of disclosure.

World Bank proposed a law (Code) for corporate governance, the training of managers and board members to recognize their roles and duties and explain their legal responsibilities, and the creation of an institute for senior management, and organization of the audits.

Egypt has begun to pay attention to corporate governance since 2001 though the initiative of the Ministry of Economy and Foreign Trade. It was found that the economic reform program, which had begun in Egypt since the early nineties, was not complete without a regulatory framework and oversight that govern the interactions of the private sector in a free market. The World Bank, in collaboration with the Ministry of Economy and Foreign Trade, the Capital Market Authority and the Stock Exchange, in addition to a number of research centres, accounting and auditing firms, and interested economists and lawyers, prepared the first report to assess corporate governance in Egypt. Among the most important findings of the report are the following (World Bank, 2004):

- The rules governing the management of companies applied in Egyptian companies tally with the international principles in the context of 39 principles of a total of 48 principles of corporate governance used by the International Working Group.
- There is a lack of applying some of the principles of corporate governance in the Egyptian market practically. This might be attributed to the lack of awareness of those standards on the part of shareholders or directors of companies. Besides, these rules do not practically conform to seven principles of the total 48 principles, and there are two principles which are not applicable at all in the Egyptian market.

The rules of corporate governance for Egyptian companies were published in a seminar held in 2005 where 400 participants attended the discussion on corporate governance and privatization. This is considered to be the first copy written in Arabic and apply to listed
companies, family businesses, financial organizations, and joint stock companies (Center for International Private Enterprise, 2005 (d): 7-9).

Regarding Lebanon, although Beirut Stock Exchange was established in 1918, the events that befell Lebanon had seriously affected it. Listed companies were only 13 in number as in 2003, and 15 in 2006. In reviewing the surrounding environment of companies operating in Lebanon, it is noted that (Aliafi, 2003: 12):

- There is a high concentration in ownership structure. In the year 2001, major controlling shareholders owned 65% of the total shares of non-financial companies listed in Beirut Stock Exchange. In 1999, the contribution of banks formed 40%, non-financial companies had 12%, financial institutions constituted 13%, while contributions of individuals formed 14%, and other contributions accounted for 21% of the shares of companies listed in Beirut Stock Exchange.

1. Regarding the issue of boards of directors, shareholders control administration of companies, often representing the interests of families and relatives while ignoring small shareholders.

2. In 2004, the Centre for International Private Enterprise (CIPE) held a conference in the Lebanese capital, Beirut, in conjunction with the Global Forum for Corporate Governance (GCGF), and a working group of corporate governance in the Lebanese private sector, and the Lebanese Transparency Association. Twelve standards of the international standards recognized by the sound financial systems were adopted. These standards fall under three broad areas:
   a) The policy of macroeconomic and data transparency,
   b) The political environment of organizations and markets.
   c) The financial regulations and financial supervision.

3. In 2006, the Lebanese Transparency Association issued a manual of corporate governance for small and medium-sized enterprises in Lebanon, which constitute 90% - 95% of private sector companies in Lebanon. The manual contains the rights of shareholders and their obligations, property records, timely company-related information, information related to pre-vote company’s plans, the responsibilities and powers of boards of directors, executive powers, and duties of board committees.

In Morocco, corporate governance started in 1993 when Casablanca Stock Exchange was privatized and updated. In 1995, the Companies Act was issued, which stipulated for the need for the existence of an independent board of directors, a dual structure with a supervisory board,
a management committee, an increase in transparency and disclosure, and greater protection to minority shareholders. Generally, Morocco started to become more and more interested in international standards since 1997, i.e. the date of setting up a company for central deposit of securities and to monitor the implementation of international standards (CIPE, 2003).

In 2004, the General Union of the Facilities Moroccan conducted a study on corporate governance for the purpose of exposing and reviewing the practice of corporate governance in accordance with the principles of OECD, and for measuring the current understanding of corporate governance. The study was conducted on 40 Moroccan companies from various sectors, but only 45% of the sample companies chose to respond to the study, 14 of which were listed companies.

It has been noticed that (CIPE, 2005, (e): 5-6)

1. Most of those companies did not get correct information on the principles of the Organization of Economic Cooperation on Corporate Governance.
2. There is respect for the right of shareholders to obtain information on their rights.
3. The failure of the board of directors and executive managers to disclose their material interests in any process or subject that affects the company directly.
4. There is lack of transparency with regard to nomination, elections, and remuneration of board of directors.
5. Regarding the role of stakeholders, major companies are implementing the Labour Code and have mechanisms to protect environment and the rights of consumers.

In the Arab Gulf States, it has been found that (Saidi, 2005):

1. Family businesses account for 85% of the size of the companies, and are characterized by short longevity when compared to companies in OECD countries.
2. Most company laws do not allow the separation between the president of the board of directors and executive management.
3. There is limited investment awareness, leading to markets instability and alteration of a large number of investors to speculators.
4. Markets are suffering from the decline in foreign investment despite the lifting of restrictions in full in some markets, and partially in others, but markets are still characterized by low level of disclosure and transparency, small size, and lack of sophisticated financial services.
5. There is conspicuous weakness of the legal and regulatory environment suitable for investment.

In a survey administered by the Institute of Corporate Governance of the Dubai International Financial Centre and the Institute of International Finance in 2005, it was observed that GCC companies apply 50% of international standards related to corporate governance. It was also anticipated that this percentage would increase to 85% in the coming years. Although the results of the survey recorded a marked improvement in standards of corporate governance in the Arab Gulf States, differences were detected between GCC countries: e.g. Oman came at the forefront of the Gulf States for the best level of application of standards of corporate governance, having met 70% of the standards following the issuance of a legislation for corporate governance in 2002 (Saidi, 2005).

3-4. Corporate Governance in Republic of Yemen:

The concept of corporate governance is a new subject for the Yemeni business environment, but there is a serious move by the experts, researchers and businessmen in order to attempt to explain this concept and to identify the aspects of corporate governance and how to apply it in the business sector of Yemen, whether through studies and research conducted or by holding conferences and seminars. The Centre for International Private Enterprise (CIPE), in collaboration with Yemeni Businessmen Club (YBC), held in February 2007 the first ever conference in Yemen - Sana’a to address corporate governance of family companies, attended by about 250 businessmen and business owners from Yemen and the Middle East. In the opening speech, the then Prime Minister of Yemen called on the government to play a leading role in addressing the problems that might face family businesses through improving the regulatory environment and legislative framework, and stimulating companies to implement the best practices of corporate governance. He also stressed that transparency and accountability should be viewed as essential for the growth of family businesses and the development of Yemeni economy as a whole (Issues and Trends, 2007: 2).

At the conference the president of the board of directors of YBC indicated that corporate governance practice currently in Yemen was not widespread, and that there was scant planning for the future. He also acknowledged the existence of many problems in family-owned business sector, as some had suffered losses and many others went bankrupt due to several problems the most significant of which were the interest conflicts among family members.
This conference also addressed the internal and administrative systems of family businesses in Yemen, and offered suggestions for resolving internal conflicts and for developing effective succession plans. The participants also reviewed case studies highlighting successful family-owned businesses. Finally, the conference yielded strategies and methods for better application of corporate governance in Yemen (Musa, 2010: 87-88).

On February 6th, 2008, a conference, entitled "Corporate Governance - Reality and the Future", was held in an attempt to bring about awareness of governance, its importance, and the foundations for its application in the Yemeni economy. Nearly 200 participants and experts from the Center for International Private Enterprise, the Global Forum on Governance, Dubai Institute for Corporate Governance, in addition to figures from the Yemeni Government and Yemeni businessmen sector, addressed various issues related to corporate governance and its relationship with economic growth, comparing the reality of governance in Yemen with the experiences of other countries in the region, and pinpointing the advantages and challenges of the application of corporate governance in Yemen. The participants in the Conference accentuated the importance of reinforcing awareness in the governmental as well as business sectors regarding the issues and implications of corporate governance, and encouraged these sectors to apply the principles of corporate governance. They stated that effective application of the principles of corporate governance in both public and private sectors would lead to stability and growth, attract investments and prevent financial meltdowns. In this connection, teamwork was formed to follow up and formulate guidelines for the application of corporate governance in Yemen by means of proposed plans and mechanisms, including many workshops.

Richard Frederick (2008) recognized the parties that must adhere to the Code designed for Yemen: i.e. listed companies, unlisted companies, small and medium-sized enterprises, family-owned businesses, state-owned enterprises, and banks. At the same time, the parties that must collaborate in the development and application of this code are legislators, regulators, stock market, investors in organizations, professional organizations, and other various groups interested. The factors that lead to the success or failure of the Code have been classified into two types:

1. Controllable Factors: These include commitment, the quality of work, organization, comprehensiveness, and post-drafting support.
2. Uncontrollable Factors: These include economic environment, political support, and support for companies.

In the final statement of the conference, the participants recommended execution and conduct of extensive research and studies to identify the extent of applicability of the principles of corporate governance in enterprises on a regular basis, and stressed the importance of training members of boards of directors and top and middle executives at public and private enterprises on the methodologies of effective application of the principles of corporate governance and how to overcome the difficulties they might face.

On February 10th, 2008, CIPE in cooperation with YBC held a workshop for a core group of stakeholders in the private sector and government ministries, media, and academicians in order for the participants to gain a deeper understanding of the issues of corporate governance. Following that, CIPE and YBC stressed on the need to make an assessment of the existing legal and regulatory framework to develop local guidelines appropriate for corporate governance. In October 2008, the Yemeni Center for measuring public opinion in cooperation with CIPE and YBC administered a field survey within the framework of corporate governance program which included 200 companies and large and medium economic institutions in five governorates in Yemen. The study aimed to measure the level of awareness of the principles of corporate governance for Yemeni companies and institutions, to identify the level achieved by the business sector in the application of the principles of corporate governance and the nature of the changes that Yemeni companies want to bring about in order to apply the principles of governance, and also to identify the sectors which are the most efficient in the application of the principles of corporate governance as well as those that are most eligible to applying these principles. The study focused on a number of principles and the main axes of corporate governance, especially in terms of the form and powers of the Board of Directors, transparency and disclosure, and the rights of shareholders.

The study showed that 60.5% of the companies refrain from revealing and disclosing their profits, and 57.5% refrain from disclosure of the top owners of shares. By contrast, 67% disclose their strategies and objectives. The study also noted that 35.7% of the insurance companies of Yemen are supervised and controlled by Board of Directors with regard to granting of delivery “credit”. Telecommunications companies disclose their strategies and objectives at the rate of 100% compared to companies in other areas. The study showed that
14.3% only of family businesses have inside offices that organize and manage the business and affairs of the family regarding the company’s business.

The Executive Director of CIPE indicated that the commitment to corporate governance is meant for the benefit of each facility separately and for the entire economy. Since Yemen is still in the early stages of establishing a stock market, the subject of corporate governance is of great importance. Besides, in order to create the legislative, legal, regulatory and administrative environment necessary to accommodate the application of corporate governance, the Government of Yemen – in the context of its recent increasing interest in the rules, principles, standards, recommendations and guidelines of the governance – in collaboration with the institutions of civil society and the private and public sectors, has taken serious steps backed by many international institutions and YBC to assess the legislation and laws and the reality of their own public and private companies regarding corporate governance (Al-Absi 2010: 23-24). In this regard, YBC, in collaboration with CIPE and The US-Middle East Partnership Initiative (MEPI) and with the support of the partnership initiative with the Middle East, issued a report on the legal and regulatory framework for corporate governance in the Republic of Yemen in March 2009, with the goal of conducting a comprehensive review of the laws and regulations pertinent to assess the viability of their compatibility with the central principles of the corporate governance, documenting cases in the law on the basis of their (in)compatibility with the principles of corporate governance, assessing the impact of these laws and regulations on the general environment of public business, reviewing the legal framework in connection with these principles, and preparing recommendations on what should be changed or added to make the legal framework in line with the best international practices of corporate governance – for example, the principles of corporate governance of the Organization for European Economic Cooperation.

On March 29, 2010 YBC, in cooperation with CIPE, with funding from MEPI Foundation, issued the Guide to Corporate Governance in the Republic of Yemen, which aims to provide guidance and direction to the business community of Yemen to meet the growing need to improve the environment of corporate governance practices and their application in Yemen. This Guide is a voluntary non-binding application for companies.
As for corporate governance in Yemeni banks, the financial and banking sector is currently undergoing a process of comprehensive restructuring and modernization. The legislative banking system deployed in Yemen has contributed to the achievement of positive results on the reality of the banking activity and kept up with Yemen’s efforts to integrate its economy in the economies of the Gulf Cooperation Council Countries and join the World Trade Organization (Ali, A 2009: 73).

The aim of the Central Bank’s supervision of banks operating in Yemen is mainly to maintain the integrity of their financial centres, and bring about a sound banking sector that preserves the rights of depositors and investors and ensures a proper implementation of the monetary policy of the State to contribute effectively to the development and prosperity of the national economy. Meanwhile, the Central Bank of Yemen is currently preparing a directory of corporate governance, which will serve as an outline for the commercial and Islamic banks to prepare their own guidelines of governance. It will become mandatory on all banks to prepare guidelines of governance of their own, and all operating banks will be required to review the guidelines of governance and amend them from time to time whenever the need arises in order to keep pace with changes in the needs and expectations of both the bank and the banking market.

It is important to note that the practice of corporate governance in Yemen is weak compared with some countries in the region, such as Egypt, Jordan, United Arab Emirates, Oman, and Saudi Arabia. The researcher opines that there are several reasons behind the low level of governance in the Republic of Yemen, most notably the following:

1. The absence of adequate legislation, especially in the field of commercial laws and company laws, in addition to the absence of many important legislations, despite their importance, such as antitrust and bankruptcy laws. Besides, there is a sense of non-conformity and lack of commitment to the laws and legislations issued by most companies and institutions owned by persons with high positions in the government.
2. Most of the companies in the Yemeni market are family-owned businesses or firms in which a small number of shareholders own large proportions of the equity (ownership).
3. There is no market for the Securities and Exchange which contains registration requirements for institutions and companies.
4. The poor level of accounting and auditing profession, and the small number of financial institutions and companies specialized in providing information and financial analysis or providing financial consulting.

5. The limitation of the community culture regarding the concept of governance.

6. The weakness of the government and its inability to maintain control and regulation and, the impact of this on the technical performance of these institutions on one hand and on their financial position and on the other hand.

7. The absence of guidelines of corporate governance in Yemen binding all companies and institutions in line with the guidelines of corporate governance in the other countries of the region.

8. The lack of local accounting and auditing standards, or a legislation binding firms and institutions apply the standards of international accounting and auditing.

3-5. The Role of Disclosure and Transparency in Promoting Corporate Governance:

More attention has been paid in recent years to the rules of transparency and disclosure, especially after some major companies in the United States and Europe have been hit since the beginning of this century by severe financial crises which blew away some of them even before the current crisis. This has eventually given rise to the issue of corporate governance along with the relevant issues of transparency and disclosure and the associated confidence among the public on the one hand, and the large institutions and those who run them on the other hand, as well as the modern state’s position of the both parties, especially with regard to the application of corporate governance and market regulation and monitoring implementation of laws and the rules of transparency and disclosure in a timely manner.

Transparent has become the password for the move from the crisis to the solution. In the Thirteenth Conference of Transparency International in Athens, Greece, which was held between October 30 to November 2, 2008, and which was called the “conference of resisting corruption”, the final statement stipulated for the acknowledgement of the vital role of transparency and accountability in order to face recession and the big losses of emerging economies as well as the bigger losses of the less developed economies. The poor cannot afford the cost of the greed and mismanagement of the financial institutions in rich countries, and so the fight against corruption must remain on the list of international action. The participants recognized the importance of upholding the principles and rules of Global Governance and the
solutions it provides. The American President, George W Bush, in his inauguration speech in January 20, 2009 stressed the importance that those in charge of the management of public money should shoulder full responsibility for spending wisely, the need to reform bad habits, and the performance of duties in broad daylight in order to restore trust between citizens and their government. The crisis clearly showed that, without control, the market could come out of discipline and that the nation cannot be prosperous if it discriminates only in favour of the rich (Al-Mushat, 2009).

3-5-1. The Concept of Disclosure and Transparency:

Several scholars have touched on the concept of disclosure and its importance. Hendrickson defines it as a “presentation of information important to investors, creditors and other beneficiaries in a manner that allows the prediction of the project’s ability to make profits in the future and its ability to meet its liabilities” (Hendrickson, 1982: p 504). Choi (1972:160) defines it as “the dissemination of all economic information related to the project, whether quantitative or otherwise, to help the investor to take decisions and reduce uncertainty regarding future economic events”. The above definitions consider disclosure as a tool through which to extrapolate future performance of the company, including help to make future decisions.

Chandra has defined disclosure as “a procedure through which the economic unit makes contact with the outside world“(Chandra, 1974, p733). The American Institute of Certified Public Accountants defines disclosure as a “presentation of the financial statements in a clear way and in accordance with the accepted accounting principles, and this relates to the form and classification of the information contained in financial statements and the meaning of the terms contained therein“ (AICPA, 1975:83). This appears to be the most elaborative definition of the concept of disclosure in the presentation of data. (Al-Mehandi)

On the other hand, transparency has been defined by Bushman & Smith (2003) as follows: “It is the provision of relevant, reliable and sufficient information about the financial position, periodical performance, investment opportunities, governance, risk and value of the company traded in the market.” (Sadani,2007) defines it as "the company/party's act of provision of information and data concerning its activity, putting such at the disposal of the shareholders and stakeholders and customers in the market, giving an opportunity for those who want to see them, and not withholding information or data except for those that would harm the interests of the
company/party provided that the confidentiality of such information and data reflects the true and realistic position for the company” (Ammar Ali: 47).

According to some researchers, transparency is the public disclosure of reliable data provided in a timely manner to help users of such data to conduct an accurate assessment of the financial position of the company and its achievements, activities, risks and management of such risks.

Disclosure alone does not give the required transparency, but the information provided must be accurate and complete in terms of quantity and quality, and are provided in a timely manner and based on sound measurement. Transparency is more general in terms of encompassing various aspects of the political, social, and economic life of a society: it implies the availability of a climate that provides access to all general information, data or methods of decision-making on individuals or companies. Gray & Morris (2007) opine that disclosure of financial information in a company’s annual reports as per accounting standards plays a key role in the measurement of financial transparency. Ensuring the transparency of financial statements is made through full disclosure and by a clear presentation of information necessary for economic decision-making to a wide range of users and, in the context of public disclosure, it should be easy to interpret financial statements.

1- Terms of transparency:

There are several conditions that must be met in any of the information or actions to be characterized by transparency, including:

1. Transparency should be timely, since late transparency is usually worthless and is sometimes provided only to meet the required formalities: this can be exemplified by the declaration of the budgets of companies after months or years of publication.

2. Transparency should be made available to all parties at the same time, for there is no benefit of employment advertisements issued after the appointment of relatives and acquaintances?

3. Transparency should be self-explanatory: what is the value of vague and unclear transparency? Some companies may publish their financial statements in newspapers to satisfy the legal form or without attachments or without an auditor or detailed items. It should be noted that transparency must not breach the general principles to maintain some confidentiality of certain information relevant to the work.
4. Transparency should be followed by accountability: transparency \textit{per se} is not an end but a means to show the mistakes and punish the perpetrators, and, of course, within the framework of the legal means of that organization.

\textbf{2- The importance of disclosure and transparency:}

Disclosure and transparency constitute the main dimension of supervising companies. Disclosure helps to improve public understanding of the structure and aspects of the company’s activity, and enables shareholders to exercise their basic rights and protect them on bases that are measured and pre-established in advance. The importance of disclosure of accounting information is highlighted by the value of information provided to the beneficiaries, whether investors or shareholders or creditors or others. Also, the level of disclosure of information in financial reporting plays a prominent role in reducing uncertainty and the gap of information asymmetry between management and employees, helping those interested in assessing the performance of companies in an objective way. The importance of disclosure of accounting information has increased in the present time due to the increasing importance of the economic role of capital markets after the published accounting data have become an important source of information necessary for decision-making.

Non-application of accounting principles, the lack of disclosure and transparency, and withholding factual data and information that reflect the financial conditions of the economic units are among the important reasons for a collapse of many of these economic units. This has been reflected in a number of negative effects the most important of which is the loss of confidence in accounting information and thus loss of the information quality. Lack of transparency of information on all administrative and financial matters and procedures related to the company, and avoiding to provide an opportunity for the shareholders and the community to inspect administration have opened the door to corruption and unfair administrative decisions, hence leading to the financial scandals at major international companies and the loss of confidence in the selection mechanism of executives and senior staff (management side) and the scope of adherence to accounting standards and procedures especially with regard to disclosure and transparency (Darwish, 2003).
Transparency is also a way to strengthen accountability and internal discipline and best governance as well as improving transparency and accountability in the decision-making process. If acts and decisions are visible and understandable, the cost of monitoring can be reduced, the public is better able to monitor the institutions of the IPO sector, the shareholders and staff are able to form a better idea of corporate administration, and the creditors can monitor borrowers in a better and more sufficient way. Therefore, bad decisions do not pass without notice or without queries and questions being raised (Ammar Ali 2009:47).

The framework of corporate governance practice methods should ensure the realization of accurate and timely disclosure of all matters relating to the establishment of the company, including the financial and administrative position and property and the style of exercising administration powers. Regarding disclosure and transparency, corporate governance aims to the following: (Maureen, M, 2004).

1. To provide financial statements prepared in accordance with fair and sound accounting standards and treatments regarding the financial position of the company, business outcomes, and cash flow; provide sufficient disclosure and transparency through financial non-financial listed statements to meet the needs of the users of financial statements (e.g. investors, banks, financial analysts); and prepare and provide bulletins to call for subscription in shares and bonds as per the requirements of the law and regulatory bodies.

2. To provide credibility to the financial statements and prospectuses through the review of an independent body (the auditor) in accordance with generally accepted auditing standards, and reviewed by the regulatory agencies.

3. To strengthen transparency in all company’s transactions and business processes as well as its accounting procedures and financial audits in such a way as to make it possible to take hold of the elements of corruption at any stage.

The rules of disclosure and transparency are among the most important pillars of corporate governance owing to their utmost importance in enabling the management of the company to achieve the targeted balance between the interests of all groups concerned with the performance of the company, i.e. the company’s management, shareholders and, then, the other interested parties. The laws of companies and financial markets, and the ensuing instructions, have given high significance to disclosure and transparency by stipulating several disclosure rules that bind public shareholding companies, especially with regard to the powers and responsibilities of the
board, and the annual or interim financial statements published by such companies (being responsible for the preparation of such data). During preparation, the company management should take into account to follow the accepted accounting standards as well as the relevant local legislation. Besides, in order to provide the element of credibility of the information offered, the company management should be careful to assign the task of examining the data to an independent chartered accountant who will carry out the auditing task in accordance with generally accepted auditing standards.

In this context, some studies (Castellano, 2002) have shown that the concern of public shareholding companies to provide additional voluntary or optional disclosures in addition to the compulsory or mandatory disclosures enhances the system of corporate governance in the company. This is because the general framework of the compulsory conventional disclosure normally provides the minimum disclosure requirements while the stakeholders look for getting more information that will contribute to the rationalization of their decisions, particularly information regarding future expectations and estimates. In addition, voluntary or optional disclosure, as seen by Peter (2002), enhances public confidence in company and is reflected positively on its reputation, market value and the prices of shares in the capital markets.

Strong disclosure systems are considered a basic feature of the methods of following up companies based on market forces. They are of great importance regarding the ability of shareholders to exercise voting rights. The experience of countries where there are big markets and effective property rights has shown that disclosure is a powerful tool to influence the behaviour of firms and the protection of investors. Strong disclosure systems can also help attract capital and maintain confidence in the capital markets.

Prospective shareholders and investors need to get regular information which is characterized by a high degree of comparability with other corresponding data and a degree of detailing sufficient to enable them to assess the efficiency of administration and make decisions based on adequate information on the evaluation of companies, property rights and voting rights for different classes of shares therein. In addition, such procedure can improve the levels of public understanding of the structures and activities of projects, and also the understanding of corporate policies and performance with regard to environmental standards and the relationship with the communities in which companies operate.
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