

Advancing Corporate Governance in the Middle East and North Africa: Stories and Solutions

Center For International Private Enterprise
Global Corporate Governance Forum

February 2011



Global
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Intended to prompt discussion, debate, and action, this guide describes how companies of all types and sizes in the Middle East and North Africa region have improved their corporate governance practices through a gradual process that benefited their performance and growth. It also provides a menu of options for other companies that may be considering their own governance initiatives. This guide may be used for general guidance, as a template for action by corporations, or as teaching material for institutes of directors and corporate governance institutes.

“We couldn’t have managed our fast growth if we did not implement a sound policy of corporate governance centered on transparency and a structured communication strategy with various stakeholders, including the family.”

SLIM OTHMANI, CEO, NCA-ROUIBA, ALGERIA

“We wanted to set ourselves apart from other companies operating in the developing world — we wanted to establish the standard that other companies aspired to.”

MONA AKL, CORPORATE SECRETARY, BUTEC, LEBANON

“Corporate governance is not something that has to be imposed on corporations from outside. I can tell you in my case what developed and what evolved in Nuqul Group was done in response to challenges and actual needs on the ground — and it turned out to be what you call corporate governance.”

GHASSAN NUQUL, VICE CHAIRMAN, NUQUL GROUP, JORDAN

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The Global Corporate Governance Forum is a leading knowledge and capacity-building platform dedicated to corporate governance reform in emerging markets and developing countries. The Forum offers a unique collection of expertise, experiences, and solutions to key corporate governance issues from developed and developing countries.

The Forum's mandate is to promote the private sector as an engine of growth, reduce the vulnerability of developing and emerging markets to financial crisis, and provide incentives for corporations to invest and perform efficiently in a transparent, sustainable, and socially responsible manner. In doing so, the Forum partners with international, regional, and local institutions, drawing on its network of global private-sector leaders. The Forum is a multi-donor trust fund facility located within IFC, co-founded in 1999 by the World Bank and the Organisation for Economic Co-operation and Development (OECD).

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TABLE OF CONTENTS

FOREWORD	iii
INTRODUCTION	v
SECTION I - Motivations to Invest in Corporate Governance?	1
Access to Capital and Attracting Investors.....	1
Improving Employee Motivation	2
Risk Management	3
Managing Growth	4
Family Succession	5
SECTION II - Corporate Governance Case Studies from the Middle East and North Africa ...	7
Banque du Caire – Egypt.....	7
Nuqul Group – Jordan	14
NCA-Rouiba – Algeria	20
Butec Holding – Lebanon	24
Eramedic – Morocco	28
Commercial Insurance – Lebanon.....	31
Accelerator Technology Holdings – Jordan.....	35
Telecom Egypt – Egypt	38
Sorouh – United Arab Emirates	41
Bisco Misr – Egypt	44
Abu Dhabi Commercial Bank – United Arab Emirates.....	47
SECTION III - Implementing Corporate Governance	51
Board of Directors	50
<i>Role of a Board of Directors</i>	50
<i>Board Composition</i>	52
<i>Planning and Conducting Board Meetings</i>	55
<i>Keeping the Board Informed</i>	56
<i>Forming Board Committees</i>	57
<i>Enhancing Board Performance</i>	58
Risk and Control.....	61
Transparency	63
Family-Owned Enterprise Governance	65
<i>Phases in Family Governance Structure</i>	67
<i>Establishing a Family Constitution</i>	69
<i>Formalizing Policies</i>	70
<i>Preparing for Succession</i>	72
APPENDIX 1: Sample Outline of a Family Constitution	74

FOREWORD

Corporate governance has become a major factor affecting the success of emerging market businesses. At a time when the increasingly global economy creates opportunity, but also competitive threats, instituting good corporate governance practices is an important part of any strategy to prosper. For corporations, improving corporate governance attracts greater investment at lower cost, strengthens company strategy and execution, clarifies accountability, protects shareholders, and attracts and retains quality employees. For controlling shareholders (often founding families) corporate governance clarifies roles, allows continuing professionalization of the senior executives while ensuring accountability, and increases the value of the organization. For society as a whole, it minimizes the incidence of corruption, reduces the risk of systemic crises, and improves productivity.

While corporate governance is often considered to be the purview of large companies listed on stock exchanges, corporate governance also provides a valuable framework to address issues of sustainability and succession for small and medium-sized enterprises and for family-owned businesses. For those companies, which comprise the majority of companies in the Middle East and North Africa (MENA) region, corporate governance procedures can help facilitate a smooth inter-generational transfer of wealth and reduce conflicts within families. Good governance is an essential component for ensuring the integrity of financial reporting and effective business management.

The benefits of good corporate governance are increasingly recognized in the region. In the past several years, at least four new institutes of corporate governance or institutes of directors have been established, demonstrating the growing demand for corporate governance information, training, and guidance for companies to improve their practices. Many countries — including Algeria, Egypt, Bahrain, Lebanon, Morocco, Oman, and Tunisia — have issued corporate governance codes. However, for many companies, full code implementation can appear daunting. Whether standards are obligatory or voluntary, the key to success is to understand that even incremental progress towards such principles can help companies reap outsized benefits.

This guide presents real-world, practical examples that show how companies in the region overcame barriers and improved their governance practices in ways that benefited performance and growth. The case studies illustrate that corporate governance is not a one-size-fits-all concept. The featured companies have taken an incremental, nuanced approach, focusing on the corporate governance improvements most applicable and relevant for their size, industry, market, ownership structure, and corporate strategy. They then lay the foundation for ongoing improvements by developing buy-in from key stakeholders. The cases demonstrate how key principles can be translated into actual practice to elicit tangible results. In other words, the case studies in this guide focus on the business case for corporate governance, not on theoretical or academic models.

We hope that this guide will prove to be a useful tool to advance the adoption of corporate governance principles and practices. As governments increasingly look to the private sector to stimulate economic

growth, the business community has a unique part to play in promoting values of accountability, fairness, and responsibility. This new role will help to advance democratic institutions and strengthen business ethics to the benefit of the public sector, the private sector, and the general public.

A handwritten signature in black ink that reads "Philip Armstrong". The signature is fluid and cursive, with a long horizontal stroke at the bottom.

Philip Armstrong
Head, Global Corporate Governance Forum

A handwritten signature in black ink that reads "John D. Sullivan". The signature is cursive and elegant, with a prominent loop at the end.

John D. Sullivan
Executive Director, CIPE

INTRODUCTION

The Middle East and North Africa (MENA) region is experiencing rapid private sector growth. While each country is unique, visionary companies throughout the region embrace improved corporate governance as a strategic advantage in their quest for growth and profitability. Reasons for introducing these practices are as varied as the companies involved, but include attracting lower-cost and differentiated sources of capital, employee motivation, corporate sustainability, efficiency, and, for family-owned companies, resolving inter-generational issues.

This guide provides concrete and relevant examples of corporate governance successes in the MENA region taken from interviews that were conducted with medium-sized enterprises, larger companies, and banks in the MENA region. They represent the breadth of corporate structures in the region; some are family-owned, some partially state-owned, and some have private-equity ownership. The studies provide real-world examples of companies' incremental steps on the long path toward corporate governance improvement. These companies' achievements were not easy accomplishments; they took time, effort, and resources. What the case studies demonstrate, however, are the tangible benefits to improved corporate governance practices.

The guide is divided in three parts: Section I focuses on the primary motivations and benefits for improving corporate governance; Section II presents cases of corporate governance challenges and successes from the Middle East and North Africa; and Section III focuses on the key mechanisms that the companies used to improve their practices.

How can this guide be used?

The guide is intended to serve a real-world purpose: To provide assistance and motivation to directors, senior managers, controlling shareholders, regulators, and others as they try to improve existing corporate governance practices. The guide may be used for general inspiration, as a template for action by corporations, or as teaching and consultation material for institutes of directors and corporate governance institutes. Regardless of its ultimate use, the guide is intended to prompt discussion, debate, and action.

Cases Selected

Small and medium-sized enterprises are particularly important in MENA countries, where they comprise more than 90 percent of all businesses and account for most non-agricultural employment.¹ Many are family-owned, therefore, a conscious effort was made to include family-owned companies in this guide, along with state-owned enterprises, companies with private equity interests, and other forms of ownership.

The case studies include nine companies and two banks in six MENA countries (Algeria, Egypt, Jordan, Lebanon, Morocco, and the United Arab Emirates). The interviews were conducted with board directors, CEOs, and high-level management over the course of several months.

1 *Diversifying MENA Economies to Improve Performance*. Organization for Economic Co-operation and Development, MENA-OECD Investment Programme, Working Group 4. Available at: www.oecd.org/dataoecd/56/19/36086867.pdf.

Section III: This section examines four areas of improvement that will drive corporate governance change.

- ▶ **BOARD OF DIRECTORS:** Improving and clarifying board functions enables better accountability and increases the professionalism of senior management.
- ▶ **RISK AND CONTROL:** Anticipating risks and establishing internal controls helps mitigate uncertainty and alleviates problems when they do arise.
- ▶ **TRANSPARENCY:** Fostering transparent practices — such as clear communications and quality annual reports — facilitates new business partnerships, better relations with stakeholders, more financing options, and fewer problems in family-owned enterprises.
- ▶ **FAMILY-OWNED ENTERPRISE GOVERNANCE:** Introducing new corporate governance practices allows family-owned enterprises to accommodate family changes and to address ownership, employment, and succession issues.

SECTION I

Motivations to Invest in Corporate Governance



“Good corporate governance is about raising the bar of compliance. It is not about just ticking a box. It is about doing the right thing because you are convinced of it; then inspiring a culture of good practice through leadership.”

PHILIP ARMSTRONG | HEAD, GLOBAL CORPORATE GOVERNANCE FORUM

Compliance with regulation is a mandatory first step towards good corporate governance, but is not adequate by itself to reach high standards of corporate governance best practices. In order to make a commitment to move beyond the minimum requirements, a corporate board needs to be convinced that applying corporate governance practices is worth the effort, whether the standards are voluntary or mandatory. This section of the guide details some of the benefits of improved corporate governance, including access to capital, improving employee motivation, risk management, managing growth, and addressing family succession.

Access to Capital and Attracting Investors

The ability to access a variety of sources of capital — and less expensive sources of capital — is a principle advantage of improved corporate governance. While the initial investment of company founders is usually enough to start up the business and fund some future expansion, sustaining or accelerating growth usually depends on the ability of firms to attract reliable sources of capital. Introducing good corporate governance practices that are both functional and effective can be a key element in attracting outside funding.²

An increasing number of empirical studies underscore that companies with solid governance are valued higher by the market. These studies have generally found that companies with better corporate governance have higher overall returns, particularly in volatile markets.³ As a result, investors have increasingly taken into consideration a company’s corporate governance practices when deciding where to make their investments.

As was illustrated in the case studies, a company’s corporate governance policies can affect the availability and even the pricing of public equity capital, private equity capital, and debt capital. For equity investors, this may mean a willingness to invest at higher multiples in companies they perceive

2 *Practical Guide to Corporate Governance: Experiences from the Latin American Companies Circle*. International Finance Corporation. September 2009. Available at: [http://www.ifc.org/ifcext/corporategovernance.nsf/AttachmentsByTitle/CG_Guide_LAC_full_report/\\$FILE/CG_LAC_Guide_full_report.pdf](http://www.ifc.org/ifcext/corporategovernance.nsf/AttachmentsByTitle/CG_Guide_LAC_full_report/$FILE/CG_LAC_Guide_full_report.pdf).

3 “GMI Governance and Performance Studies.” *GovernanceMetrics International*. Available at: <http://www.gmiratings.com/Performance.aspx>. Also see: Paul Gompers, Joy Ishii, and Andrew Metrick. “Corporate Governance and Equity Prices.” *Quarterly Journal of Economics*, Vol. 118, No. 1. February 2003. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=278920.

to be well-governed. Similarly, fixed-income investors may accept lower interest rates and longer maturities on loans and credits.⁴

The transparency, financial controls, and clearly defined rights and responsibilities of the board, management, controlling shareholders, and external investors embedded in good corporate governance regimes reduce uncertainty for investors. Research conducted by McKinsey & Company, in cooperation with the World Bank, shows that investors are willing to pay a higher premium for companies with corporate governance practices versus those without such practices.⁵ That premium generally decreases with an investor's perception of the maturity of the market, meaning that the premium — or the discount for a well-governed company — is high in many emerging markets.

When making investment decisions, investors may also look at the relationship that a company has with its stakeholders. Research has demonstrated that corporations that engage with, and respond to, a wider group of stakeholders are more likely to be sustainable and better equipped to achieve higher financial results.⁶ Stakeholder engagement is therefore a relevant concern for all companies, whether a company's motive is serving the community, enhancing shareholder value, or both. In terms of its link to corporate governance, the challenge of stakeholder engagement lies in a board's ability to balance the interests of its stakeholders and shareholders and to ensure the profitability and sustainability of the company.

Improving Employee Motivation

One set of stakeholders that is essential to every company is the work force. Building a reputation as a fair employer can improve a company's ability to attract and retain talent — today's most expensive and valuable asset. Corporate reputation affects whether or not a company is an employer of choice. Being an employer of choice can help attract a better-skilled and more productive workforce. But building this reputation requires constant monitoring of corporate policies and the competitive landscape to ensure that employees are well treated and fairly remunerated, while maintaining the long-term objectives of the company.

With the changing dynamics of employment policies across the world and the constant pressure for corporations to focus on efficiency and competitiveness, short-sightedness in managing employees can occur. An apparent short-term financial positive, such as reducing payroll through lay-offs or below-market wages, can have very negative long-term effects, such as labor unrest or an untrained or inefficient workforce. As with many challenges facing management, the key is balance. A corporate governance structure can promote fairness and equitable treatment of employees while focusing on profitability.

Some forward-thinking companies establish a formal career development program as a way to identify and advance the careers of future leaders. One key component of these programs is a

4 *Practical Guide to Corporate Governance: Experiences from the Latin American Companies Circle*. International Finance Corporation. September 2009. Available at: [http://www.ifc.org/ifcext/corporategovernance.nsf/AttachmentsByTitle/CG_Guide_LAC_full_report/\\$FILE/CG_LAC_Guide_full_report.pdf](http://www.ifc.org/ifcext/corporategovernance.nsf/AttachmentsByTitle/CG_Guide_LAC_full_report/$FILE/CG_LAC_Guide_full_report.pdf).

5 Paul Combes and Mark Watson. "Three surveys on corporate governance." *McKinsey Quarterly*. December 2000. Available at: www.mckinseyquarterly.com/Three_surveys_on_corporate_governance_965.

6 Ibid.

mechanism to identify employees who possess the right competencies, skills, and experiences to fit the company's future needs. This has proven helpful in filling senior management positions from within the company, which is less expensive and less disruptive to corporate culture. It also helps improve employee motivation; workers understand that there are career paths open to them. Such strategies contribute to higher employee retention and lower turnover.

In addition, when a company clearly outlines a strong and consistent set of values, it helps employees to feel invested in the company and to act with integrity. These values build the foundation for practices that define what is acceptable within an organization. It is important to develop both corporate objectives and individual values as a part of an overall corporate governance scheme, keeping in mind that every company will have its own set of unique values.⁷ Though it may seem difficult, it is always important to try to codify corporate values. Monitoring compliance without written guidelines is difficult, and employees and managers can sometimes cut corners in the name of efficiency and productivity.⁸ An effective corporate governance system can facilitate the consistent application of corporate values through transparent internal and external communications, related party transaction policies, internal audit plans, documentation of payments, and anti-money laundering and anti-corruption policies.



“We must keep in mind that firms have to take risks. If they are not taking risks, they are probably not innovating and not generating profits for their shareholders.”⁹

JOHN D. SULLIVAN | EXECUTIVE DIRECTOR, CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE

Risk Management

From market volatility and external environmental instability to the demanding pressures of key stakeholders and competition, businesses are facing an increasingly complex and uncertain environment. At its core, conducting business is about taking calculated and managed risks. For some, the focus of risk management has primarily remained on compliance with laws and regulations. But a narrow focus on regulation often fails to understand or address the constantly emerging threats within a continuously evolving risk landscape. Instituting a strong corporate governance framework, including an engaged board and effective internal controls, helps companies assess risk more effectively and respond quickly to changes in the business environment.

7 Vadim Ketelnikov. “Balanced Organization: 5 Basic Elements. Shared Values Defined.” Available at: www.1000ventures.com/business_guide/crosscuttings/shared_values.html.

8 “A Call for Business Leadership in Society.” Boston College Center for Corporate Citizenship. January 2007. Based on the interviews of 48 top executives – including 26 CEOs – representing 27 major multi-national companies, including: IBM, Citigroup, GE, Nestle, and Verizon. EthicsWorld has featured research showing the importance of leadership in building and managing ethical companies. Available at: www.ethicsworld.org/ethicsandemployees/ethicsleadership.php.

9 Anna Nadgrodkiewicz. “Ethics and Corporate Governance in the Fight against Corruption,” Center for International Private Enterprise, *Economic Reform Feature Service*. October 15, 2008. Available at: <http://www.cipe.org/publications/fs/pdf/101508.pdf>.

Board members are a key element in setting the risk strategy and mitigation procedures for a firm. Independent board members have a special role to play; their risk assessment is viewed as unbiased since it is not influenced by management. Moreover, because many outside board members are selected for their particular experiences and skills, they may be attuned to a different set of risks than executive management.

Successful boards and management teams have found that a more integrated approach to governance, risk, and compliance can drastically improve the management of underlying risks and regulatory requirements. Doing so can also help companies spot opportunities and understand areas where they can save costs. Companies that are recognized for creating solid risk management frameworks may also have greater success in attracting investors.

Any discussion of risk management should also include attention to corruption and fraud, since such practices can increase exposure to risk, waste resources, and threaten the sustainability of the company. Research is finding that poor corporate governance is a leading factor in the emergence of fraudulent practices within organizations. According to a study conducted by the Association of Certified Fraud Examiners in the United States, organizations lose seven percent of their annual revenues to fraud. The key finding of the study was that the greatest percentage of surveyed fraud cases occurred within the banking and financial services sector, and small companies (with 100 employees or less) were especially vulnerable to occupational fraud. Lack of adequate internal controls was most commonly cited as the factor that allowed fraud to occur. Lack of management review and the ability to override existing controls were also cited as openings for corruption. Both of these areas are typical elements of a corporate governance improvement effort.¹⁰

Managing Growth

When the *Economist Intelligence Unit* surveyed more than 3,000 business leaders, the surprising conclusion was that medium-sized businesses deliberately limit their growth potential by a lack of structure.¹¹ According to the *Economist*, more than 60 percent of surveyed executives said senior management set an optimal rate of growth for their company, and nearly the same number said it had also identified an optimal size. “Management of some fast-growing midsize firms consciously try to calibrate growth to the resources at hand in order to avoid breakdowns and customer dissatisfaction,” the report explains. These findings are in fact consistent with observation. Companies must often rely on a finite amount of internal managerial capacity and expansion capital; when the skills required to manage growth are scarce, companies fear failure if growth is not properly managed.

Investing early or prior to fast growth in a solid corporate governance framework can help ensure the company’s readiness to meet the challenges of expansion. Delineated roles and responsibilities will make it clear where skills are present and where new talent needs to be recruited. One of the key components of good corporate governance is a strong, well-functioning board of directors, which is essential to guide a company’s growth strategy and ensure that expansion does not undercut the company’s success. The board must set forth a clear vision of the company’s future and make decisions to move along that path in a clear, strategic, and intentional manner.

¹⁰ 2008 Report to the Nation on Occupational Fraud and Abuse. Association of Certified Fraud Examiners. 2008.

¹¹ “Thinking Big Midsize Companies and the Challenges of Growth.” *Economist Intelligence Unit*. February 2006..

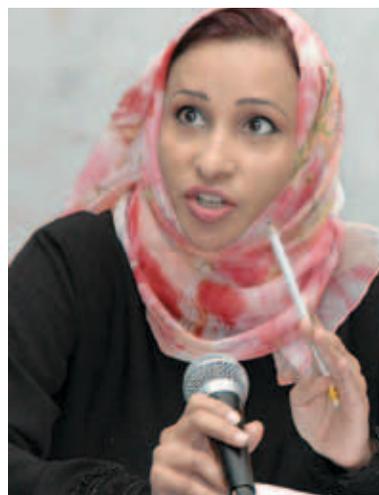
Bringing external directors onto a board can give a firm an edge in enhancing internal capacity, acquiring new knowledge, and improving its competitive position.¹² Having a board with experienced external directors can prove a strategic resource, providing timely advice and counsel to the CEO and other management as the company embarks upon its growth strategy.¹³ This can take the form of appointing representatives of key stakeholders as board members or bringing in directors with specifically needed expertise in order to achieve better business results.

The long-term sustainability and success of a firm also depends on its ability to engage with and manage the challenges created by its external environment. Constant interaction with the surrounding environment is necessary to identify suppliers, find new distribution channels, or expand the client base in local or outside markets, as well as to deal with competitive threats, regulatory issues, and reputational challenges. Having a well-informed board allows firms to better understand their environment, generate a stable flow of information, and make more informed decisions that will ultimately mitigate uncertainties and enhance growth opportunities.¹⁴

Family Succession

In some developing countries, nearly 90 percent of businesses are family-owned companies. Yet, research shows that only 30 percent of family-run businesses survive into a second generation, 12 percent make it to a third, and a mere 3 percent transition successfully into a fourth generation and beyond. Companies face major crises in managing succession if it is not appropriately planned.

The problem of succession inevitably arises when the founder or family patriarch is nearing retirement or is otherwise unable to carry on management functions. If the issue of succession has not been discussed or resolved, the transition can cause a major upheaval in the company as various family members vie for control, or if the company falls into disarray because the required talent and knowledge are not present in the current company structure. The results can be divisive and detrimental to the company and the family. In addition, family members may be hesitant to relinquish control to outside managers even if they recognize that qualified executives are not present within the family.¹⁵



Participant at conference in Bahrain to launch a consultative process on the corporate governance code, May 2008.

12 Jonas Gabriellsson and Morten Huse. "‘Outside’ Directors in SME Boards: A Call for Theoretical Reflections." *Corporate Board: Role, Duties & Composition*, Vol. 1, Issue 1. 2005. Available at: www.virtusinterpress.org/additional_files/journ_cb/paper03.pdf.

13 External directors are persons who are not directly affiliated to the company.

14 Jonas Gabriellsson and Morten Huse. "‘Outside’ Directors in SME Boards: A Call for Theoretical Reflections." *Corporate Board: Role, Duties & Composition*, Vol. 1, Issue 1. 2005. Available at: www.virtusinterpress.org/additional_files/journ_cb/paper03.pdf.

15 Mohamed J. Jaffer and Syed Bulent Sohail. "Corporate Governance Issues in Family-Owned Enterprises." Center for International Private Enterprise, *Economic Reform Feature Service*. April 20, 2007.

If the founder-owner or other members of the family can open the discussion and create a succession plan in advance of such a transition, the potential to avoid conflict and guarantee the sustainability of the company is vastly improved. The key to successful succession planning is anticipating and mitigating potential conflicts, professionalism, and selection criteria based on merit.

Organizations state that time and resources are the biggest challenges in planning for succession. Owners, boards and senior managers can be too occupied with everyday problems and overlook the need to prepare the company for a smooth transfer of leadership. Succession planning can also



Ken Rushton, member of the Private Sector Advisory Group of GCGF, speaks at a 2008 conference that launched a consultative process on the corporate governance code in Bahrain.

be a sensitive topic with the owner or patriarch of the family not feeling completely secure in training a successor, fearing the loss of his or her own position. Often, just recognizing what an organization will need in the future can be difficult task.¹⁶ First and second generation owners need to assess and recognize what capabilities must be developed among future company leaders in order to prepare and ensure the longevity of the company.

A strong board within a family-owned company can play an extremely important and beneficial role in this process by providing a venue for these discussions, posing difficult questions, and ensuring a fair and equitable process. A well-functioning board that serves the business will maintain a positive environment within the company and with the family by promoting open communication and transparency. For family-run businesses, however, the board sometimes acts only as a formality. If the board

is strictly comprised of family members, or occasionally including close friends who are accomplished in their careers and trusted by the family, then the board might not give strategic guidance or facilitate a neutral process. For this reason, including non-family members, independent directors, or informal advisors to the board is paramount for the company's success. In order to do this, the company must determine how to include the expertise and perspective of outsiders while maintaining the trust and confidence of the family.

The idea of a family constitution or a family charter, as described in Section III, can help family-owned businesses navigate these challenges by clearly outlining expectations for family and non-family members and setting up mechanisms to transition to the next generation.

¹⁶ Ibid.

SECTION II

Corporate Governance Case Studies from the Middle East and North Africa



BANQUE DU CAIRE | EGYPT

Banque du Caire (BDC) is an Egyptian state-owned enterprise. A proposed sale fell through for a variety of internal and external reasons. Banca Comerciala Romana is a Romanian bank, which was sold following extensive corporate governance improvements, and which may or may not be an example for BDC to follow as it contemplates future potential sale.

KEY LESSONS LEARNED

- ▶ Implementing corporate governance changes in state-owned enterprises presents unique challenges.
- ▶ Corporate governance can play a role in creating value for shareholders (*the case of Banca Comerciala Romana*).
- ▶ Implementing sound corporate governance practices is important in a privatization context.

Background

The Egyptian Banque du Caire (BDC) was established as a privately-owned bank in 1952. The bank was nationalized in 1961 as a result of political changes in the country, and still falls under the purview of the Ministry of Finance. In 1964, there was a restructuring that divided the bank into three sectors: finance of foreign trade, housing and public utilities, and information and tourism. By 1971, the government decided to shift the composition again, this time to “functional specialization” meaning that it was divided along services and construction sector lines.¹⁷ This structure allowed the bank to establish a strong relationship with the public sector, as well as with the contracting, housing, tourism, insurance, healthcare, and transportation sectors.

In the early 1990s, Egypt faced a serious economic crisis as a result of mounting external debt, increasing rates of inflation, and a high budget deficit. In response to the crises, an economic reform program was pursued, led by the World Bank, International Monetary Fund (IMF), African Development Bank (ADB), and other donor institutions, with financial sector reform and privatization at the heart of the program. As a result, BDC began courting the private sector to expand its client base, focusing heavily on larger corporations while developing and marketing a broader range of products and services. Simultaneously, the government considered putting BDC up for sale to a private investor.

¹⁷ “Banque du Caire of Egypt: a state-owned retail bank case study.” USAID. microREPORT #59. February 2006. Available at: www.alternative-credit.com/Banque_du_Caire_Egypt.pdf.

However, the bank's limited expertise in credit risk management resulted in poor lending practices. By 2000, the bank was experiencing major loan defaults, and as a result, was not in a position to be privatized. Instead of selling the government reconfigured the BDC board to draw heavily from the private sector. Led by a new chairman, the Egyptian government brought in seven directors with private sector backgrounds and appointed a team of executive advisors to assist. Senior manager positions were filled by three members of the board, including the chairman. The board was given a mandate to develop and execute a new strategy to upgrade and modernize operations. The board was also responsible for reviewing and approving proposals for new products, new expenditures that cost more than 50,000 Egyptian pounds (EGP), and plans for expansion.

The board's immediate response was to develop a strategy to expand the retail business. Simultaneously, the bank was again restructured, this time into four geographical areas for strategic and work planning purposes, with a senior management team providing oversight for each of the areas to ensure execution of the board's strategy.

Attempted Merger

In 2005, BDC, Egypt's third largest bank at the time, tried to merge with Banque Misr, the second largest bank. Combined assets would have totaled 136 billion EGP, which would have made it larger than the largest bank at the time, National Bank of Egypt (NBE), whose assets totaled 131.7 billion EGP. After the decision had been made, however, it became evident that the two banks had a series of overlapping businesses. Rather than merging, the decision was made to keep the banks as separate entities, but with a combined board of eight directors.

The government decided to sell 67 percent of BDC in 2007, despite the low profitability due to non-performing loans that were the result of limited expertise in credit risk management.¹⁸ Immediately prior to selling, BDC embarked on the early stages of a corporate governance improvement program. Several principles had been proposed and were approved by the board, all of which were documented and included in the redesigned bylaws.

Two committees were developed: the Executive Committee (mandated by law) that reviewed major credit decisions, hiring of strategic positions, and providing general recommendations to the board; and the Audit Committee, which reviewed financial practices and also assisted in making corporate governance recommendations.

To prepare for the sale it was necessary to organize the bank's financial portfolio. Among the key problems were a number of real estate properties that were not registered in the bank's name; without the title in the proper name, the bank was unable to properly account for the properties. The audit committee made great strides and reconciled the majority of the properties. Second, the bank sold off its non-performing loans (NPLs) to Banque Misr, resulting in a restructuring of the balance sheet. The government covered 40 percent of BDC's under-performing loan portfolio, which was placed under the management and supervision of Banque Misr. Banque Misr also covered the acquisition and sale of nearly 95 percent of BDC's investment portfolio.¹⁹ Finally, early retirement plans were

¹⁸ Ibid.

¹⁹ Shirene El Medany. "Banque du Caire Auction Postponed." *Daily News Egypt*. June 25, 2008. Available at: www.dailystaregypt.com/article.aspx?ArticleID=14643.

offered to BDC employees to prevent overstaffing and JP Morgan was contracted to perform due diligence on the 215 branches, which held 50.1 billion EGP in assets and 6.7 percent of deposits. BDC also made some improvements to its organizational structure. In the previous two years, as part of Egypt's broader banking sector reform, the bank established enhanced risk management procedures designed to make loan origination more profitable. This process involved renovating credit risk management-related departments and procedures, as well as strengthening the internal control department.²⁰ Corporate credit origination was mostly centralized with final loan approval coming from executives in the main office. Retail lending, which included loans to civil servants, small business loans, and small corporate credit amounts, was decentralized. This led to greater efficiency as branch level personnel implemented head office-defined lending criteria.²¹

Attempted Sale

The plan was to sell a 67 percent stake in BDC. Three banks met the basic requirements to bid: National Bank of Greece (NBG), Dubai's Mashreq Bank of the UAE, and a consortium formed by Jordan's Arab Bank and the Saudi Watany Arab Bank. Yet none of the three banks placed a bid above the minimum valuation that had been established, so the sale did not occur.



"In the end, the highest bid by NBG of \$1.4 billion failed, by \$200 million, to meet the minimum acceptable sale price set by the valuation committee.²² It became necessary to end the sale process since Egyptian law stipulates that a sale must be halted if it fails to meet the minimum valuation price."

SAMIR HAMZA | MEMBER OF THE BOARD, BANQUE DU CAIRE

A number of factors led to the failure to sell. First, in 2006, an 80 percent stake of the Bank of Alexandria was sold for \$1.6 billion. This led BDC to believe that it could ask for and expect this figure as a minimum price. While Bank of Alexandria was sold at 6.1 times its book value, NGB's offer came in at just 4.1 times BDC's book value (based on BDC's book value of 2.67 billion EGP, or about \$500 million, as of March 31, 2008).²³

In addition, several days prior to bidding on the BDC sale, the rating agency Moody's published a report that lowered its outlook for Egypt's foreign currency bonds from stable to negative, raising a warning flag to any investors with interest in the Egyptian banking sector. Other economic conditions, such as the high inflation rate (around 21-22 percent) and high rates of unemployment and poverty could also have played a role. Investors may have been scared off by the prospect of a slowdown in private consumption.

20 "Banque du Caire — Descriptive Memorandum." *JP Morgan*. January 2008.

21 Ibid.

22 Shirene El Medany. "Banque du Caire Auction Postponed." *Daily News Egypt*. June 25, 2008. Available at: www.dailystaregypt.com/article.aspx?ArticleID=14643

23 Ibid.

At this point, there was some concern regarding whether the cancellation of the sale would damage the bank's future. Pursuing another merger was no longer an option, and the bank was required by law to wait at least two years from the initial auction before attempting to sell again.

The Experience of Banca Comerciala Romana (BCR)

Despite a number of negative external factors facing BDC, several internal areas can be improved and controlled to enhance the overall health of the bank, priming it for another attempt at privatization. Banca Comerciala Romana (BCR) underwent a similar crisis in Romania and managed to reform the bank and sell to a private investor, even after multiple failed attempts to sell. It may prove to be an example BDC can follow.

BCR, established in 1990, took over the commercial business of the National Bank of Romania as a result of a privatization program that began in 1991. The bank was structured as a retail bank, focusing on corporate lending, and was staffed with 13,000 employees. With a \$1 billion book value, the bank was 70 percent state-owned, while the remaining 30 percent was held by five local investment funds that specialized in handling privatization programs for large institutions.

Similar to BDC, two attempts were made to privatize the bank in 2000 but both failed because of an unfavorable international investment environment.²⁴ In addition, the bank faced major corporate governance challenges. First, the management structure and board were indistinguishable and unable to perform their respective functions in a complementary way. Second, the board met over 25 times a year, a staggering figure when considering that many boards meet only three or four times per year. Such frequent meetings are often an indication of a lack of clear definition between the role of the board and that of management. That, in turn, can lead to micromanagement by the board and usurpation of power by management. Perhaps most importantly for a bank, the risk management function was non-existent; internal controls were lax and the audit functions lacked any real enforcement power.

The government was tasked with producing an unorthodox plan to successfully privatize the bank. It invited the International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD) to partner in developing a solution. Once IFC and EBRD obtained an ownership stake in the bank, the internal operating structure of the bank was rebuilt using proven corporate governance practices, a system coined "Governance for the Interim."²⁵ An institution-building program was also implemented to prepare for privatization, which included organizational changes, increased business development, and human resource investments, along with the introduction of solid corporate governance practices.

The board and management were separated to create the appropriate system of checks and balances, and new board directors with the required qualifications were nominated by IFC and EBRD. The bank's charter was redrafted, taking into account new amendments in the banking laws. The board also created functioning audit, compliance, and compensation committees.

24 Magar Kouyoumdjian and Ekaterina Trofimova. "Banca Comerciala Romana Rating Raised to 'B+' on Improved Economy: Outlook Positive." *Standard & Poors*. January 19, 2004. Available at: www.roembus.org/english/news/international_media/2004/Standard_and_poors_19.01.2004_banca_comerciala_romana_rating_r.htm.

25 Mike Lubrano. "Banca Comerciala Romana Deal Structure, Value Added and Outcomes." International Finance Corporation.

A two-stage training program was developed to assist in training executive management. The first phase consisted of an international seminar led by the International Institute for Management Development and the International Institute of Finance, designed to help top executives improve the business performance of their areas of responsibility. This was followed by a tailored in-house training program targeted to the specific needs of the bank.

The changes resulted in increased engagement during board meetings as well as a professionalization of the shareholders' meetings. There was also a remarkable improvement in risk management and internal controls; an IFC-sponsored resident advisor in the internal controls unit was a key to that effort. But perhaps most telling was the rating upgrade the bank received after the changes had been implemented. The individual rating rose from D to C/D and Standard and Poor's (S&P) long-term counterparty rating from BB to B+. The rating agencies cited improvements in corporate governance and risk management as the major reasons for the upgrades.

At that point, enough progress had been achieved to allow another attempt at privatization. Interest was initially expressed from eleven bidders, with seven submitting bids. Ultimately, two finalists, Erste Bank (Austria) and BCP (Portugal), bid for the government and IFC/EBRD shares.

The process ended with Erste Bank paying €3.75 billion to purchase the government, IFC, and EBRD shares, giving it a 61.88 percent stake in the bank. When the transaction closed in October 2006, it marked a six-fold increase in the 1 billion book value as of June 2005. For the IFC, the internal rate of return of its investment (including dividend distributions), was estimated at 157 percent.

BDC Moving Forward

Can BDC follow in BCR's footsteps?

One of the biggest challenges in setting up a system of corporate governance is follow-through. In order to ensure implementation, BDC has established an audit committee consisting of three non-executive directors. It also included the heads of compliance and inspection as non-voting ex officio members. In addition to the normal audit committee role, oversight of the bank's corporate governance principles was placed in the hands of the audit committee.

Prior to the corporate governance changes, the bank was principally focused on the compliance-related aspects of risk management. A move was made to switch from a compliance-based system to a risk-based model. The bank decided to give the existing risk manager greater influence in final decisions, and the audit committee recommended a separate risk committee. A credit committee was established as a way to mitigate bad loans and the ensuing defaults that underpinned the previous near failure of the bank. That committee included the risk manager, who was granted veto power over decisions. As a control on that unilateral power, any solo risk manager vetoes are sent to the board of directors to review.

Compliance is still very much present in the bank's corporate governance practices. The board has created a compliance manager position that reports directly to the chairman. This individual will be responsible for revising and implementing the various compliance functions. The compliance manager will coordinate with the audit and anti-money laundering functions in the bank, as well as

the board's audit committee. In essence, this new position will have a large degree of independence, so as to encourage more objective oversight.

The boards of Banque Misr and BDC officially separated in September of 2008, but continue to retain the same non-executive chairman. As a subsidiary of Banque Misr, BDC is indirectly owned by the government and has salaries set by the Central Bank of Egypt. Some new committees have been formed, but not yet a committee dealing with the nomination of new directors or executive remuneration. The bank must adhere to law 159 of 1981, which states that salaries are set by the directors of a banking reform fund, which itself is funded by contributions of a small percentage of the profits of the three government-owned banks. The Central Bank maintains oversight of the funds. The BDC board's remuneration is not currently tied to performance nor has the board adapted its regulations to comply with the amendments from Banking Law 88 of 2003, which has tackled many issues related to strengthening corporate governance, forming audit committees, publishing reports, and adopting measures dealing with conflict of interests.

New performance regulations were set for employees, including penalties and disciplinary measures for non-compliance with the new standards and procedures established in accordance with the private sector labor law. A code of ethics was also developed, approved by the board, and given to all bank employees. Employee signatures were required to verify that the ethical regulations had been read and understood. Various functions of the bank, including employee performance, were required to be evaluated according to a five-point system. The bank became more client-focused, scrutinizing the relationship between branches and clients and evaluating whether managers were aware of client issues and concerns. Until 2009, managers' compensation was tied to performance in the form of bonuses, but not directly linked to salary.

Still, many challenges remain. The risk and credit committee has only recently been established and the new chief risk officer has yet to undertake many planned initiatives. Additionally, the risk analysis committee had just begun to gather data, analyze situations, and take charge of the audit and anti-money laundering units.

Another concern is that the information that reaches the board is overwhelming and not properly prioritized. Since 2005, the board has met, on average, twice a month—one meeting for BDC, one for Banque Misr. The meetings originally lasted 12 hours, but the duration has been shortened to half that the time.

The bank still owns around 400 unwanted properties throughout Egypt and is seeking to sell all those not used by the bank. Each sale must be approved by the board, which is an arduous process. To maximize value received, the board needs to know the details of the properties and the reasons it is in the best interest of the bank to sell. This information is not well documented; rather, it is informally held by those who have worked at the bank for a long period of time. As might be expected, documentation and preparation for sale therefore becomes time-consuming.

BDC has undergone many changes, both before and after the first attempted sale. As the Romanian BCR example proves, these changes may help pave the way to a sale in the future. Still, the question remains: Will they be enough?



DISCUSSION QUESTIONS

- ▶ What path do you suggest BDC take in the future (e.g. merger, put up for sale, leave as is, IPO etc.) and how should it prepare?
- ▶ Based on the BCR case, how could corporate governance improve the situation of BDC?
- ▶ What type of restructuring and upgrading would you propose in terms of corporate governance to prepare the bank for another sale? Compose comprehensive recommendations to structure BDC using the following themes:
 - General Framework for Good Corporate Governance
 - Rights of Shareholders
 - Transparency
 - Internal Control Environment
 - Structure, Functioning, and Responsibilities of the Board of Directors
 - External Monitors (Ministry of Finance, auditors, rating agencies)



NUQUL GROUP | JORDAN

This Jordanian firm is a producer of manufactured goods. Nuqul Group realized that in order to expand and to attract partners and investors it had to establish a solid corporate governance structure. Along the way, this family-owned company set the stage for a smooth succession between generations by ensuring that all family members understood their roles, responsibilities, and rights.

KEY LESSONS LEARNED

- ▶ The company's growth depends on maturing from a "one-man show" to a professional management cadre.
- ▶ Transparency is a key element in building trust among stakeholders.
- ▶ Family governance is a process that requires long-term planning, commitment, and resources.
- ▶ Implementing corporate governance best practices helps to attract and retain first-rate employees.

Background

Established in 1952, Nuqul Group is now a conglomerate of over 30 companies and one of the Middle East's leading industrial groups. The company was founded as Nuqul Brothers Company by the current chairman of the board of directors, Elia Nuqul. It is privately-held, family-owned, and employs around 6,000 people.

The company started out as a modest trading operation focused on the importation and distribution of food products. Over the years, management embarked on an expansion strategy that centered on trading integrated industries, expansion, and diversification throughout the Middle East. Its lines of business now cover a wide range of products, including: hygienic tissue paper, non-woven fabrics, processed meats, aluminum profiles, ready-mix concrete, synthetic sponge/foam, plastic pipes, stationery, and printed packaging materials.

Moving from a "One-Man Show": Institutionalizing Nuqul's Systems and Processes

Ghassan Nuqul, the vice chairman of Nuqul Group, took a leading role in 1985, 33 years after his father, Elia Nuqul, founded the company. At the time, the company had grown its line of business from wholesale supply to include manufacturing goods. By 1985, four plants were in operation, and Ghassan Nuqul immediately recognized that in order for the company to grow and sustain itself, he would need to institutionalize processes, allocate tasks, and develop accountability mechanisms.

He was faced with a challenge found in many family-run businesses. The operation begins as a “one-man show” with all decisions passing through a single person. But as a company grows, this system becomes nearly impossible to run effectively. Business theorists call this a “span of control” issue.

At Nuqul Group, the head office had to absorb and process all purchase orders as well as accounting and auditing documents from the four plants. Little accountability existed outside the head office. This became the major impetus behind assigning and institutionalizing corporate practices. For one of his first projects, Nuqul painstakingly inspected, updated, and documented all the procedures and systems. This allowed him to proceed with a decentralization program to streamline activities. His father fully supported him, encouraging him to put his theoretical education to practical use. Nuqul says he felt fortunate to have a father who was open to listening to the ideas of other people, regardless of their age or position. This culture of openness has proven to be a major asset to the company.

Over the next five years, Nuqul headed the decentralization process. He separated and delegated tasks, created job descriptions, established measures of accountability for managers and employees, drew up business plans, established key performance indicators, created balanced performance scorecards, and evaluated the company against others in the industry both regionally and internationally. Much of the process was fundamental, with the work performed in-house. As they observed the usefulness of the initial steps, the company later contracted consultants to help them reach the level of professionalism to which the company aspired.

The result of these reforms is accountability among managers, employees, and the family, which ensures the company’s sustainability. A 10-year business plan was implemented, with forecasted budgets for every year. The company was able to create benchmarks and measure itself against global best practices. They have continued to grow in terms of size and level of profits.



IMPLEMENTING CORPORATE GOVERNANCE

“[Corporate governance] evolved from what seemed innate and relevant. It didn’t come from attending a particular seminar or bringing in a consultant who said ‘this is exactly what you need.’

“We did it ourselves. And you know what — a few years later, I attended a seminar on the subject, and it was then that I realized it was called ‘corporate governance.’ We probably already had 80 percent of what they were talking about. Eighty percent! And this proves that corporate governance is not something that has to be imposed on corporations from outside.

“I can tell you in my case what developed and what evolved in Nuqul Group was done in response to challenges and actual needs on the ground — and it turned out to be what you call corporate governance.”

GHASSAN NUQUL | VICE CHAIRMAN, NUQUL GROUP

Building an Effective Board

Nuqul Group has established a strong board composed of both family and non-family members. It includes board members who work for the company, board members from outside the company, and board members with specializations in fields other than wholesale and manufacturing.

The current board includes three family members, two Nuqul Group CEOs, a corporate affairs director, and two independent directors. Two other independent directors sit on board committees, but not on the board itself. As Vice Chairman, Ghassan Nuqul chose to add two independent directors from outside the industry — an engineer and a banker with extensive experience in their fields — because he believed they would bring a fresh perspective to the board and would challenge the way the other directors think and operate. The six other board members all have extensive experience within Nuqul Group and can accurately reflect the interests of the company. While it may be counterintuitive to some, Nuqul believes that the mixed board structure ultimately serves the best interests of the family.

Two committees function under the board's oversight: an audit committee, and a management development and compensation committee. Both committees are chaired by Ghassan Nuqul. The audit committee also includes the corporate affairs director, the banker (as an independent director), and the CFO of a large regional company. Marwan Nuqul (the brother of Ghassan), the corporate affairs director, a human resources director from a multinational company, one of the independent directors, and Ghassan Nuqul sit on the management development and compensation committee.

Independent directors are remunerated according to the board charter. Each year a renewal letter is extended to current directors, which opens a window for a change in board membership or a confirmation of the existing composition. The board adheres to the by-laws, charters, and role descriptions that were established as the company developed its governance model. Yet, as Ghassan Nuqul emphasizes, even though procedures and protocols have been developed and institutionalized, it is important to remain open to changing them.

Setting up the Family Constitution

Ghassan Nuqul first encountered the idea of a family constitution at a conference on family businesses. The conference provided an opportunity to learn from other family-owned companies that shared similar experiences and challenges. CEOs and directors were able to learn about best practices that informed the direction of their respective companies.

Creating the family constitution required considerable effort and took a year and a half to complete. Nuqul admits it was a challenging process, but in the end, the carefully developed framework laid the groundwork for a fortified corporate structure that helped to minimize potential family conflict. From his experience, a key element for success is timing; it helps to develop a family constitution when the family patriarch is in complete control of the company and when there are no apparent conflicts on the horizon.

Although Nuqul Group was not in a moment of crisis, it realized that issues addressed in the family constitution would have surfaced at some point in the future. When issues did appear, they were able to navigate the issues smoothly because they had a concrete and clear action plan. The articles of the

family constitution also fed directly into the articles of association in the holding companies operated by Nuqul Group, which allowed for uniform operation of all Nuqul Group subsidiaries.

While it is not necessary to contract an expert or consultant to formulate a family constitution, Nuqul Group found it useful to work with PriceWaterhouseCoopers, which offers services to family businesses to help draw up family constitutions. The Nuqul constitution governs all aspects of family involvement in the business, including who is allowed to sit on the board, who is allowed to act as chairman of the board and the requisite qualifications for board positions, who is allowed to take over or own shares in the business, bloodline versus in-law privileges, how to conduct evaluations of family members, and the employment, compensation, and education policies.

Employment policies are clearly defined, such as rules about how family members can enter the company and to whom family members can report (e.g. a son/daughter cannot directly report to a mother/father). Family members are required to obtain at least two years of outside experience before joining the company. This is a common guideline for family businesses: By requiring family members to pursue work experience outside the company, both company and employee benefit from the experience.

The structure of family ownership was also addressed in the protocol. As a part of the succession and sustainability plan, and as a way to maintain wealth within the family, the constitution set forth a plan for family members to begin owning shares in Nuqul Group subsidiaries.

Voluntary Transparency

Since Nuqul Group is a private, non-listed, family-owned company, it is not required by the government to publish financial statements. Yet, the company assembles an internal annual report voluntarily disclosing information including employee numbers, staff turnover, corporate social responsibility indicators (such as environmental footprint), community service participation, and philanthropy operations in the family foundation.

Nuqul Group recognizes the importance of presenting a track record to existing and potential partners in order to secure strategic partnerships. Most recently, for example, the company became a licensed distributor for Audi, Porsche, Volkswagen, Skoda, MAN, and Lamborghini automobiles. A requirement for the licenses was the clear documentation of their operations. The annual report functions as a transparent communication tool for partners with whom the company does business.

Attracting and Recruiting First-rate Employees, Professionalizing Management, and Separating the Role of Ceo and Chairman

The company's transparent practices have attracted high-caliber employees, which the vice chairman emphasizes is a main factor contributing to the company's success. Employees are fairly compensated according to corporate policy, and are clearly informed of the paths for advancement within the company. The corporation is structured so that, even though the company is family-owned and managed, any capable person can move up the ranks, even to the level of CEO.

Many family-run businesses never consider having a non-family CEO. However, Nuqul Group realized that the CEO does not exercise corporate power unilaterally, but rather executes the wishes

of a well-functioning board, which, in turn, represents shareholders. As a number of family businesses have discovered, it can be better if the CEO is not a family member, particularly in the second and third generations and beyond. An effective CEO may be found within the family, but seeking a CEO from outside the family can widen the available talent pool, as well as minimize or prevent friction between various parts of the family. Moreover, even if a family member is chosen as CEO, the ability to select an outsider can serve as motivation for the family member, since skill, drive, and competence will determine the CEO selection, rather than birthright. Both the founder and the second generation of Nuqul Group commented that in a family-run business, it is difficult to retain high caliber employees because of the perceived ceiling for opportunity that exists for outsiders. Additionally,

IMPACT OF A SOLID CORPORATE GOVERNANCE FRAMEWORK

“Lack of structure, procedures, uniformity, and consistency would definitely present a big risk for you in times of difficulty. This is because you might have certain managers that, because of lack of experience, might make certain decisions that could really cause a lot of damage, not only financial, but also in reputation.

Common sense says there is something called a corporate entity separate from the individuals who make up the corporation. If you don't institutionalize your company's business practices with written procedures, documentation, communication plans, vision, mission, etc. you are at the risk of a person leaving with that information and finding that it is lost.”

GHASSAN NUQUL

VICE CHAIRMAN, NUQUL GROUP

foundation of corporate governance. The company's extensive documentation of financial figures and annual reports has been a key to attracting and establishing partnerships.

The company views its improved corporate governance practices — such as the institutionalization of previously informal practices, a strong board, and functional checks and balances — as key ingredients in its expanded growth. Nuqul Group has found that banks and private equity firms are more eager to work with the company than with companies that have not codified their practices, particularly if those companies operate in emerging markets where government oversight and regulation can sometimes be hampered by a lack of resources.

family members can, in the absence of specific policies outlining performance expectations, take their positions for granted and fail to exert maximum effort.

There are other benefits as well. According to the vice chairman, ambitious people scrutinize an employer as much as they themselves are scrutinized in an interview. From his experience, they want to know what opportunities exist to advance and the nature of the corporate culture, particularly in a family-owned company. In the case of Nuqul Group, the company directly attributed the ability to attract and retain excellent employees to their corporate governance practices, and to the specific policies that promote employee advancement.

According to the experience of Nuqul Group, the implementation of corporate governance practices both improved internal efficiency and enhanced its relationship with stakeholders.

Although not a listed company, Nuqul Group has made investments and entered into partnerships that would not have been possible if the company had not displayed a solid

Nuqul Group has expanded from four subsidiary companies in 1985 to 30 today. According to the vice chairman, this level of growth would not have been possible without the improved corporate governance practices.



DISCUSSION QUESTIONS

- ▶ How is corporate governance different for a family-owned company, compared to a company with either a non-family controlling shareholder or diverse ownership?
- ▶ Do you believe an outsider can serve effectively as the CEO of a family-owned company, or should the CEO always be a family member?
- ▶ What are the advantages of providing increased levels of transparency to your shareholders, employees, and partners? What are the disadvantages?



NCA-ROUIBA | ALGERIA

This family-owned firm in Algeria was founded in 1966 as a manufacturer of food and agricultural products. In order to facilitate further growth, the company decided to bring in an equity partner. As a condition of investing, the partner required NCA-Rouiba to change the firm's governance. These modifications led to corporate stability and growth that benefited both NCA-Rouiba and the investor.

KEY LESSONS LEARNED

- ▶ Transparency plays a significant role in attracting capital.
- ▶ Structured communication with family members is essential for the success of family-owned companies.
- ▶ Implementing corporate governance best practices helps resolve potential inter-generational family conflicts.

Background

Throughout the 1970s, NCA-Rouiba operated as a manufacturer of food and agribusiness products. At that time, under Algeria's socialist-driven policies, the government was involved in the company's investment decisions and the company's management style was far from transparent. By the 1980s, economic restrictions were somewhat eased and the company obtained approval to expand, although the government continued to restrict the operating capacity of the company's equipment.

The 1990s ushered in a new era of political and economic liberalism. These political and economic changes came at a critical moment, just as the family's second generation confronted the fundamental challenge that many family businesses eventually encounter: If the company does not expand, the family will outgrow the company. The CEO recognized that new capital would be needed to fund adequate growth. However, it was impossible to seek funds from a bank because the company's debt ratio was too high. Therefore, a bold decision was made to bring in an outside private equity firm. Despite much hesitation, family members were finally persuaded that this move provided the only viable option for growth.

The Ability of Transparency to Attract Investment

When Slim Othmani became CEO of NCA-Rouiba in 1999 he noticed that due to the lack of clear rules, and with guidelines dating back to the company's initial formation, its accounting practices were not in line with international best practice.

Government policies and an onerous tax environment discouraged not only NCA-Rouiba, but much of the private sector in Algeria, from fully disclosing financial information. However, Othmani, who had been educated in Tunisia and worked in Canada for four years, was eager to push the company to compete on the international level. He recognized that to achieve his business objectives, issues

such as quality assurance, resolution of related party transactions, and transparency with shareholders would need to become a priority.

The company's main business had been a food processing plant, but around the time Othmani became CEO, it gained the license to manufacture and sell soft drink products. This became an ideal opportunity to introduce a new method of operation. The family maintained the original company, but was informed that the new branch would implement a management style that would be completely transparent for the family, workers, investment funds, banks, and stakeholders.

The soft drink franchise acquisition occurred at an opportune moment. The market was in the midst of many changes and, due to the state's influence, the company was operating in a supply-driven mode that was not responsive to the market. At the same time, the family was growing and the company had to devise a path for profitable expansion.

Othmani studied and reactivated distribution networks, cleaned up the production line, and introduced training programs for employees. Those actions were necessary to obtain working capital for the company's expansion. In the first year, the new operating system was difficult to implement, but the company was rewarded with a 50 percent increase in sales as a result of optimizing performance.

Throughout the process, Othmani formalized consistent and transparent communication with shareholders. All shareholders were either directly involved in, or at a minimum informed of, key decisions. Without this structured communication, he may not have been able to obtain the support of shareholders to endorse the company's new vision, which ultimately led to the company's current success.

Importance of the Annual Report in Communicating With Shareholders

Starting in 2003, NCA-Rouiba began publishing an annual report, allowing clear and effective communication among shareholders, employees, investors, and the family. Shareholders, who consisted mostly of family members, no longer needed to individually ask about profits and losses or what the company was doing; it was all published in the report. In order to encourage accountability, each department head was responsible for his or her section in the annual report. This included sections on marketing, finance, and the environment. The CEO wrote an executive summary of all the sections.

At the beginning of each business year, the CEO would write up his vision for the next year. Addressed to the directors and shareholders, the letter was an overview of how he imagined the company should



“Once the private equity fund entered into the company in 2005, things changed completely — we were able to attract new investment and rise to a whole new level in our governance.”

SLIM OTHMANI | CEO, NCA-ROUIBA

operate in the upcoming year on strategic, organizational, and operational levels as well as in terms of sales, shares, and strategic direction. The document also included an assessment of the previous year's expectations measured against actual results.

Financial performance and solid operations are the main factors to attract investment, but information about the company needs to be communicated in a clear and transparent way that enables people

“We couldn't have managed our fast growth if we did not implement a sound policy of corporate governance centered on transparency and a structured communication strategy with various stakeholders, including the family.”

SLIM OTHMANI | CEO, NCA-ROUIBA

to assess and evaluate what the company has to offer. At the time, NCA-Rouiba was one of the few local companies in Algeria to produce an annual report. It included the company's expansion strategy and vision, profit and loss figures, as well as key performance indicators. Unique to this market, and ahead of their competitors in terms of transparency, NCA-Rouiba was able to gain investor trust and attract new investment through a regional private equity fund called AfricaInvest.

When the private equity fund invested in 2005, it mandated material changes in the governance of the company as a way to safeguard its money. As it turned out, the changes were “win-win” developments. The governance adaptations gave AfricaInvest increased confidence in its investment, while NCA-Rouiba improved its internal structure, gained stability, and expanded its capital. The company's increased growth benefited both AfricaInvest and NCA-Rouiba.

Resolving Conflicts

In any company, there will always be disagreements among those making decisions. But in family-run companies, the sensitivity of personal relationships adds yet another dimension. Serious conflicts can arise, and sub-optimal business decisions can be made. At NCA-Rouiba, most family disagreements were not properly addressed in board meetings.

A procedure was devised to mitigate conflicts by documenting the situation. Each time a disagreement on an issue occurred, the CEO recorded the issue and the solution in an official letter. This simple step solved a problem common to many companies (whether or not family controlled), which is that differing perceptions and the passage of time lead to different recollections of what actually occurred.

When Othmani joined the family business he quickly realized that the family was growing faster than the company. He estimated that there were some 45 family members, given all the marriages and births that had occurred since the company's inception. In another six years, that number was expected to increase to more than 65. Therefore, he needed to think of other ways to bring capital into the company while maintaining the family's role and ability to share in NCA-

“If money is managed in an obscure way, it creates internal tension with those who manage the financial flows. If the revenue flows are not transparent, the strategic vision and the future of the company will not be sustainable.”

SLIM OTHMANI | CEO, NCA-ROUIBA

Rouiba. If the situation had remained unchanged, the family's demands for cash flow could have suffocated the company.

The next stage of the company's strategy was to publicly list on a stock exchange and float 20-25 percent of the capital. To successfully enter the stock market, however, a company needs the confidence of the marketplace. Fortunately, the company's corporate governance improvements, particularly in reporting and transparency, prepared it for this next step. Constant communication and negotiation within the family was necessary while implementing the changes required to publicly list. All family members needed to understand the dynamics and implications of these decisions, as it would affect their plans to remain in or exit the company. To do that in a structured manner, the CEO designated a person from the family, who was a lawyer by profession, to review and coordinate key decisions and strategic plans with the rest of the family, and disseminate other information concerning this process.



DISCUSSION QUESTIONS

- ▶ What is the proper level of transparency in running a business?
- ▶ Are the communications in your company adequately structured to serve as assurances to shareholders, business partners, and potential investors?
- ▶ Does documenting how various issues are resolved add consistency in addressing them in the future, or lock a company into a "check the box" mentality, with no room for flexibility?
- ▶ NCA-Rouiba used the occasion of its entry into a new business to launch a major change in how it operated and communicated. Do you know of other businesses which have used new products/businesses to change their fundamental operating methods? Do you think NCA Rouiba could have changed its corporate governance without the soft drink business opportunity?



BUTEC

BUTEC HOLDING | LEBANON

This family-run business needed to attract capital and higher-caliber employees in order to continue to grow. Improved corporate governance practices served the company's needs for growth as well as assured fair and equal treatment among both family and non-family employees.

KEY LESSONS LEARNED

- ▶ Transparency plays a significant role in attracting capital.
- ▶ Structured communication with family members is essential for the success of family-owned companies.
- ▶ Implementing corporate governance best practices helps resolve potential inter-generational family conflicts.

Background

Butec is a medium-sized Lebanese construction company that was established in 1963. 75 percent is owned by the Younes family, 15 percent by other shareholders and employees, and 10 percent by the International Finance Corporation (IFC). The company is still led by its founder, who serves as chairman of the board. His son is currently the deputy general manager.

The company focuses primarily on oil and gas, utilities, waste-water management, and infrastructure projects, which account for around 90 percent of its revenues. Its expertise is diverse, ranging from design and civil engineering to the installation of specialized plants and equipment, along with public works and building construction. Butec has expanded to other countries in the region including Algeria, Qatar, and the United Arab Emirates.

Butec has a history of being innovative and open to different methods of enhancing its operations. The company had expanded its projects in several countries, often by operating within joint partnerships, which has allowed it to acquire new knowledge and to experience different business practices.

The company has been experiencing fast growth, with a 360 percent increase in revenue from



“As is the case for all companies, but especially in our industry, it is important to have a sustained flow of capital and highly competent manpower. To do that, creditors need to trust the information you provide them. For us, our commitment to serious auditing allowed us to gain that trust.”

MONA AKL | CORPORATE SECRETARY, BUTEC

2005 to 2007 (from \$24 million to \$88 million).²⁶ Much of this growth has been the result of the company's ability to understand international markets as well as its commitment to quality.

The Corporate Governance Improvement Process

Butec's governance was subject to serious scrutiny when the International Finance Corporation (IFC) bought a stake in the company, investing \$15 million in quasi equity. The IFC, a subsidiary of the World Bank that invests in private sector development in emerging markets, promotes corporate governance practices as a mechanism to encourage more robust companies and, ultimately, economies.

As an investor in Butec, the IFC required implementation of certain corporate governance practices as a way to increase the sustainability of the company. Based on the IFC's recommendations, Butec added independent directors to the board, improved the internal audit process, implemented transparent financial reporting guidelines, and established new procedures for human resources management.

"We wanted to set ourselves apart from other companies operating in the developing world — we wanted to establish the standard that other companies aspired to."

MONA AKL | CORPORATE SECRETARY, BUTEC

Restructuring the Board

Butec decided to add three independent directors to its board. The board invited a well-known lawyer to join as an independent director, and his input assisted the company in conforming to legal practices in Lebanon and other countries where it operated. Another independent director is the editor of an important economic news magazine in the Arab World, and his knowledge of the countries where Butec is expanding is considered a major asset to the board. A former World Bank officer also joined the board and provided valuable expertise regarding the internal audit process that was under development at the time.

Consistent with the corporate governance recommendations, these directors were chosen because of their expertise outside of Butec's core business. The company felt they would be able to provide its investors with added confidence, as well as assist in new market expansion by way of their fresh, informed ideas. This structure provides partners and investors with reassurance of continuity and stability in the decision-making process of the company. This has also refined and improved Butec's reporting procedures and has aided management in analyzing the company's risks.

Improving the Internal Audit and Financial Reporting

During an assessment by IFC, the underdeveloped nature of Butec's audit system emerged as a major concern. Since March 2009, Butec has focused on the establishment of an internal audit department, which is not as common in Middle Eastern companies as in some Western and Asian countries. In addition to ensuring that policies and processes are in place and working, an internal audit provides senior management and the board with assurance about the quality of the reports that

26 *Reference Guidebook on the Corporate Governance of Family-Owned Enterprises*. Lebanese Transparency Association. Available at: <http://www.transparency-lebanon.org/publications/foecgen.pdf>.

they receive. An internal audit department also gives the company an added analytical capacity that can be deployed more quickly and employed more flexibly when compared to the use of outside auditors or consultants.

Butec was able to take advantage of one of its joint-venture projects with a key French partner to help develop its internal audit capability. Butec personnel joined a team of established professionals in evaluating processes implemented in the execution of the project's contractual obligations. They participated in creating and carrying out audit plans on site and in field offices, thereby becoming active



Butec engineering team meets to discuss financial transactions.

participants in the monitoring and evaluation of projects and in reporting to the joint venture's executives. As a result, the project's steering committee adopted and implemented the internal audit's recommendations, which ultimately resulted in better collaboration within the joint venture and improved the final results of the project.

Today, the department periodically conducts audits in various company branches. The system of checks and balances inherent in the audit process are improving the company's daily functions, such as financial reporting,

inventory evaluation, demobilization, modification of standard procedures, and communication between field sites and agencies, as well as between agencies and the head office.

To complement improvements in the internal audit, a manager with a financial background was hired to ensure that the accounting system was in compliance with international regulations and procedures. He was also charged with establishing transparency of accounts throughout the company.

Human Resources Management

Butec was aware of the need to improve human resource management as it grew. The company began addressing this issue in 2009. Instead of filling key positions haphazardly or based on existing ties, the recruitment process was improved by bringing in specialized experts to match company needs to people with the right set of skills. The recruitment process also focused on the needs of the company's Gulf operations, in order to provide the right personnel to work in that developing market.

In terms of addressing the performance of employees, the company introduced a procedure whereby one-on-one evaluations were conducted to ensure a proper appraisal of capabilities. This was then linked to compensation.

According to management, employee tenure at Butec tends to be longer when compared to other companies with a similar profile. In order to maintain employee satisfaction, Butec has arranged for career growth opportunities. Employees are encouraged to improve and diversify their competencies. New job opportunities are first posted internally to give employees the chance to enhance their career growth. The company is also in the process of developing a plan to address individual requests.

Because of the nature of its work, corporate governance measures have encouraged the company to pay special attention to the issue of health and safety. This, in turn, has enhanced existing policies, including the creation of a department dedicated to ensuring high standards of health and safety. Corporate governance recommendations have resulted in fewer injuries on projects, particularly in the Gulf region where the issue of health and safety has been quite sensitive.

The company has observed a multiplier effect in terms of benefits as a result of the steps that were taken to encourage employee satisfaction. Management observed an increase in seminar attendance, the number of apprenticeships undertaken, and, perhaps most importantly, an improvement in productivity.



DISCUSSION QUESTIONS

- ▶ What are the benefits of a robust internal audit program?
- ▶ What skills or experiences would be useful on your board? Do you have them? Would you consider adding an independent director to gain them?
- ▶ What policies can a board and senior management adopt to best motivate a workforce?



ERAMEDIC | MOROCCO

Recently obtained by a private equity firm, Eramedic realized that it would need to establish good corporate governance and corporate citizenship practices in order to grow and maintain its market position. These practices would reflect the company's commitment to the community in which it operates and to other stakeholders, including investors or employees.

KEY LESSONS LEARNED

- ▶ Establishing strong corporate values and responsible behavior towards the community can position a company as the premier provider in its field and attract an outstanding client roster.
- ▶ It is essential to build trust between shareholders and management through sound corporate governance practices, transparent reporting, and pro-active communications.

Background

Eramedic is a medium-sized company in Morocco and one of the largest suppliers of medical equipment in the Middle East and North Africa region. The company was founded by two brothers in 1976, operating as a family-run business until 2007 when it was bought by a private equity firm. Eramedic operates with a clear strategic vision, embracing corporate responsibility and sustainable development, thereby positioning Eramedic as a service partner with its customers and the broader community in mind. The board is led by investors from the private equity firm, which holds 95 percent of the company's shares. The other 5 percent is held by the CEO.



"Building a culture of strong values is our approach to ensure the sustainability of Eramedic. We embrace fairness and transparency in all our dealings and we are known for it. In fact, the only way that works is management by values. Look for people who are smart and competent, but more importantly, people who will care and preserve your core values."

While 65 percent of our business is generated through public tenders, we never tolerated opacity or corruption in our tendering processes. In my experience, it is very dangerous to those who say that corruption is important for business. They will never be able to develop internal competencies and capacity. Unfortunately, they took the easy way."

RASHID BELKAHIA | CEO, ERAMEDIC

Building Strong Company Values

In 2006, company CEO Rashid Belkahia formally initiated a sustainable development policy for Eramedic. The main driver behind the policy was a long-term vision of a company culture that respects the community and environment. The set of corporate values was consistent with Eramedic's commitment to the Global Compact, a United Nations strategic policy initiative for businesses committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labor, environment, and anti-corruption.

Core company values included encouraging responsibility, motivation, and creativity on the job; promoting a communicative, cooperative team approach at all levels of the company; expecting integrity and exemplary actions in the context of employees' daily work; supporting education and training; providing a quality work environment; and respecting established laws as well as industry best practices.

By upholding these principles, Eramedic has become the vendor of choice for clients for whom trust, integrity, commitment to quality, and ability to deliver, are important. Eramedic has managed to attract such clients as the Ministry of Health, university and military hospitals, and the national health care provider, in addition to research, clinical, and pharmaceutical laboratories. The CEO attributes this success to the company's commitment to doing the "right thing" for clients and the surrounding community.

For instance, the company launched a campaign to raise awareness of the infection risks associated with hospital hazardous waste. Eramedic developed a toolkit for hospitals, including detailed processes and procedures for safe waste management. The toolkit was produced internally; the employees put in time beyond working hours as part of their belief in the societal benefits of the program. The publication was printed and distributed to clients for free through a series of seminars and workshops organized by the company.



*Emmanuel du Boullay,
President of the French
Institute of Directors,
facilitating a GCGF and IFC
workshop on establishing
institutes of corporate
governance, Rabat,
Morocco, 2009.*

Building Trust Between Management and Shareholders

Just as Eramedic communicates externally to clients, it also focuses on internal communications between company managers and the shareholders. The company believes this has contributed to an atmosphere of trust. This is particularly valuable since the private equity firm, like most such firms, is active on the board.

Each month, management prepares a report to investors highlighting key financial statistics. It includes relevant information such as a summary of income and expenses, cash flow, impending risks, potential opportunities, margin analysis, and bank loans. This allows the investors to know the story behind the figures and to have a context in which they can review performance. The report also details progress towards strategic goals. The disclosure of information on a regular basis helps the private equity firm and Eramedic management to work together to help the company grow and increase in value.



DISCUSSION QUESTIONS

- ▶ Do you think the corporate citizenship activities, such as those at Eramedic, are generally worth their cost, or are they just “feel good” activities that don’t affect the bottom line?
- ▶ How do you measure the value of reputation in the community?
- ▶ What sort of periodic reporting is in place from management to the board? Do you think it is sufficient to allow the board to truly be a partner with management in improving profitability?



COMMERCIAL INSURANCE | LEBANON

This family-owned commercial insurance company in Lebanon realized it needed to better manage risk, enhance decision-making, and attract better employees. Improved corporate governance practices reassured employees of fair treatment and inclusion in the decision-making process. This accountability led to higher retention of capable employees, which translated to improvements in corporate profitability.

KEY LESSONS LEARNED

- ▶ Corporate governance can improve accountability, thereby driving productivity and managing risk.
- ▶ Providing clear job descriptions and performance expectations improves employee motivation
- ▶ High-profile examples of adhering to a policy reinforce respect for the policy and the company.

Background

Commercial Insurance is a privately-held family-owned company providing a wide range of insurance services within Lebanon. The company was founded in 1962 by the late Roger Zaccar. Since then, the company has built a solid reputation for itself in the insurance industry through sound financial practices and an innovative marketing approach. Currently led by the second generation of the family, the company aims to expand regionally in the coming years.

Implementing Corporate Governance Best Practices to Manage Risk

As an insurance company, Commercial Insurance is in the business of managing risk, both for its clients and for itself. The family discovered that implementing sound corporate governance practices can play a significant role in effectively mitigating risk through standardizing procedures. Adding an effective internal audit function can further aid risk management. Consequently, those reforms can improve profit margins and efficiency.



“Managing the company’s risks in a better way is one of the major reasons we felt the need for better corporate governance practices.”

MAX ZACCAR | CHAIRMAN, COMMERCIAL INSURANCE

“You need at least two years to change mentalities. . . you have to convince both yourself and others that you can handle changes in an accepted way of doing things. It was the first time for staff and management to experience an audit, which was much less intimidating than immediately bringing in an outside party to examine company policies, procedures, and finances. Introducing big, drastic changes can be overwhelming for employees and can end up being counterproductive for the well-being of the company if they do not support the changes.”

MAX ZACCAR

CHAIRMAN, COMMERCIAL INSURANCE

Historically, all decision-making authority in the company was concentrated in the managers, which slowed work considerably as the managers were overloaded with responsibility. When the company committed to improving corporate governance, it institutionalized procedures that allowed employees to take direct action on specific issues. The formal system standardized the criteria to be used in making certain business decisions, enabling employees to make front-line decisions while allowing managers to hold them accountable. This allowed managers to provide oversight and use their time more efficiently by dealing with exceptions instead of every case. The change also empowered employees and increased their commitment to the company.

exceptions needing managerial review. Regular meetings were established in which any problem encountered could be discussed and addressed in a group setting. Thus, the new procedures not only save time, they also create more employee motivation, standardize how various issues are addressed, systematize feedback, improve accountability, and improve planning and forecasting — allowing for more effective risk management.

Nearly 80 percent of the company’s case load can now be resolved by employees with few



Event in Beirut to launch the corporate governance guidebook for family-owned enterprises and listed companies developed by the Lebanese Transparency Association, May 2009.

Introducing Internal Auditing

The next step in improving efficiency and accountability was to establish an internal audit function. Once there were established procedures, it made sense to understand just how much they were being used. Moreover, the company was growing and there was a need to ensure effectiveness and efficiency. Commercial Insurance piloted an internal audit at a low cost by using two summer interns to conduct the process. The audit examined whether the company was following procedures and applying them in practice, and whether job descriptions were accurate and reflected tasks performed. Utilizing the interns allowed the company to gain comfort with the idea of an internal audit, in a low pressure and non-threatening environment. Once the company had experienced an internal audit, it felt more confident in the process, and moved forward with a professional internal auditor.

Succession Planning

As it grew, the company approached the stage when it would pass into the hands of the third generation. The CEO of Commercial Insurance recognized the need to institutionalize the practices of the family as well as the company, so as to establish a clear and concrete way for family members to be involved in the business. To meet this challenge, Commercial Insurance developed a family constitution. Under the constitution, family members are required to obtain relevant experience outside of the company before joining in a management or board position. The policy was put to a test with the daughter of the CEO; she was hired by the company only after having worked several years for a private sector consulting company. The implementation of the policy served to instill confidence in the seriousness of efforts to ensure equitable treatment and high standards for hiring.

The CEO also recognized that succession planning was relevant for all management levels. He ensured that each high-level manager had an assistant manager trained and fully capable of performing all the management duties. This ensures the smooth operation of a department in the event that a manager leaves or is unable to fulfill his tasks, and also encourages the next level of future managers by signaling advancement opportunities within the company.

In addition, the CEO intends to create a proper succession plan that will transfer the power to select the next CEO to the board. The family is expanding and deems it necessary to have a fair way to elect a new leader.

The Experience of a Family Business In Attracting Top-Tier Employees

Commercial Insurance recognized the need to develop internal processes as a way of creating efficiency and accountability. The company began by developing job descriptions and performance

“I read a lot about family-run businesses worldwide in terms of how to react in particular situations, and I found that the companies who were concerned with employee satisfaction had much better results as a company overall than the ones who were not focusing on that specifically. As soon as we developed norms, applied benchmarks, and established equitable salary ranges for various levels, I noticed a definite increase in efficiency among employees and less oversight was required of me.”

MAX ZACCAR

CHAIRMAN, COMMERCIAL INSURANCE

evaluations for all employees. Many employees were apprehensive towards the new changes for fear of losing their jobs, but there was reassurance from management that these changes would enhance employee-management interaction. Importantly, management also created incentives for meeting and/or exceeding codified performance standards as indicated by job descriptions. These actions led to increased responsibility and accountability among employees.

The company gradually implemented the changes in order to build two-way trust. The employees learned how the job descriptions and procedures helped to define their workload with clear indicators to measure whether or not objectives were achieved. Similarly, management began to feel comfortable with delegating decision-making authority, such as evaluating employee performance and awarding bonuses, since there were clear guidelines to follow.

Today, Commercial Insurance is able to attract high-caliber workers as a result of their reputation as a company that has strong expectations, yet rewards and compensates fairly. Moreover, employee satisfaction helps to attract additional competent and effective employees who learn about the positive work environment from existing employees.



DISCUSSION QUESTIONS

- ▶ Commercial Insurance was able to improve productivity by standardizing some decision-making criteria, thereby enabling the decisions to be made further down in the company. Are there any decisions being made in your company that could be delegated further than they are?
- ▶ The fact that the daughter of the CEO had to follow the same family policies as everyone else reinforced respect for those policies. Can you cite examples, either in your company or elsewhere, where exceptions were made for influential people? What was the effect on the organization of those exceptions? When should exceptions be made?

Accelerator Technology Holdings

ACCELERATOR TECHNOLOGY HOLDINGS | JORDAN

In 2005, Accelerator Technology Holdings (ATH) was created as a venture capital (VC) firm to invest in the region's developing capabilities in the media, technology and telecommunications industries. As a VC firm, its primary goal is to increase shareholder value by investing in and helping to guide other companies that need capital to grow. First, ATH needed to attract its own investors by addressing the perceived risks in its strategy. ATH discovered that implementing good corporate governance from the start reassured investors and set the stage for long-term stability.

KEY LESSONS LEARNED

- ▶ Implementing good corporate governance practices is a foundation for growth in a start-up context.
- ▶ High levels of transparency help attract investors and retain shareholders.

Background

Accelerator Technology Holdings was born out of both need and opportunity: very few bona fide venture capital firms exist in the MENA region. The founding members sought socio-economic development in the region, financed from within the region itself. From the outset, the firm selected investments that would bring technological development and enhance strategic relationships in the region.

The company has a unique relationship with its shareholders. The board consists of the founders and elected shareholders. As expected in a VC firm with few employees, the company's board of directors and its investment committee play a critical role in helping management drive the company strategy



"Our idea and vision was long-term, yet it was a nascent idea and vision. We came into a market that nobody believed in. So we structured ourselves and had good governance in place to give our shareholders the comfort and faith that while they were absorbing a lot of market uncertainty, at least the company from an operating perspective or from a governance perspective can mitigate that risk to the best of our abilities."

EMILE CUBEISY | VICE PRESIDENT, ACCELERATOR TECHNOLOGY HOLDINGS

and achieve defined goals and objectives. The key to ATH's success has been recruiting individuals with extensive regional and international knowledge and experience to govern these institutions.

Corporate Governance as a Foundation for Building Shareholders' Trust

There is a dearth of venture capital firms in the Middle East and North Africa region; but, even where VC more common, it is still a risky business. The traditional "rule of thumb" in the United States, which has the most developed venture capital industry in the world, is that a majority of start-up and early stage companies will fail but that a small number of companies will realize dramatic success, more than compensating for the failures. The key to success as a VC firm, therefore, is strength in selecting companies for inclusion into the portfolio, the structure of the capital invested into the companies, and providing technical assistance to the companies in order to maximize its success (for example, VC firms often sit on an investee company's board).

Therefore, the founders recognized that they faced significant challenges to succeed in the venture capital industry. The first step was to attract capital; even countries with robust growth, such as China and India, had not been able to achieve the same level of venture capital availability as in the United States and Europe. The economies in the Middle East region present even more difficult terrain. It was clear that it would take great effort to convince investors that investing in the MENA region would be worthwhile. ATH therefore set out to create a value proposition that could be

sold to any investor, local or global, especially an investor who recognized the potential of the region and its nascent technology and media industries.

"We weren't building a company for the short-term — we were building a company for perpetuity. We wanted to ensure that every building block — which can be painful when you are 'young' — would run itself when we were much bigger."

EMILE CUBEISY

VICE PRESIDENT,
ACCELERATOR TECHNOLOGY HOLDINGS

ATH offered shareholders a higher level of engagement and enhanced oversight over portfolio investments, so as to build confidence in its investment decisions. Accelerator formed two subsidiaries, one to hold the investments and the other to act as investment manager. Although the structure is different from a typical U.S. VC fund (typically established as a partnership, with the VC firm acting as the general partner), the specific governance model

matched ATH's needs. ATH ensured that it would be an investment company where shareholders participated in governance through an elected board that oversees an investment committee with clearly defined oversight and investment decision guidelines.

This governance foundation served to attract the keen interest of a group of about 35 investors from the United States, Europe, and MENA countries, including entrepreneurs and institutional investors, who invested alongside co-founder Dr. Fawaz Zu'bi and ATH management. Perhaps most tellingly, many of the investors are individual entrepreneurs, each having experienced the challenges and the successes of entrepreneurial endeavor and understanding the governance structure's value.

As a relatively young company in a sector with high global standards Accelerator Technology Holdings was able to draw from the experience of venture capital firms outside the region and incorporate international governance practices at its inception. Doing so allowed shareholders to focus on the investment strategies presented to them, instead of worrying about whether the board, committees, auditing, or compensation methods were functioning properly.

Investing in Transparency To Retain Shareholders

A particularly important part of ATH's governance structure was creating mechanisms to communicate the corporate strategy to shareholders who might not be familiar with the nuances of the venture capital industry. This is critical considering the company's entry into an emerging field where information is not easily accessible, investee targets may face uncertainty in the market in the short-term, and returns may be uncertain in the short-run. Therefore, communicating ATH's longer-term vision and the progress toward that vision took on added importance in keeping the investors satisfied.

In addition to annual shareholder meetings and annual reports, the company shares information and engages with its shareholders through quarterly shareholder reports. ATH prides itself on transparency and fostering good relationships with its shareholders, and when they request additional information, the company accommodates these requests to the utmost of its ability.

Since the company is registered as an offshore entity, ATH complies with the laws and rules of governance required by the offshore jurisdiction. Additionally, according to its articles of association, the company's shareholders appoint its board of directors, approve its audited financial statements, and appoint its auditors. These governance provisions enable shareholders to feel they are protected.



DISCUSSION QUESTIONS

- ▶ What is the role of the private equity fund or VC firm in a company's development?
- ▶ Are there any shareholder rights you think ought to exist at every company?
- ▶ Has your company ever looked to international best practices for guidance? Have you had to adapt them to fit local regulation and culture?



TELECOM EGYPT | EGYPT

Telecom Egypt (TE) is the country's main provider of telecommunication services. In order to list on the London Stock Exchange (LSE), the company needed to meet the LSE's corporate governance listing standards. TE's successes prompted the company to move beyond compliance and become a regional leader in corporate governance practices.

KEY LESSONS LEARNED

- ▶ Good corporate governance extends beyond complying with regulations.
- ▶ Developing well-structured board committees increases effectiveness.
- ▶ Corporate governance practices can help prepare a company for listing on local or international stock exchanges and attract cross-border investment.

Background

Telecom Egypt is the largest provider of fixed-line telecom services in the Middle East. It provides retail as well as wholesale telecommunications services and holds a 44.95 percent stake in Vodafone Egypt, which provides mobile telephone and data services. TE Data, a subsidiary of Telecom Egypt, also provides internet and data services.

The company traces its origins back to the first telegraph line in Egypt in 1854. In 1918, the Egyptian Government nationalized the Eastern Telephone Company and created the Telephone & Telegraph Authority, a forerunner of Telecom Egypt. The company was transformed into a joint stock company in 1998, though the Egyptian government initially maintained 100 percent ownership.

In 2005, the Egyptian government announced an initial public offering (IPO) of 20 percent of its Telecom Egypt shares to retail investors in Egypt and international institutional investors.

The impetus for modernizing Telecom Egypt's corporate governance was the need to attract investment from international capital markets, in anticipation of its 2005 initial public offering. TE needed to meet the listing requirements of the London Stock Exchange (LSE), which mandates specific governance provisions for its listed companies.

Going Beyond Compliance

Enhancing corporate governance for the IPO benefited the company beyond merely meeting requirements. Demonstrating a high level of transparency is of particular importance to gain cross-border investors who may not be familiar with the company by local reputation. Today, the corporate website provides free access to financial statements, annual reports, conference call transcripts, and resolutions from general assembly meetings, as well as general shareholder and bondholder information. As a result of this level of responsiveness to investors' needs, Telecom Egypt was awarded the 2008 Global Trade Matters/Egyptian Exchange (GTM/EGX) Award for Best Financial Transparency.

Achieving Results as a State-Owned Enterprise

Telecom Egypt was unique in that it was a hybrid company — partially owned by the state and partially owned by private-sector investors — when it took giant steps in improving its corporate governance. After the IPO, the government owned 80 percent of the company while the remaining 20 percent was floated on the stock exchange. Also, as a listed company on the Cairo & Alexandria Stock Exchange (CASE), it was necessary to comply with various corporate governance practices, including those mandated by the Egyptian Capital Market Authority. In order to meet the disclosure requirements of both LSE and CASE, the company also publishes two sets of financial statements, following both the internationally recognized International Financial Reporting Standards (IFRS) as well as the local Egyptian Accounting Standards (EAS).

Partially as a result of those changes, investors had such a high degree of confidence in TE that within four years, ownership switched to 80 percent held by institutional investors and 20 percent by retail investors. This indicates that an effective board of directors and corporate governance system led to strong, long-term investment demand, providing the company with a stable capital base from both international and local investors.

After listing, much of the established management was initially retained, but the company slowly began restructuring senior management until 80 percent of managers were young, dynamic leaders with experience in the private sector. The transformation of management and the implementation of improved corporate governance were mutually reinforcing, as the corporate governance changes helped assign accountability and the structure became more sophisticated over time.

Structure and Composition of the Board of Directors

The board of Telecom Egypt is composed of 11 members, three of whom are independent directors elected by the General Assembly. One is an employee representative elected by the company's labor syndicate and seven are appointed by the Prime Minister upon recommendation from the Ministry of Communication and Information Technology. Four active board committees assist the board, making recommendations on strategic decisions. Committee meetings are held regularly, after which the board receives a report from each committee delineating its activities.

The audit committee is composed of three members, one of whom is an independent director. The committee provides oversight for internal audit functions and the performance of external auditors, as well as reviewing and approving financial statements.

The remuneration committee is made up of five members, one of whom is an independent director. This committee reviews and approves compensation of the executive directors and senior management. The committee bases its evaluations on performance, in light of set corporate goals and objectives, and makes recommendations to the board of directors with respect to incentive and equity-based compensation plans.

The investment committee is composed of five members, one of whom is an independent director. The committee is responsible for developing and recommending policies on investments and overseeing implementation of these policies for the board.

The technical committee is composed of three members, none of whom is an independent director. It is charged with the study and review of technical matters involved in the performance of the operations of the company.

Telecom Egypt is implementing its corporate governance standards in a methodical way and has discovered that doing so creates efficiency at the board level. Furthermore, transparency about those procedures and policies, as well as about financial results, instills confidence in its investors and shareholders.



DISCUSSION QUESTIONS

- ▶ The corporate governance changes at Telecom Egypt occurred in anticipation of a change from state ownership to private sector ownership. Do you think the changes would have been beneficial even if TE had remained 100% state-owned?
- ▶ Does full or partial state ownership hinder a company's ability to make corporate governance changes? Does it present opportunities?
- ▶ What board committee structure would be most appropriate at your company?

Sorouh

Places that matter

SOROUH | UNITED ARAB EMIRATES

Needing to finance growth, this real estate company's corporate governance practices allowed it to issue more than \$1 billion (USD) worth of securitized Islamic certificates with higher ratings from Moody's and Standard and Poors than would otherwise have been possible. This resulted in millions in savings for Sorouh. The debt issuance was the first of its kind and size for a Middle East and North Africa (MENA) region corporation.

KEY LESSONS LEARNED

- ▶ Implementing sound corporate governance practices has a positive impact on the company's risk rating.
- ▶ Investing in good corporate governance best practices reduces cost of capital.

Background

Sorouh was established in June 2005 with 2.5 billion AED (\$680.6 million USD) in capital.

In 2009, Sorouh was ranked the first in Abu Dhabi and third regionally by the BASIC2 GCC-wide study of corporate governance. The BASIC2 ranks GCC firms on the basis of liquidity, transparency, and volatility, and is produced by the National Investor (TNI) in partnership with Hawkamah Institute for Corporate Governance and supported by Muadara- Institute of Directors (IOD).

The company's corporate governance success is rooted in the improvements it made to its corporate governance framework, in compliance with the UAE Securities and Commodities Authority's (SCA) standards.²⁷ In 2007, two years ahead of the compliance deadline, Sorouh adopted these regulations and implemented all its material requirements.

The Experience of Sorouh in the Issuing of Islamic Certificates ("Sukuks")

A key element in how a credit rating agency evaluates an investment is its assessment of business risk, and its judgment of how the board and management monitor and manage that risk. Proper



"The actions we took for our corporate governance had a direct impact on the rating we received for our Sukuk and ultimately the interest rate premium, which resulted in paying a lower premium compared with other companies in the region."

AFSHAR MONSEF | CHIEF CORPORATE OFFICER, SOROUH

²⁷ "Corporate Governance Regulations for Joint-Stock Companies and Institutional Discipline Criteria." UAE Securities and Commodities Authority Decision No. R/32.

monitoring and reporting controls, clear documentation of policies and procedures, and risk oversight at the board level are essential to ensure effective business management. The quality of Sorouh's corporate governance signaled to credit rating agencies the company's advanced level of maturity in these areas. Sorouh's policies and procedures instilled confidence and assured the market that business risks would be managed appropriately.

Raising More Than \$1 Billion

From 2006 to the first half of 2008, Sorouh did not undertake any major borrowing efforts; however, the company wanted to finance growth. To do so, it issued securitized Islamic certificates, or Sukuks, to help finance the development of 170 hectares on Al Reem Island and the Saraya development in Abu Dhabi's central business district. During this process, Sorouh's corporate governance practices were assessed by external credit agencies responsible for rating the Asset Backed Securities (ABS)²⁸ transactions that Sorouh used to raise the money.

Moody's rated the majority of the notes "AA3" and S&P rated them "A". The high ratings helped gain market acceptance for the Sukuks and alleviated concerns stemming from the fact that the bonds were the first of their kind and size. As a result, Sun Finance, the company that issued the Sukuk bonds for Sorouh, won the "Structured Finance Deal of the Year 2008" award.

Whistle-Blowing

In line with its Code of Conduct, Sorouh has developed an Employee Disclosure Policy that outlines Sorouh's commitment to ensuring that employees are able to "blow the whistle" by raising concerns when they have reason to believe that ethical conduct has been breached. The policy and guidelines were developed to encourage employees to report misconduct, while protecting them from discriminatory treatment while their concerns are investigated and after reaching a resolution.

Sorouh has also set-up a system to ensure that investigations are conducted in an independent and neutral manner. Under the policy, support processes for employees will be monitored, with activity reports submitted to the audit and governance committee and the board.

Insider Trading

To ensure that Sorouh's directors and employees do not misuse their possession of the company's stock price-sensitive information, the company has developed an Insider Share Dealing Policy. It contains an explanation of the prohibitions related to insider trading and establishes restrictions on dealing in Sorouh securities.

The policies and restrictions go beyond the mandatory requirements of the Abu Dhabi Exchange (ADX). For example, Sorouh directors, executive management, and staff are required to notify management before or at the same time as lodging applications with ADX for an insider trade, regardless of the nature or value of the trade. In addition, directors and designated executives must

²⁸ An asset-backed security is a security whose value and income payments are derived from and collateralized (or "backed") by a specified pool of underlying assets. The pool of assets is typically a group of small and illiquid assets that are unable to be sold individually. Pooling the assets into financial instruments, a process called securitization, allows them to be sold to general investors, and allows the risk of investing in the underlying assets to be diversified since each security will represent a fraction of the total value of the diverse pool of underlying assets. The pools of underlying assets can include anything from common credit card payments, auto loans, and mortgage loans, to esoteric cash flows from aircraft leases, royalty payments, and movie revenues.

notify the chairman of the board of an intended insider trade before any transaction takes place. In these cases, Sorouh reserves the right to veto or restrict a trade when it considers it “reasonably probable” that unpublished price-sensitive information relating to the Sorouh’s business will be exploited. The policy also outlines instances where the company may impose additional restrictive periods during which no insider trades may be executed by the board of directors, executive management, or staff.

Risk Management

In 2007, Sorouh implemented an enterprise-wide risk management system, which was initiated to structure and formalize existing risk management practices. The company sought international best practices and was keen to align its risk management with the successful model of the Australian/New Zealand Standard on Risk Management.²⁹ These guidelines are viewed by industry experts as one of the most effective risk management models. It outlines a logical and systematic approach to implementing a corporate-wide framework for assessing and dealing with risk. This provides board members and managers with reasonable assurance that both strategic and division objectives will be achieved within a tolerable degree of risk.

Sorouh’s CEO and managing director are both responsible for implementing the risk management framework and the board is responsible for approving the risk policy, reviewing the effectiveness of the risk management process, and determining Sorouh’s tolerance for risk. To ensure proper oversight and analysis of the company’s risks, an audit and governance committee assists the board in fulfilling its risk management obligations.

“Sorouh considers effective risk management a fundamental element of good management practice. It is committed to maintaining risk management systems to safeguard shareholders’ investments, other stakeholders’ interests and Sorouh’s assets, and to prevent breaches in applicable laws or regulations.”

SOROUH WEBSITE



DISCUSSION QUESTIONS

- ▶ Corporate governance is generally thought of in terms of benefiting equity investors. As the Sorouh case study indicates, good corporate governance can also affect debt investors. Do you think that improving the corporate governance of your company could lower your cost of capital?
- ▶ Given the capital structure of your company, which areas of corporate governance are most important to you? To your investors?

29 This refers to the Australian and New Zealand risk management guidelines AS/NZ4360. This has been superseded by AS/NZS ISO 31000:2009 “Risk Management – Principles and Guidelines.” Available at: http://infostore.saiglobal.com/store/getpage.aspx?path=/publishing/shop/promotions/AS_NZS_ISO_31000:2009_Risk_Management_Principles_and_guidelines.htm&site=RM.



BISCO MISR | EGYPT

Bisco Misr was established in 1957 as a publicly-owned food product company that provided affordable products to the general public. In 2005, a controlling share was sold to a conglomerate of investors. The investors changed the management style to encourage a more entrepreneurial spirit at the well-established company. These corporate changes, while still on-going, have made the firm more attractive to private sector investors.

KEY LESSONS LEARNED

- ▶ Investing in corporate governance builds trust and increases shareholders' value.
- ▶ Investing in employees as a key stakeholder contributes to the value and profits of the company.
- ▶ Encouraging entrepreneurial spirit and growth with the right balance of executives on the board improves company performance.

Background

Bisco Misr, a well-known presence in the Egyptian market for the past half-century, is famous for its cookies and wafers that are highly popular with schoolchildren and the military. Today the company has three large factories, one in Cairo and two in Alexandria, and exports its products to more than 20 Middle Eastern and African countries.

The publicly-owned company was partially sold during a privatization effort in 1999, although 60 percent of the ownership remained with a government-owned holding company. In 2005, Bisco Misr was fully privatized when the 60 percent stake was sold to a group of private investors. The new shareholders streamlined management so that the company operated more like a private sector enterprise and brought in a team with experience working in multi-national companies in the fields of operations, marketing, information technology (IT), sales, distribution, and export.



“There are many stakeholders involved in the successful operation of a company. Having the buy-in of employees is crucial and their welfare is very important to this success...therefore, it is important to make the company attractive for employees who in turn, as a result of better productivity, will help make it attractive to investors.”

AREF HAKKI | CHAIRMAN, BISCO MISR

Striving for Sustainability and Increased Productivity by Investing in Manpower and Capital

In 2005, a private equity management company led by Concord's New York-managed Egyptian Direct Investment Fund, along with the American University Endowment Fund (Karnak), Commercial International Bank, and other private sector partners, acquired 61 percent of the company.³⁰ When the private sector management took over, Dr. Samir Sabet, an experienced businessman in the pharmaceutical industry, assumed the role of both chairman and CEO. Key decisions were quickly made to improve productivity and alter the company's image. Machinery was upgraded, early retirement was offered to cut down on excess employees, a performance-tied salary structure was introduced, IT systems were put in place to track company statistics, and management began working to change the mentality of employees from a public sector to a private sector mindset.

The board and management viewed the employees as crucial stakeholders in the company's success. Restructuring the workforce and providing the right incentives resulted in overall gains in productivity. Today, Bisco Misr is known in Egypt for paying one of the highest shares of its profits to employees. In spite of the costs of restructuring, increasing the salaries of its employees was a worthwhile investment, and operating profits are still on the rise.

Configuring an Effective Board to Move the Company Forward During Restructuring

In 2008, Aref Hakki took over as chairman and CEO of the company. At his request, a Chief Operating Officer, a Chief Financial Officer, and the Head of Internal Audit were asked to join the board of directors, which also included institutional investors representing banks and private equity funds. The new internal directors added sector-specific expertise to the board, giving it a wide variety of professional expertise.

The board created an audit committee, which oversees both the internal and external auditing processes. The committee requires that the company evaluate and renew the auditor each year during the annual shareholders meeting. The internal auditing process allows the company to assess its performance and improve in areas it deems necessary — beyond hiring external auditors just to comply with regulations.

Bisco Misr has built confidence in the company by choosing key investors to serve as board members, therefore including investors in all major decision-making. Developing an accountable structure has reassured the shareholders that the company is moving in the right direction, even though a significant amount of money has been put into restructuring. Operationally, the focus remains on increasing production while fine-tuning profit margins. Institutional investors have been holding their shares, indicating investor confidence in the changes.

30 Fatima El Sadaani. "Something in the Oven." *Business Today*. March 2007.



DISCUSSION QUESTIONS

- ▶ Leaving aside regulatory requirements, does an internal or external audit better benefit your company? Does your opinion change if you are the CEO? An external shareholder? The regulator looking at your company?
- ▶ Bisco Misr is known for paying a high ratio of its revenue to its workforce. Do you target a certain pay-out percentage for your labor force? How sensitive is the payout to profitability?



ABU DHABI COMMERCIAL BANK UNITED ARAB EMIRATES

The Abu Dhabi Commercial Bank (ADCB) was established in 1985 and is the United Arab Emirates' (UAE) third largest bank in terms of total assets. Following internal control concerns, the bank's board brought in a new management team and formed a governance committee that instituted new practices to allow the board better oversight and control of management. Such changes have strengthened the company and helped build its reputation for excellence.

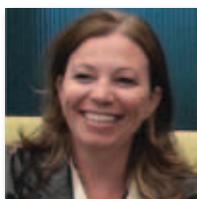
KEY LESSONS LEARNED

- ▶ Establishing a board committee devoted to corporate governance yields concrete benefits.
- ▶ Bringing in a dedicated team of qualified professionals to lead and implement corporate governance improvement plans benefits the company.

Background

ADCB was formed in 1985 following the merger of Khalij Commercial Bank, Emirates Commercial Bank, and Federal Commercial Bank. In 2003 and 2004, ADCB underwent restructuring to become a diversified, full-service bank. It is active in corporate, retail, and commercial banking services, as well as in the areas of treasury derivatives, infrastructure finance, private banking, and wealth management.

In 2005, ADCB formed a strategic alliance and a joint venture with Australia's Macquarie Bank, focusing on infrastructure advisory services and fund management. An Islamic banking division was launched in September 2008 with the intent to further develop Islamic banking services and partnerships. The ADCB group, with a staff of approximately 2,700 employees, delivers banking as



"One of the things that make us unique, compared to many other institutions, is that we have a board committee devoted to corporate governance. We regularly review our corporate governance at least a few times a year. The board committee oversees the implementation of our action plan, stays abreast of developments in the market, continuously reviews our policies, as well as updates on best practices, development of training programs or evaluations to improve our governance."

SONYA SANTOLIN | CORPORATE SECRETARY, ADCB



The Abu Dhabi Commercial Bank wins a “2009 Bank Corporate Governance Award” from the Hawkamah Institute of Corporate Governance in November 2009.

well as brokerage and asset management services through a network of some 49 branches in the UAE and India. It also holds 25 percent of Malaysian banking group RHB Capital.

Establishing an Effective Governance Committee to Ensure Robust Internal Controls and Oversight

In 2005, the board brought in a new management team to modernize the bank’s products and services. The board realized that implementing best corporate governance practices would be important for the long-term stability and financial soundness of the bank. It also realized that an established corporate governance structure has to be complemented by a commitment to a corporate culture based on overarching principles. The bank’s guiding governance principles, publicly published on their website, consist of four main elements:

- ▶ **Responsibility** with clear division and delegation of authority;
- ▶ **Accountability** in the relationships between the bank’s management and the board, and between the board and the shareholders and other stakeholders;
- ▶ **Transparency** through disclosure that enables stakeholders to assess the bank’s financial performance and condition; and
- ▶ **Fairness** in the treatment of all stakeholders.

To achieve quick results, the board identified the need to have corporate governance champions within the bank. Accordingly, they formed a governance committee dedicated to implementing and promoting the governance framework throughout the bank. The team used an earlier corporate governance evaluation that was conducted for the bank to identify priorities and develop an action plan.

One key achievement was the formation of the board's audit and compliance committee. The purpose of the committee is to oversee and ensure the integrity of the bank's financial statements, and the independence, qualifications, and performance of external auditors and the internal audit department. It also develops and monitors internal controls, ensures compliance with legal and regulatory requirements as well as the bank's code of conduct, and monitors compliance with the bank's ethics and anti-fraud policies.

These policies and procedures have proven effective in enhancing the control environment of the bank. They are widely distributed throughout the bank, further contributing to the control environment, and all committees' terms of reference are also published on the bank's website. In the first half of 2009, the bank's customer deposits totaled 83 billion AED, up 6 percent from December 2008.³¹ While it is difficult to attribute this to any single factor, there is no doubt that depositors are demonstrating trust in the bank's operation and financial soundness with their money.

In November 2009, the bank received the award of excellence in corporate governance, which was jointly awarded by the Union of Arab Banks and Dubai-based Hawkamah Institute of Corporate Governance.³² As part of its commitment to governance and its continuing effort to improve, the bank has also recently signed a partnership agreement with Hawkamah to promote corporate governance reforms on a regional level. In February 2010, the World Finance Awards recognized ADCB's corporate governance as the best of any company in the UAE.

"We are one of the only banks in Abu Dhabi to have a dedicated team of suitably qualified professionals (including qualified corporate secretaries) to perform the role of the Board Secretariat and to support the board and board committees."

SONYA SANTOLIN
CORPORATE SECRETARY, ADCB



DISCUSSION QUESTIONS

- ▶ Can corporate governance play a special role for an entity that relies on its reputation for safety and prudence, like a bank? Or on a reputation for consumer product safety, like a food product company?
- ▶ One notable feature of ADCB's governance is how widely it disseminates its policies both within and outside the bank. Why do you think that is effective?

31 "ADCB announces 1H'09 net profit of AED 657mn." Abu Dhabi Commercial Bank Media Center. July 23, 2009. Available at: http://www.adcb.com/Images/ADCB%20announces%201H09%20net%20profit%20of%20AED%20657mn_tcm20-14883.pdf.

32 "ADCB's corporate governance recognized as best in UAE." Abu Dhabi Commercial Bank Media Center. November 11, 2009. Available at: http://www.adcb.com/common/pr/2009/nov/corporate_governance.asp.

SECTION III

Implementing Corporate Governance³³

Board of Directors

In the Middle East and North Africa (MENA) region, the majority of companies are closely held, family-owned enterprises. With the exception of the Gulf Cooperation Council (GCC), small to medium-sized family-owned enterprises dominate the private sector landscape. Within this structure, the roles and relationship between the family, board, shareholders, and management tend to be overlapping and unclear. Therefore, the first step for companies committed to implementing good corporate governance practices is to establish appropriate distinctions between those entities; the best place to start is with an effective board.

Role of a Board of Directors

The board of directors is the central player in the governance of companies. It is responsible for overseeing all operations by providing leadership and strategic guidance, and by monitoring management. It is normal to find that boards, in the early stages of a company's life, function in an informal and ad hoc manner. While this informality has many advantages, such as responsiveness and flexibility, it can be unsustainable as companies grow. As the business grows, ad hoc decision-making no longer serves the best interests of the company, there are too many decisions that need to be made to approach each as if it were new and unrelated to the ones that went before.

As corporate governance is first and foremost about governance, improvements often begin with an examination of the roles, responsibilities, and accountabilities at a company. Processes and procedures are then instituted to make sure those responsibilities are clearly defined and assigned. Such processes smooth day-to-day business and create efficiencies. They also enable firms to operate in the absence of the main owners in cases of emergency, allow for the stable hand-over to other parties if needed,³⁴ and better equip the company to manage risks and face crises.

Lack of written procedures is, however, a constant challenge for some firms in the MENA region. With limited resources at hand and operating in an oral-based culture, many do not realize that the procedures in place for managing the business need to be documented to reduce the incidence of errors — a major cause of unnecessary cost for businesses. Well-defined processes and procedures, designed early in the company's history, are proven to improve operational efficiency and profitability. These procedures and policies should include: the corporate governance structure of the company, methods to ensure that corporate legal and regulatory responsibilities are being met, executive remuneration policies, and a code of conduct, among other items.

The clear distinction between the roles of the shareholders, the board, and management is crucial. Each party should have explicit duties and responsibilities that do not overlap. There are certain tasks

33 Many of the recommendations in this section follow the "Corporate Governance Guidance and Principles for Unlisted Companies in Europe" developed by the European Confederation of Directors' Associations (ecoDa), which is a not-for-profit association founded in December 2004 under the laws of Belgium.

34 "Guidelines on Corporate Governance for SMEs in Hong Kong." Hong Kong Institute of Directors Limited. 2nd Edition. 2009. Available at: www.hkiod.com/document/corporateguide/sme_guidelines_eng.pdf.

TASKS OF THE BOARD INCLUDE:

- ▶ Setting (or at a minimum approving) corporate objectives and strategy,
- ▶ Communicating with external stakeholders,
- ▶ Setting the responsibilities and accountability of management,
- ▶ Setting the remuneration and incentives of executives,
- ▶ Setting key performance indicators for supervising and monitoring the CEO's performance,
- ▶ Setting clear targets to supervise and monitor the company's progress,
- ▶ Approving expansion plans and major corporate ventures,
- ▶ Approving all accounting policies and financial statements,
- ▶ Approving major financial transactions (capital increase, borrowings, etc),
- ▶ Developing guidelines for external communications,
- ▶ Meeting on a regular basis to fulfill their duties, and
- ▶ Ensuring the company is complying with its legal and financial obligations in an effective and transparent manner.

reserved for the board and others delegated to management. The balance between these roles should be under constant review. Over time, through the establishment of an effective board, founding owners will be better equipped to delegate tasks to line management and step away from the day-to-day operations of the business.

Independent judgment is also needed to oversee managerial decision-making. However, companies often find it difficult to transition to a more independent, professional board — especially if the founders are still running the company. In the MENA region, there is general skepticism about bringing in outsiders (such as directors) who might access sensitive company information and interfere in company affairs. This fear, although real, should not stand in the way of good corporate governance. As a company expands, its development becomes progressively more reliant on the board and its ability to make independent judgments. It is in the best interest for the founders to ensure that the board can attract experienced and skillful directors who will be able to provide leadership and strategic direction to move the company forward.

There are often fears that a strong board might add bureaucracy to the decision-making process, as well as affect the power of the founders, managers, or owners in running the business. The value that board members will bring is often underestimated, sometimes because of these fears. The legal

framework in many MENA countries can exacerbate this further, as the law often stipulates that in order for a director to hold a seat, he/she must also own shares in the company.

As an alternative or interim solution, companies can form an advisory board or committees to complement the company's regular board. The advisory board can thus provide advice and counsel without affecting the governance, ownership, and power structures of the firm.

As more trust is built between the advisory board members and regular directors, members of the advisory group can be invited to join the main board as non-executive directors. Given that the advisory board members are not legally liable for a company's activities, ultimately, the goal should be to include fully empowered, independent directors.

Board Composition

In order for a board to function effectively, it should be comprised of directors who are qualified (through experience, expertise, and temperament), understand their role in bringing value to the company and shareholders, and have the ability to make objective decisions, independent of external influences. Building a strong board begins with establishing the appropriate role, size, structure, and role of the board.

The primary role of the board is centered on providing leadership, strategic direction, and oversight to the company. The board should oversee and approve the company's overall business strategy and hold management accountable for execution of that strategy. To fulfill its duties effectively, the board should:

- ▶ Ensure that all board members are objective in their judgments and contribute to setting the corporate objectives.
- ▶ Elect a chairman to the board who can provide leadership, ensure the board's integrity (including the documentation of all board meetings), and resolve any potential conflicts that may arise between members.
- ▶ Appoint an executive team (primarily the CEO) to implement the strategy set by the board.

As a starting point, the board or owners might find it useful to appoint an external lawyer and accountant to ensure that the board fulfills its roles and statutory obligations. When the board is more established, the company might appoint a board secretary to help the board fulfill its requirements.

There is no ideal formula for the structure and composition of the board. Each company has its own set of challenges that vary depending on the company's level of development and specific needs. These challenges may require a specific set of expertise that can be gained by including a diversity of board directors. This need could be for industry specific expertise, for instance for construction knowledge for an expanding company that anticipates building new facilities in the future, or for knowledge in finance if the company is seeking loans or expanding its capital.

How many directors should sit on the board? Again, there is no magic number. Too few might restrict the types of skills and experience that are needed to make the company prosper and might not allow for robust discussion of strategic options. Too many can become overly bureaucratic, making consensus and decision-making difficult. In general, managing effective discussions and



Launch of the Yemen Guidelines for Corporate Governance organized by the Yemeni Businessmen Club and CIPE, March 2010.

constructive debates tends to be difficult if the board exceeds 12 directors, and smaller boards tend to be more effective and productive. The key is to find the most effective balance while still keeping in mind legal requirements.³⁵ In most developed countries with dispersed ownership, boards average seven to 11 members.

It is also important to select the right mix of executive, non-executive, and independent directors, based on the company's needs. Understanding the nature and function of each role is an important part of establishing that formula.

In most MENA countries, owners of companies tend to fulfill the roles of both chairman and CEO (many times referred to as general manager, president, or managing director). These variations of titles tend to complicate the understanding of the underlying functions of the CEO position. When selecting executives' titles, it is therefore important to document and clarify the roles, responsibility and accountability of each function to avoid any underlying confusion with the companies' stakeholders, especially with creditors.

³⁵ "A Corporate Governance Survey of Listed Companies and Banks across the Middle East & North Africa: 2008." International Finance Corporation and Hawkamah. March 2008. Prepared and drafted by the IAAG and International Finance Corporation, and supported by the Union of Arab Banks, Egyptian Banking Institute, Egyptian Institute of Directors, Lebanese Transparency Association, and Abu Dhabi Chamber of Commerce. Available at: [www.ifc.org/ifcext/mena.nsf/AttachmentsByTitle/CG+Survey+of+Listed+Companies+and+Banks+across+MENA/\\$FILE/MENA+Corporate+Governance+Survey.pdf](http://www.ifc.org/ifcext/mena.nsf/AttachmentsByTitle/CG+Survey+of+Listed+Companies+and+Banks+across+MENA/$FILE/MENA+Corporate+Governance+Survey.pdf).

FIGURE 1

Executive Directors

- An executive director holds an operational position in the company and is a member of the board — typically the CEO and CFO
- Executives are involved in the day to day operations. Their participation in board meetings is crucial to update members on operating results as well as changes in the market.

Non-Executive Directors

- Non-executive directors are board members who do not hold an executive position in the company. A non-executive director may or may not be independent.
- Non-executive directors may contribute by providing additional external experience and knowledge and an outside perspective that is more objective. They can also be a good resource to provide external contacts for the company.

Independent Directors

- An independent director is a director who has no material relationship with the company beyond his or her directorship. An independent director should be independent in character and judgement, and there should be no relationships or circumstances which could affect, or might appear to affect, the director's independent judgement.
- The purpose of identifying and electing independent directors is to ensure that the board include individuals who can effectively exercise best judgement for the exclusive benefit of the company and all shareholders, whose judgement is not clouded by personal interest or loyalties and either real or perceived conflicts of interest. Independent directors are best able to assess situations openly, and bring an objective and unbiased view to discussions, without the fear of possible retribution.

SOURCE: IFC, and Hawkamah, "A Corporate Governance Survey of Listed Companies and Banks Across The Middle East And North Africa: 2008".

At the risk of simplification, a chief executive officer runs the company on a day-to-day basis and is responsible for execution of a strategy approved by the board. The CEO may also be the primary architect of corporate strategy, which he then submits to the board for approval. By contrast, the chairman of the board runs the board, making sure it oversees management (including the CEO).

Proponents of a combined chair/CEO cite the unambiguous leadership it gives to companies. Advocates of separating the chair and CEO roles ask how the same individual, serving as chair, can oversee himself in the role of CEO. The debate over the proper structure is robust and global, and there is no consensus as to which is best. Amongst family-owned companies, few accept the idea of bringing in a CEO from outside the family or the majority shareholder coalition, and still fewer appoint an independent chairman to the board. However, as evidenced in the Nuqul group case study, sometimes separating the positions allows a family or shareholder coalition-controlled company to bring in a high-level, experienced CEO, while maintaining ultimate family control through the board. Whatever the structure, a key to good corporate governance is to make a clear distinction between the responsibilities of both roles.

Planning and Conducting Board Meetings

Similarly, board meetings should be separated from management meetings, as the two cover different agendas and have different roles. Even if the company is owned by executive managers, it is still recommended that it plan separate board and management meetings. This allows the board to focus on setting strategy oversight, rather than getting weighed down by the myriad of management issues that arise.

If the board meets too often, it may put too much focus on day-to-day operations. If the board does not meet often enough, directors may not be able to complete what is required, and timeliness of decisions can be compromised. Smaller companies usually meet at least four times over the calendar year, though many meet more often. Boards at larger, more complex companies, tend to meet more frequently. And, of course, much of the work of the boards is done in the committees, which hold their own meetings. Finally, boards will frequently hold an annual strategy meeting separate from the regular board meetings, so as to enable directors to focus on the long-term. That special meeting often features executive managers presenting their strategic plans for the upcoming year. Planning and confirming board meeting dates well in advance will facilitate attendance, particularly for non-executive directors.

The chairman is in charge of running meetings in an efficient manner. Meeting procedures and agenda-setting should be developed as board guidelines. The following example illustrates a typical structure for board meetings:



Participant from a workshop on creating a corporate governance task force in Oman facilitated by CIPE, February 2008.

- ▶ The chairman prepares an agenda reflecting all issues to be discussed.
- ▶ The agenda and any related documents are circulated prior to the meeting for the purpose of familiarizing directors with the issues in advance.
- ▶ The meeting minutes are recorded and should reflect the topics discussed. All decisions made should be noted, including any dissenting opinions. The minutes should also include any designated tasks and a timeline for completing them.
- ▶ Progress should be examined in light of previously approved plans and budgets to ensure the board fulfills its obligations.

Keeping the Board Informed

Board directors need to be consistently updated on the state of affairs of the company if they are to make good decisions. The board is responsible for requesting relevant information to understand the issues at hand. Management is responsible for providing the information in a useful format, one that is designed and shared in a way that maximizes comprehension and allows the directors to make effective use of information. Documentation for the meetings, including the agenda and all exhibits, should be sent to the board members far enough in advance so that they will have adequate time to read and analyze them before the meetings.

The board must be clear in defining what information it finds useful for decision-making. Many boards have begun to use key performance indicators that include both financial performance, as well as other data that may be more forward-looking, including satisfaction of clients, employee



Tunisian journalist receives award for best corporate governance article in 2009, at an event hosted by L'Institut Arabe des Chefs d'Entreprises (IACE), a business association in Tunisia.

training and development, and operational indicators such as regulatory compliance or health and safety violations.

Directors may also seek information outside the board room, whether from speaking with managers not usually present at board meetings, or through information provided by third parties, such as think tanks, governments, or stock analysts. In general, it is considered best practice to allow directors to receive such information unfiltered by the CEO, but to keep the CEO informed of such requests in order to avoid any appearance of a split in the relationship between the CEO and the board.

Board meetings need to be documented in a proper fashion. There are usually legal obligations surrounding what is covered in board meetings and such documentation is usually required for any external financing. The board should clearly designate who will record the proceedings of the meetings and how the information will subsequently be shared.

Forming Board Committees

Smaller companies may perform functions with a board acting as a “committee of the whole”, but, generally, unless a company is very small, it will feature at least an audit committee (or finance committee that includes the audit committee functions).

- ▶ The number, size, and type of committees should reflect the needs of the company. Larger companies’ boards generally include committees for nomination, remuneration, and auditing. Adding other committees is left to the discretion of the company.
- ▶ The role and purview of the committees should be clearly stated and reviewed by the board on a regular basis. Publishing committee charters, outlining the responsibilities and rights of the committees, is considered best practice.
- ▶ Best practice has evolved to allow committees access to resources without going through corporate management. For example, the audit committee is often the formal entity that engages the company’s outside auditors.
- ▶ Board committees should make use of independent, non-executive directors, as they are often able to give the most objective advice.

The nomination committee typically recommends appointments to the board. It is tasked with examining the knowledge, experience, and skill-set of nominated directors and managers. Desired qualities and specific requirements should be prepared before an appointment takes place. The committee sometimes also reviews the company’s corporate governance generally. Succession questions are often within the purview of this committee, but may also fall under of the duties of the remuneration committee or the board as a whole.

The remuneration committee sets the compensation of all senior executives, including pension plans, stock-based compensation, and fringe benefits. It is also responsible for defining and monitoring the remuneration for senior management. An important responsibility of the remuneration committee is to try to align the structure of compensation so as to motivate employees and management to achieve corporate goals.

Because of the nature of the audit committee’s functions and duties, it is important that one or more individuals sitting on the committee have the financial expertise to make recommendations and

decisions. Practically speaking, this would imply that the person should be familiar with accounting. Auditing and finance experience are also common qualifications for audit committee members. It is recommended that the committee be made up mostly of non-executive and preferably independent directors. In some developed market jurisdictions, only independent directors are allowed to serve on the audit committee, and the committee must have at least one qualified financial expert.

The audit committee provides monitoring and oversight for both internal and external audit functions, with the following principle responsibilities:

- ▶ Monitoring financial statements, ensuring both quality and accuracy,
- ▶ Providing oversight for internal controls and risk management,
- ▶ Reviewing and monitoring risk and risk management, (This is sometimes the responsibility of a separate risk committee.)
- ▶ Ensuring that the internal audit function is working effectively,
- ▶ Recommending the selection or dismissal of an external auditor,
- ▶ Determining how to engage the external auditor, including what level of non-audit services is appropriate,
- ▶ Overseeing internal audit, and
- ▶ Setting up the mechanism for reports of misbehavior and/or review such reports (known as whistle-blowing).

The committee meetings should only include the committee members, although they may bring in others for particular sessions to provide additional expertise or information. The committee chairmen should then report on the discussions and decisions of the committee at the next full board meeting.

Enhancing Board Performance

Maintaining a valuable board is a continual process. Some boards charge the chairman with ensuring that directors are prepared to assume their responsibilities. Some boards arrange or reimburse directors for professional training that complements their relevant skill sets, including membership or training at institutes of directors or corporate governance institutions. Providing for both general training and company-specific orientation for non-executive board members is important if they are to effectively advise on corporate matters and provide a proper level of oversight. Executive directors understand and operate in a functional environment; therefore, they may also benefit from an orientation that prepares them for decision-making at the strategic level. Prior to the first board meeting, new directors often meet the other members of the board or request some form of orientation, which indicates their commitment to their position.

There are now associations that offer board leadership programs in the MENA region. Some offer certification for board directors. Such programs help develop skills and professional qualifications of directors, improving their contributions. They also keep directors up-to-date with the most current information on corporate governance practices and changes in the local and regulatory frameworks where the company is operating.

FIGURE 2: LIST OF INSTITUTES PROVIDING CORPORATE GOVERNANCE TRAINING PROGRAMS IN THE MENA REGION

EGYPT



The Egyptian Institute of Directors designs and delivers a wide variety of professional certificate programs and training courses covering all areas of corporate governance. These certificates and courses are targeted at board members and senior managers, but also other interested parties. Training programs are designed and delivered to specifically meet the practical needs of participants from listed companies, smaller family-owned enterprises, and state-owned enterprises. Training covers both basic and advanced levels of corporate governance. Additionally, tailored courses meeting specific company needs are offered. Such courses might include in-house training for board members, designed to tackle the specific challenges of the companies they direct.



The Egyptian Banking Institute serves Egypt’s banking industry by providing training to enhance the sector’s competitiveness. The Institute offers a comprehensive range of education and training programs, including specialized programs for corporate governance designed for bank directors. The Institute also coordinates joint courses with leading overseas training providers.

UNITED ARAB EMIRATES



Mudara – Institute of Directors (IOD) is a membership organization serving board members, directors, and governance professionals in the MENA region. Headquartered at the Dubai International Financial Centre (DIFC) in the UAE, Mudara IOD promotes director excellence by advocating the interests of boards and facilitating professional development through education, research, information, networking, and dialogue.



The Abu Dhabi Center for Corporate Governance encourages and assists the private and public sectors to adopt the highest standards and practices of corporate governance by providing training and advisory services, and by raising awareness about the value of corporate governance implementation.

FIGURE 2: LIST OF INSTITUTES PROVIDING CORPORATE GOVERNANCE TRAINING PROGRAMS IN THE MENA REGION *(continued)*

LEBANON



The Lebanese Transparency Association created an Institute of Directors that provides corporate governance training for board members and top level directors, organizes awareness-raising conferences and workshops, and produces research papers and publications.

TUNISIA



Established in June 2009, the Centre Tunisien de Gouvernance d'Entreprise (CTGE) works to raise awareness about the importance of good corporate governance in maintaining investor confidence and improving sustainable performance of the national economy. CTGE provides training, educational programs, and consultation to encourage business leaders and executives to adopt the most advanced practices in corporate governance. The Center was established by the Institute Arabe d'Chefs des Entreprises (IACE), the largest business association and think tank based in Tunis.

Professional training is not always an option in some locations; therefore, directors may develop their skills through other forms of education, business associations, or professional mentors.

Another way a board maintains and enhances its effectiveness is through a board evaluation process. It is important to remember that the purpose of the evaluation is to improve the functioning of the board, not to affix credit or blame to individual directors. Some evaluations consider the processes and procedures of the board, some examine contributions of individual directors, and some do both.

Evaluation techniques should take into consideration the size of the company and its level of sophistication and complexity. The board can be evaluated in several ways, including self-evaluations, bringing in an external facilitator, or creating an in-house system to evaluate each director's performance. Discussions on how the board is operating should be frank and honest. The following questions can serve as a guideline in evaluating the board:

- ▶ Is the board performing its duties in the intended way?
- ▶ Are the board's deliberations appropriately balanced between the day-to-day (compliance, review of financial results, etc.) and more long-term strategic discussions?
- ▶ Are board members investing an appropriate amount of time in board duties, arriving at meetings prepared, and carrying out obligations?

- ▶ Are all board members engaged in the board's work?
- ▶ Is there enough information to make sound decisions? Is there too much information submitted, which makes decision-making more difficult, and how can that be avoided? Is information available in a timely manner?
- ▶ Is the board engaging with shareholders and key stakeholders?
- ▶ Is the committee structure appropriate for the company? Is it functioning well?
- ▶ Are board members able to question executive management in a way that supports constructive dialogue?
- ▶ Has the board been able to strike a balance between independent decision-making power and expert knowledge of company activities?
- ▶ Are there skills or experiences missing from the board that would improve the board's abilities to carry out its functions?

Examining the performance of individual directors must be approached with caution, as it is a sensitive topic. Many boards shy away from such evaluations, choosing only to focus on the processes and procedures of the board as a whole. While individual director evaluation is considered an emerging best practice, directors can easily become aggravated by such a process. It is therefore important that the chairman or an external facilitator creates an environment in which directors feel safe to provide constructive criticism. It is also important to use discretion when dealing with sensitive information such as individual performance evaluations.

Should an issue be identified, the chairman or designated facilitator can give feedback to board members and can help guide directors individually to encourage them to work towards better performance. Board directors may benefit from coaching and advice from the chairman to improve the overall synergy of the board.

Board directors should also examine the performance of the CEO. This duty should be headed by the chairman, if the company has an independent chairman. Other boards choose to have the chairman of the nominating or remuneration committee lead the review, though, ultimately, it is always a subject for the full board. Some boards have opted for an evaluation whereby the CEO assesses his own performance and that is compared with an evaluation performed by the chairman and other directors.

Risk and Control

Managing risk is a key component of any business. Risk management is the process of identifying potential risks and the mitigation of those risks. More sophisticated risk management efforts also evaluate the probability of risks, the severity of the possible consequences of those risks, the time a risk will take to become fully developed, and how robust the company's response can be to any risk. It should be noted that risk can come from either internal company operations or from the external environment. In effect, risk is the dark side to strategy, and risk management is a key to success in managerial execution of that strategy. An emerging best practice is for the board to include a brief description of its risk oversight in an annual statement. Various investor groups, such as the International Corporate Governance Network, have called for such disclosures.

One key tool for management is internal control, which is why boards find it so valuable to carry out an evaluation of the internal controls covering finance, operations, compliance and internal risk management systems. For smaller companies, professional consultants or advisors can help determine the best internal control processes to pursue. This becomes more important as companies increase their size and sophistication, particularly if a company is thinking about accessing external financing, as strong internal controls will be essential to prospective investors.



Hüseyin Erkan, Chairman and CEO of the Istanbul Stock Exchange at an event to launch a new governance guide for family companies, developed by the Corporate Governance Association of Turkey (TKYD), January 2010

For larger companies, the board's audit committee or the internal audit department might be involved in the risk management process. Financial companies often have risk committees at both board and managerial levels, and usually an entire risk management department. Nonetheless, although a department in the company may address risk, it should always be one of the oversight functions of the board as well. The CEO particularly should either work very closely with the risk manager or imbed some of the duties involved in risk management into his own responsibilities. Many companies find it helpful to provide a manual of the company policies to all employees. Where appropriate, those manuals should include internal controls and risk mitigation procedures.

A documented list of the identified risks can assist in determining direction and strategy. It should be reviewed by the board periodically and include the following points:

- ▶ Identification of the main risks in the company,
- ▶ What the impact might be if such a risk occurs,
- ▶ How likely it is that it will happen,
- ▶ What to do if it actually occurs, including the corporate manager in charge, and
- ▶ Any tactics or steps to take in advance that might help mitigate the risk, including a log of when the action has/will be completed and by whom.

Assessing risk also includes consideration of corruption or fraudulent activities. A key part of the board's oversight is to ensure that employees can safely report any unethical or unlawful actions. The details of such policies are usually outlined in a code of ethics or code of conduct. There should also be legal protection for anyone that reports on something that was observed. Companies are increasingly adopting whistle-blower policies to ensure that employees or other stakeholders who report misconduct are not penalized for sounding the alarm on corrupt or unethical practices. The Lebanese Transparency Association has developed the Code of Ethics & Whistle Blower Procedure for Small and Medium Enterprises in order to assist companies in developing such procedures.

FIGURE 3: ECODA CORPORATE GOVERNANCE GUIDANCE AND PRINCIPLES FOR UNLISTED COMPANIES IN EUROPE

The following points should be covered in the policies:

- Anti-fraud,
- Anti-money laundering,
- Cash management,
- Monitoring of banking covenants,
- Business continuity,
- Data security and reliability,
- Records management,
- Regulatory compliance, and
- Health and safety compliance.

The following procedures may assist the function of the internal control environment:

- Authorization limits,
- Segregation of duties,
- Accounting reconciliations and monitoring of cash flow,
- Suitable qualifications and training,
- Budgetary controls,
- Controls over funds, expenditure and access to bank accounts, and
- Security of premises and control over assets.

SOURCE: *The European Confederation of Directors' Associations (ecoDa)* www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_article_corp_gov_unlisted_companies_eu.pdf.

Transparency

Corporate practices in the MENA region are often shrouded in secrecy. Many companies try to keep business and financial practices away from public knowledge and scrutiny. Whatever the perceived benefits of this strategy, opacity has its drawbacks, including reduced investment from outside sources.

Traditionally, companies were also reticent to bring in outside investment for fear of losing control; however, attracting outside investment is slowly becoming more commonplace. That path is only open if potential external investors know enough about the company and can monitor its results. Investors have more confidence in companies that provide clear and accessible information, allowing them to evaluate the potential risks and rewards of their investments.

With a new generation of managers in the MENA region who understand the benefits of external financing and the growth it can bring, greater transparency will become more demanded and



Participants in a corporate governance training-of-trainers program in Sana'a, Yemen, June 2010 conducted by the IFC and CIPE.

accepted in the market. As evidenced in many of the case studies, when there has been a need for capital, companies in the region have provided the requisite information. That trend is likely to quickly become more widespread.

All publicly-listed companies are required to disclose financial results. However, a more detailed annual report is not a requirement for most companies in the MENA region. In some instances, companies disclose more than what is required in order to generate and maintain confidence in their operations or to establish trust with stakeholders. Such disclosure is an essential tool to attract and inform investors and potential partners. In smaller companies, shareholders may consist mainly of the controlling family so the annual report can also serve as a unifying communication tool.

A survey conducted by PriceWaterhouseCoopers of 685 institutional investors and 445 stock market analysts across 14 countries indicated that they considered an annual report more as a communications tool on the dynamics of business development than evidence of performance. The market is no longer only interested in past financial performance, but also its future direction in terms of strategy, investments, and projected growth. In this regard, anticipated future performance of a company (correctly characterized) is of key interest to investors, as their profits are largely tied to the company's strategy and execution.

The layout and information contained in an annual report can have a major impact on potential readers. Stakeholders are interested in the structure and content, including cover pages, important events that occurred during the calendar year, the layout, images, financial results, and any predictions for the future. Annual reports also allow for informal practices to be codified and communicated as a part of the ongoing development of corporate culture.

Countries have different customs and norms concerning the actual make-up of an annual report. In addition, international annual report disclosure standards have surfaced as a result of the globalization

of capital markets. The Organization for Economic Co-operation and Development recommends that annual reports include a discussion and analysis of company operations by management. Combining that discussion with a company's financial statements creates a powerful and transparent message. As a regional resource, the Institut Arabe des Chefs d'Entreprises in Tunisia developed a Guide for Annual Reports to provide a model for companies regarding the content and structure of annual reports.

Filing management reports in conjunction with financial statements is also recommended by the International Accounting Standards Board,³⁶ including:

- ▶ An explanation of key financial and performance indicators,
- ▶ Statements on the company's financial position,
- ▶ Potential risk factors,
- ▶ Market and industry trends,
- ▶ Sources of capital, and
- ▶ Basic information on how risk is managed.

A company can disclose information beyond what is necessary, such as its environmental policy or corporate social responsibility initiatives. Some companies include such information in their annual reports, and others in special corporate responsibility reports.

Family-Owned Enterprise Governance

Family-run businesses have traditionally consisted of a strong family patriarch who established the business, often taking the initial form of a "one-man-show." Family members are often actively involved in establishing the board of directors, whether by actually sitting on the board themselves, or by suggesting other family members, relatives, or friends to serve as directors. If the CEO comes from the family, then boards tend to wield less power, with most of the control remaining in the family's hands. Family and other shareholders also have the ability to extend their influence in less direct ways, as a result of shares held in holding companies and/or subsidiaries.

The old model of highly centralized family control functioned well when business depended heavily on relationships, which served as the glue in murky regulatory markets. It is questionable whether this system will be as valuable in the future. Increasing competition requires companies to become more strategic in how resources are allocated and brings family-owned companies into competition with global corporations. This interaction provides family businesses new opportunities to access to capital and talent.

Family businesses typically go through three stages of development, which are characterized by certain features.

³⁶ "Financial Statement Presentation." International Accounting Standards Board. Updated July 1, 2010. Available at: www.iasb.org/Current+Projects/IASB+Projects/Financial+Statement+Presentation/Financial+Statement+Presentation.htm.

FIGURE 4

	STAGE 1 Founder (1st generation)	STAGE 2 Next Generation (2nd generation)	STAGE 3 Extended Family (3rd generation)
Common Characteristics	<ul style="list-style-type: none"> • Business owned and managed by the founder (chairman & CEO) • Decisions made primarily by the founder with little external input • Simple and informal governance structure • Few shareholders • Board made up of family members, oftentimes also shareholders 	<ul style="list-style-type: none"> • Management and ownership transferred to children of the founder • Governance issues become more complex as the company grows 	<ul style="list-style-type: none"> • More family are directly or indirectly involved including children of siblings, cousins, and in-laws • Any conflicts are carried over
Typical Shareholder Issues	<ul style="list-style-type: none"> • Leadership transition • Succession • Estate planning 	<ul style="list-style-type: none"> • Maintaining teamwork and harmony • Sustaining family ownership • Leadership transition • Succession • Formalizing business processes and procedures • Establishing effective communication 	<ul style="list-style-type: none"> • Allocation of corporate capital: dividends, debt, and profit levels • Shareholder rights • Family member employment • Shareholder liquidity • Family conflict resolution • Family participation and role • Family vision and mission • Family linkage with the business

SOURCE: International Finance Corporation, Family Business Governance Handbook. Washington, DC, 2008. Available at: [www.ifc.org/lifcext/corporategovernance.nsf/AttachmentsByTitle/Family+Business_Second_Edition_English+/\\$FILE/English_Family_Business_Final_2008.pdf](http://www.ifc.org/lifcext/corporategovernance.nsf/AttachmentsByTitle/Family+Business_Second_Edition_English+/$FILE/English_Family_Business_Final_2008.pdf).

Phases in Family Governance Structure

Establishing family governance practices at the appropriate time in the business' life-cycle can strengthen family relations, bring stability to business operations, help recruit management talent, and provide for more effective management. These governance practices provide a forum for open communication, allowing the family to discuss issues related to the business and provide family members the opportunity to network. An effective governance structure will help address issues that will occur throughout the life of the business, such as employment of family members, conflicts, and ownership of shares.

One effective cornerstone of governance at a family-owned company is to develop written procedures that can be referred to periodically, such as a family constitution and a shareholding policy. Effective policies strengthen and assist in the growth of business. Each company will have a unique governance structure, and it is important to inform family members of its purpose and function in order to develop consensus and support. Often, those structures resemble the following.

Family Meeting — At the earliest and most informal stage, when power is usually centralized with the founder(s), family meetings are called and run by the founder, who often operates the business in an unilateral manner. The meetings function as an informal way to share information, build consensus, and generate new ideas.

General Functions:

- ▶ Communicate the ongoing activities of the business and future direction,
- ▶ Develop a company mission and vision based on agreed upon family values,
- ▶ Begin to outline and develop policies regarding employment and share ownership,
- ▶ Discuss and obtain ideas for growth, and
- ▶ Begin designating and preparing the next generation of business leaders.

Family Assembly — As the second generation of the family becomes active in the business, a more formal process for communicating information often becomes necessary. The assembly convenes on a more formal basis one to two times per year, at which time any relevant issues related to the business are addressed. This not only allows the family to stay informed but also gives the family the chance to share opinions on business development. At this stage, if formal policies are not in place, conflicts may begin to arise.

General Functions:

- ▶ Review changes in the family values and vision,
- ▶ Inform family members of their rights and responsibilities,
- ▶ Review and authorize employment and compensation policies (whether formal or informal),
- ▶ Elect family council members (if in effect), and
- ▶ Elect family committee members to deal with issues such as education and training, or philanthropy.

FIGURE 5

	FAMILY MEETING	FAMILY ASSEMBLY	FAMILY COUNCIL
What Phase?	Founder (1st generation)	Next Generation (2nd generation)	Extended Family (2nd-3rd generation)
What is the status?	Informal	Formal	Formal
Who participates?	Any family member with a vested interest in the company	Any family member with a vested interest in the company	Family members are elected by the Family Assembly. Selection criteria is defined by the family.
What is the size?	Small — usually the immediate family of the founder (e.g. 6-10)	Medium — depends on the size of the family and participation criteria	Small — depends on the criteria established; usually 5-9 members
How often do they meet?	Depends on the stage of development. Can be as often as once in week in the early stages	1-2 times per year	2-6 times per year
What are the main activities?	<ul style="list-style-type: none"> • Communication of family values and vision • Discussion and generation of new business ideas • Preparation of the next business leaders 	<ul style="list-style-type: none"> • Discussion and communication of ideas, disagreements, and vision • Approval of major family related policies and procedures • Education of family members on business issues • Election of family council and other committees' members 	<ul style="list-style-type: none"> • Conflict resolution • Development of the major family related policies and procedures • Planning • Education • Coordination of the work with the management and the board and balancing the business and the family

SOURCE: IFC Family Business Governance Handbook. *International Finance Corporation. 2008. Available at: [www.ifc.org/ifcext/corporategovernance.nsf/AttachmentsByTitle/Family+Business_Second_Edition_English+/\\$FILE/Englilsh_Family_Business_Final_2008.pdf](http://www.ifc.org/ifcext/corporategovernance.nsf/AttachmentsByTitle/Family+Business_Second_Edition_English+/$FILE/Englilsh_Family_Business_Final_2008.pdf).*

Family Council — As the second generation expands with in-laws and cousins in the fold, a governing body that represents the interests of the broader family may be appropriate to aid in decision-making. Family members on the council are elected and usually meet two to six times per year. The council addresses any issues that may arise and communicates these issues and business activities to the rest of the family.

A chairman is normally elected or appointed by the family assembly to serve as the principle contact person who guides the process and activities of the council. It is also useful to elect a secretary who records the outputs of the meetings and circulates the information among relevant family members.

General Functions:

- ▶ Serve as the main liaison between the family, the board, and senior management,
- ▶ Propose candidates to serve on the board,
- ▶ Review and modify anything related to the vision, mission, and values of the business, and
- ▶ Review and modify any policies related to employment, compensation, and shareholding.

It is ideal to begin formalizing policies and procedures to document the vision of the founder during the first generation. At that point, the founder can help to forge an agreement amongst the rest of the family.

In addition to formal policies, formal communications facilitate the sharing of information among family members. That, in turn, engenders trust and allows for any issues or conflicts to be addressed openly, which minimizes the potential for damage. The family should be informed of ongoing business activities and the challenges the business is facing.

Family meetings and assemblies are the most appropriate venues to communicate the details of the business, but ongoing communication can take the form of emails, internet portals, monthly reports, annual reports, etc.

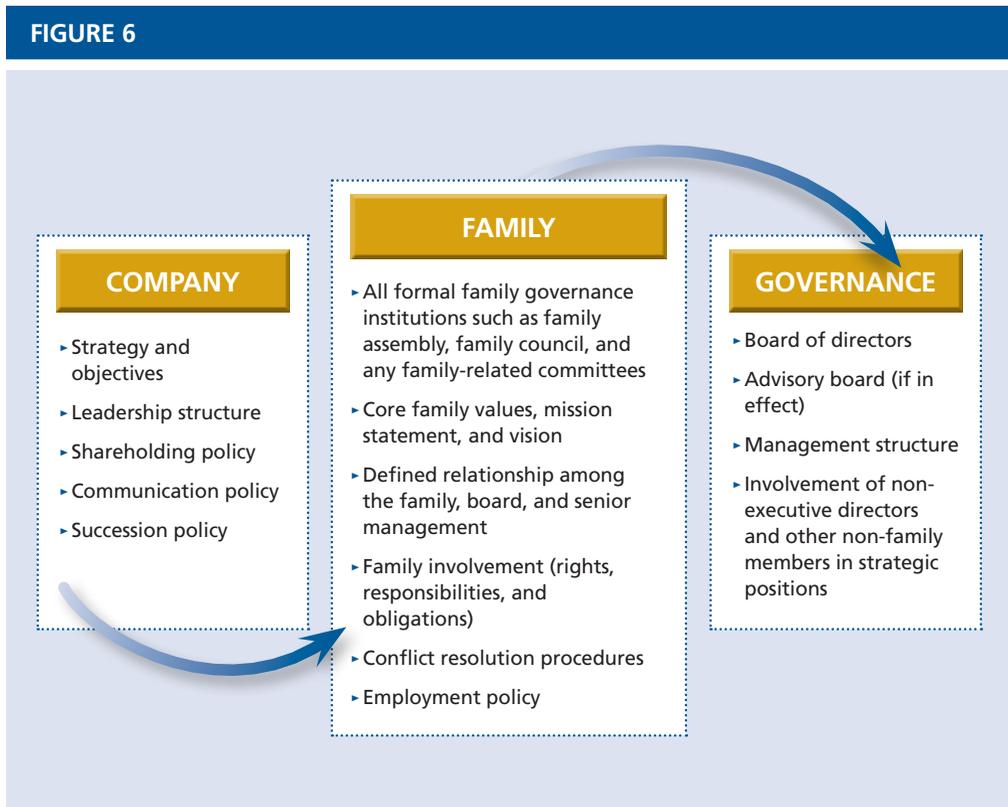
Establishing a Family Constitution

The family constitution, also known as a family protocol, is a fully developed document that outlines the principles and policies to which a family business subscribes. It includes the core values, mission, and vision of the company, as well as describes the roles and function of each governance body, including the owner, board directors, shareholders, management, and employees. It also stipulates how family members can become involved in the business. As noted, such written procedures can anticipate and deter misunderstandings and can help perpetuate the family's vision and values for generations.

Experience shows it is best to formulate a family constitution while conditions are stable in the company, before any problems occur, so that potential issues can be dealt with dispassionately. In the early stages, many families have an informal set of rules and customs that guide the relationship between family members and the business in terms of rights, obligations, and expectations of family members. As the family and the business expands, it is important to formalize policies in a written document for all family members to recognize.

Succession planning is a key element in family constitutions, mitigating potential disagreements that may occur as ensuing generations take over. It also provides general policies for blood relatives and extended family. Most family-owned businesses that have developed a family constitution require family members to work outside the company for a specified period of time. It is thought they will gain better experience for themselves and will develop a valuable set of skills to bring to the company.

The principle components of a family constitution usually touch upon and address the following points: employment policies, conflict resolution, family shareholder rights, and succession.



SOURCE: Created based on: Corporate Governance Guidance and Principles for Unlisted Companies in Europe. The European Confederation of Directors' Associations (ecoDa). Available at: www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_article_corp_gov_unlisted_companies_eu.pdf.

Formalizing Policies

Regarding employment policies, family-owned firms in the Middle East often face the challenge of choosing whether or not to hire family members, friends, and close personal contacts. Setting up clear policies and procedures for job qualifications and expectations can ensure that a company attracts the right people. In this way, the company can feel comfortable employing family and

friends, but also make it explicit what skills the individual must possess and what is expected of him/her in the company. Often, this means clear statements regarding the conditions of entering, staying in, and exiting the business. The policy should also address the treatment of family versus non-family employees. Such a policy establishes a hiring system based on merit rather than birthright, encouraging family members to achieve a certain standard whereby they are effective contributors. Non-family members also clearly see a path for growth in the company, encouraging their commitment and loyalty. An employment policy might touch upon the following issues:

- ▶ Employment philosophy
- ▶ Entrance
 - *Criteria for employment (e.g. existing position, or creating a position that requires certain skills)*
 - *Qualification requirements*
- ▶ Educational requirements
- ▶ Prior work experience
 - *Procedures for family members to follow in order to be considered*
- ▶ Employment of extended family
- ▶ Treatment of employed family members
- ▶ Responsibilities
- ▶ Remuneration and compensation based on the market
- ▶ Evaluation for development
 - *Supervision and reporting relationships*
 - *Performance appraisal system tied to key performance indicators (KPIs)*
- ▶ Continuing education
- ▶ Retirement
- ▶ Structure for advancement within the company

When a conflict occurs among family members it can interrupt business and interfere with normal operations. The principle reason many family-owned companies collapse is a personal conflict, not a competitive threat. The responsibility for resolving conflicts ideally falls on the shoulders of the family council, if it is operational. The council should be responsible for seeing that conflicts do not interfere with business operations and that they are solved through dialogue within a reasonable amount of time.

Policies and procedures dealing with conflict resolution should identify potential conflicts of interest and establish a process for resolution. The procedures can be included in the family constitution or as part of the company's overall policy.

Developing a shareholding policy as early as possible establishes a consistent message and informs family members of their rights. The policy should detail who is allowed to own shares (such as immediate family, extended family, and in-laws) and also if and how shares can be sold.

FIGURE 7: DEVELOPING A SHAREHOLDER POLICY

The following points should be taken into consideration when establishing a shareholder policy:

- Who has the right to own the shares in the family (only descendants, in-laws, relatives, or non-family members such as employees),
- Right of first refusal (the right of a party to match the terms and conditions of a proposed contract with another party, generally protecting minority shareholders),
- Conditions relating to issuance of new shares,
- Conditions of sale (priorities and pricing),
- Pre-emption rights (priority among members of the family in the event of intended sale of shares of a family member),
- Approval procedure in the event of transfer of shares (approval of a new shareholder by majority decision of the members of the family),
- Liens on shares,
- Dividends and subsidies for family members, and
- Other relevant provisions of the shareholders' agreement.

SOURCE: Reference Guidebook on the Corporate Governance of Family-Owned Enterprises. *Lebanese Transparency Association*. Available at: <http://www.transparency-lebanon.org/publications/foecgen.pdf>.

Preparing for Succession

Planning for the next generation or for a change in management is often a difficult process because most family-run businesses are dependent upon a founder or strong CEO. Yet as the business grows, and the next generation is primed to take over, a smooth transfer of power and knowledge is imperative. If a plan is developed well before new leadership actually takes over, the transfer tends to be smooth and successful. Pre-planning allows the founder to have input into the future direction of the company.

Many children of founders seek to take over the position of CEO. That may be acceptable, but it is not the only path possible. For example, a strong board made up of several family members may look to appoint a CEO from the extended family or consider a non-family member. The intent is to choose the best-suited person for the position, thereby continuing family control, even while allowing the hiring of a talented CEO with other experiences or skills.

When developing a succession plan, it is useful to get external input to help make effective and objective decisions. Some families have used independent non-executive directors for such counsel, while others have looked to accounting or legal firms.

The following key points should be taken into consideration when developing a succession plan:

- ▶ Goals related to the succession,
- ▶ Method and criteria to chose successors,
- ▶ Necessary steps in order to prepare successors,
- ▶ Required training for successors,
- ▶ Plan with specified timing in terms of the stages of identifying, training, and introducing a successor, and
- ▶ Contingency plan in the event the succession does not go as planned or an unexpected event occurs.

APPENDIX 1

Sample Outline of a Family Constitution

Developed by the Lebanese Transparency Association (LTA)

1. Values and Objectives of the Family Business

What are the values and the culture of the Company?

- Statement of family values and beliefs, and
- Outline of family business principles.

2. Family Decision-Making and Institutions

How does the family make decisions?

FAMILY ASSEMBLY

- Objectives of the Family Assembly,
- Functions of the Family Assembly,
- Meetings of the Family Assembly, and
- Secretary of the Family Assembly.

FAMILY COUNCIL

- Objective of the Family Council,
- Composition of the Family Council,
- Functions of the Family Council,
- Decisions of the Family Council,
- Meetings of the Family Council, and
- Secretary of the Family Council.

OTHER FAMILY FUNCTIONS AND COMMITTEES FAMILY ACTIVITIES

- Social meetings,
- Informative meetings, and
- Communication with the public.

In an environment where information is crucial, all data should be stored and protected. Rather than merely collecting the information and filing it, written information should be organized in specific files — ideally, all information should be digitalized and stored. The collection of personal documents, letters, etc. helps to build up a family archive that reflects the family history.

3. Shareholding and Provisions of the Shareholders' Agreement

What should the family business do when facing any issue related to the shares of the Company?

- Rules governing sale/transfer of shares,

- Dividends and subsidies for family members,
- Rules governing issuance of shares,
- Guarantees and liens on shares, and
- All other relevant provisions contained in the shareholders' agreement.

4. Conflict of Interest

How can the family business appropriately manage and prevent all potential situations giving rise to conflict of interest?

5. Employment of Family Members

What is the Company's policy regarding employment of family and non-family members?

- Members of the family eligible to join,
- Criteria for entry,
- Employment opening,
- Supervision policy of the family and evaluation process, and
- Family policy governing employment.

This policy should be communicated throughout the firm and consistently applied, for it can have a tremendous psychological effect on the entire workforce and non-related management.

This section should address the policy of the family business regarding how to deal with loyal and talented non-family employees as well as the potential necessity of independent/ non-executive directors or outside advisors. It should also identify how to professionalize the business and decide if experienced and capable managers with outside experience need to be brought on board.

6. Succession Issues

What are the rules applicable to next generation family members willing to work in the business and why is the family committed to next-generation business and ownership?

- Charter on succession plan to key employments, especially General Manager position.

7. Family Code of Conduct

Every family-business should operate on business sound ethics that imply good employment practices and honest dealing with third-parties, treating them as stakeholders, with respect and involvement.

A Code of Conduct should be developed by the Company. However, if the Board considers that such a Code should not be developed independently, provisions contained in this document could be inserted in the Family Constitution.

8. Family Training and Education

How can the family provide education to all its members on how to tackle all issues contemplated in the Family Constitution?

- Areas and methods of education and training of family members, and
- Who should participate in the educational process.

9. Family Philanthropy

Property constitutes a responsibility. Family members should be responsible towards other family members and express real respect for wealth and the assets of the Company. The Family Constitution should identify how the wealth produced by the business should be used. For instance, it could state whether it intends to inject the whole capital produced in investments or pay large dividends. The wealth may also be invested in education, serve as a fund in case of problems or help financing promising start-ups and other businesses of family members.

10. Revision and Overseer of the Family Constitution

The family should adopt policies and procedures designed to ensure that proper revision of the principles contained in the Family Constitution is carried out on a regular basis, at least annually. The family should pay a particular attention to the importance of ensuring proper revision of obsolete principles or policies that would no longer be appropriate in light of new circumstances affecting the Company and the family.

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