Challenging Board Effectiveness

A review of board practices in the Gulf 2013

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FOREWORD

The GCC Board Directors Institute (BDI) first published its report on corporate governance in the region in 2009. Since then, the GCC and the world in general have undergone substantial change. On the back of the worst economic crisis in living memory, the need to implement and ensure a robust and modern corporate governance framework is stronger than ever. Even if the GCC as a whole was shielded in part by high oil prices and already exhibits signs of emerging from the crisis in good shape, the lessons from the last half decade should and must not be forgotten.

This is especially critical as the thoughts of board members turn to growth scenarios rather than those of damage limitation. Companies cannot become complacent in good times. Just because the corporate scandals and financial difficulties of the last few years are now hopefully behind us does not mean that we let our guard down. The process of implementing good corporate governance initiated by many companies should be continuously enhanced. In fact, one can argue that there is no better time for companies to act, and I would strongly urge them to do so.

Thankfully, it appears that companies are heeding lessons from the misfortunes of others. The results of the latest BDI corporate governance survey suggest that boards are becoming ever more professional and more accountable to owners and shareholders.

In line with international trends, boards are becoming smaller and more focused. Awareness of the inherent value an accountable and professional board can bring to a company is growing, as is the worth of independent board members who can view decisions from a different perspective.

Nonetheless, it is clear that much still needs to be done, particularly with regards to family-owned businesses. The evidence from the survey suggests that many still treat good corporate governance as a distraction or sideshow. As private companies, they continue to persist with the thinking that governance issues do not apply to them. We have only to see some of the biggest recent corporate scandals in the region to understand the dangers of taking a lax approach to such an issue.

As ever, the continuing maturity of strong corporate governance lies in the hands of the board directors themselves. The latest data suggests that self-evaluation is growing, but not to the extent that is common outside the region. Similarly, it is not clear that boards are doing enough to rotate their membership or plan sufficiently for succession issues or developing and retaining senior management.

It is within this context that the BDI publishes its third report on board effectiveness in the region. Intended as a valuable resource for companies and directors to improve their governance practices, it also serves as a stark reminder of the work that still needs to be done in the region while appreciating the progress that has already been achieved.

Mohammad al-Ali
Chairman, GCC Board Directors Institute

EXECUTIVE SUMMARY

The authorities in the GCC have responded to the lingering global financial crisis by introducing tougher company laws and capital market regulations, with a greater onus on transparency and accountability. As a result, corporate governance is being taken more seriously than ever in the region.

The findings of this report show that boards are today being given greater responsibility. Whereas in the past directorships were largely seen as prestigious, ceremonial roles to be held by a few distinguished members of society, boards are becoming increasingly professionalised, and more accountable to owners and shareholders.

This is a sign of the growing maturity of the corporate world in the GCC in the post-crisis climate and also of the deepening of the region's capital markets. There is increased awareness of governance and the contribution that responsible and professional boards can make to the performance of a company. There is also a greater appreciation of the value of independent directors, who can challenge decisions from a performance perspective and not from an internal viewpoint alone.

However, there is still a marked distinction in the attitude to corporate governance between publicly traded and family-controlled businesses. In the latter, there is a reduced distinction between ownership and management, which makes addressing deficiencies in board members' skills and performance more difficult politically. But all companies stand to benefit from more effective boards and all boards stand to benefit from increased training and exposure to global best practices, evaluation and benchmarking.

With the growing trend for companies of a certain size and age to seek a stock market flotation in order to access capital to expand, the awareness of corporate governance is filtering down to the private sector. Tolerance of ineffective directors has long been entrenched in the region, but a new generation of business leaders is now emerging that understands the value of a dynamic board. This can only be positive for the region as a whole.

The purpose of this report

This report is intended to provide insight for board members, investors, advisers and governments, of the changes and improvements made in corporate governance practices in the GCC in the two years since the last BDI report was published. These surveys form part of an on-going process to track corporate governance and board effectiveness in the GCC with the aim of continuously working to improve the region's ability to effectively manage company operations. It also aims to enhance the standards of regional boards, bolstering the GCC's position as a leading hub for board effectiveness.

Key findings

Board members in the GCC are becoming more aware of their roles and responsibilities thanks to greater awareness of corporate governance and increased enforcement and accountability by regulators and internal processes. This is a reflection of the growing maturity of capital markets in the region and a sign that lessons are being heeded by businesses and the authorities in the wake of the global financial crisis.

Despite this, board effectiveness across the GCC is still being impeded by inadequate skills among directors and suboptimal board composition. Support for replacing ineffective board members has increased, since the last two surveys were conducted, however, in practice doing this in the GCC is easier said than done due to the close linkages between business and family. Adopting global best practices and benchmarks and participation in workshops are seen as the best ways to improve the effectiveness of boards. There is also considerable and increasing support for appointing independent board members from outside the GCC to bring more formality to the table and enhance discussions and share experiences.

A worrying new trend is the lack of confidence that boards have in the direction of their companies. More than 40 per cent of those surveyed said they think their company does not have the right strategy and 50 per cent said companies' KPIs are not clearly defined or tracked regularly. Although there is now much greater certainty over the relationship and distinction between the roles and responsibilities of the board and senior management, the role of the

EXECUTIVE SUMMARY

chairman in day-to-day operations is more ambiguous, with few respondents prepared to define one way or another the precise level of the chairman's involvement.

The average size of boards continues to be smaller than in Europe, but it is generally felt to be adequate, and cross-board representation is well established. Yet there is a strong feeling that board members are not rotating at a quick enough rate to allow new talent to join, bringing with them new ways of looking at things. Women also continue to be under-represented in the GCC, comprising on average less than 1 per cent of boards, a figure unchanged from 2011.

There has been a sharp rise in the proportion of members agreeing or strongly agreeing that their colleagues actively participate in discussions at board meetings. But there is still further room for improvement when it comes to engagement at meetings.

In particular, better use should be made of information provided ahead of board meetings to prepare. Follow-up procedures to ensure board decisions are implemented also require refining.

A major area of weakness in corporate governance in the region continues to be self-evaluation. Although more boards are conducting self-evaluation than in previous years, 84 per cent still are not. This is a clear area where major gains can be made in improving board efficiency.

Boards are also insufficiently involved in talent management, with most generally not having clear and proactive plans for developing and retaining senior management. Strategies for succession planning for critical positions are also lacking.

Average remuneration of board members has fallen since the last survey, mirroring international trends.

Conclusions and recommendations

In summary, the following recommendations for improving board efficiency have been identified:

1. Adopt global best practices and benchmark board performance against international peers
2. Provide more training for board members and encourage membership of industry associations
3. Replace ineffective board members and rotate board members more frequently
4. Appoint more international and independent board members
5. Define better the role of the chairman
6. Encourage board members to prepare for meetings by continuing to provide materials that are clear and easily digestible
7. Seek greater board engagement in devising company strategies and visions
8. Devote more board time to talent management and establish clear processes for retaining senior management and succession planning for critical positions
9. Make evaluation of board performance mandatory
10. Develop robust follow-up procedures to ensure board decisions are implemented

INTRODUCTION

Board effectiveness can be appreciated by any company stakeholder as a critical element to managing operations and growth. The GCC region's ambitions to develop itself and its standard of business are evident in the successes of each country's growth over recent years coupled with the individual successes of companies and organisations particularly amid global economic turmoil. Continuous enhancement and improvement in regional board effectiveness serves as a cornerstone to the on-going success of regional companies. In keeping with surveys of previous years, the BDI framework for board effectiveness was again utilized as a benchmark to track regional progression and development of boards throughout the GCC.

Although regional board progression can be evidenced in key findings such as increasing awareness of board member roles and responsibilities as well as more actively engaged directors, many of the key challenges and problems highlighted in previous surveys remain. Inadequate skills among regional directors coupled with limited adoption of self-evaluation processes among boards are accompanied by new challenges including a lack of confidence in regional business strategies, directions, and an under-emphasis on talent management.

The lessons learned in recent years about board development remain pertinent to this day. Effectiveness superseding mere compliance remains an important lesson for regional boards. Effectiveness should remain at the forefront of regional boards particularly in light of intensifying competition and the global economic slowdown. The development and tracking of corporate strategies, allocation of precious resources, and the retention of key people and talent needed to realise sought after strategic objectives are all underpinned by a company's ability to monitor, manage, and develop itself effectively. Maintaining transparency to stakeholders also remains a pivotal lesson for consideration to regional boards. The global financial crisis has given rise to wiser and more selective investors seeking lucrative long-term investment opportunities. Capturing and retaining investor confidence through enhanced transparency and disclosure (both financial and non-financial information) even beyond that which is mandated by law and regulations thus serves to be ever more critical in today's business environment.

As this year marks the third iteration of the BDI Board Effectiveness Survey in the region, we hope to continue to push and motivate change among regional boards and the manner in which they operate.

APPROACH

This third report on board effectiveness in the GCC seeks to measure improvements made since the previous two surveys were conducted in 2009 and 2011. It also seeks to assess the changes in corporate governance made, if any, in response to the global financial crisis. In keeping with previous years, BDI's framework for board effectiveness has been used to track progress. This framework was developed through BDI's early work with more than 100 boards in the region. As in the previous two surveys, each of these parameters were explored through a combination of analysis, opinion survey and interviews with senior directors in the region. The following elements were considered:

1. **Board composition and directors' capabilities:** knowledge and expertise; performance and talent management; commitment and availability; board diversity

2. **Director roles and accountabilities:** balancing responsibility towards stakeholders; division of roles between board and management

3. **Board structure, processes and protocols:** recommended committees; size and frequency of meetings

4. **Delivering on the roles of the board:** strategy development; risk management; performance and talent management; capital markets

5. **Effective board dynamics:** preparation; participation; decision-making; implementation and follow-up

6. **Board evaluation and renewal:** self-evaluation

Methodology

A survey was conducted targeting regional board members and senior company executives to build a clear picture of current board composition, structure and processes in the region as well as perceptions of board efficiency.

Follow-up interviews were conducted to examine further corporate governance practices in the GCC. The interviewees included board directors, board secretaries, managing directors, CEOs, CFOs, general managers, vice presidents and chairmen. Where possible, comparisons have been made internationally using as a principal resource the European Corporate Governance Report 2011 compiled by Heidrick Struggles.

Board effectiveness can be appreciated by any company stakeholder as a critical element to managing operations and growth. The GCC region's ambitions to develop itself and its standards of business are evident in the successes of each country's growth over recent years coupled with the individual successes of companies and organisations particularly amid global economic turmoil.

However, the topic of board effectiveness still does not resonate among the number of senior executives and directors as it should or might be perceived to be. The sought after sample size for this year's survey totalled in the thousands with an aggressive strategy on BDI's behalf to target the largest pool of senior executives and directors possible to gauge board effectiveness in the region. The less than staggering response rate relative to the total pool of respondents in itself evidences the secondary notion board effectiveness and its region-wide development may hold in the minds of these executives and directors across the GCC. Nonetheless, critical input and opinions of our sample pool has allowed regional board effectiveness to be again examined with key progress points in the medium identified amid growth and development of the GCC over recent years.

APPROACH

The split of respondents as shown in Exhibit 1 illustrates that the most support for the survey originated from Saudi Arabia with 52.5 per cent of respondents based out of the kingdom followed by 21.3 per cent from UAE-based directors and executives. Bahrain, Kuwait, and Qatar followed with 9.8, 9.8, and 6.6 per cent respondent contributions to the total survey pool, respectively. The majority contribution to this survey from Saudi Arabia and the UAE can be interpreted as a highly positive sign in light of their positions as the leading economies and business hubs of the GCC, and the fact that most regional companies have established a base in one of the two countries. Significant input from directors in these countries will ultimately facilitate continued investor confidence in these geographies, which is expected to align well with the robust growth and strong investment each is experiencing.

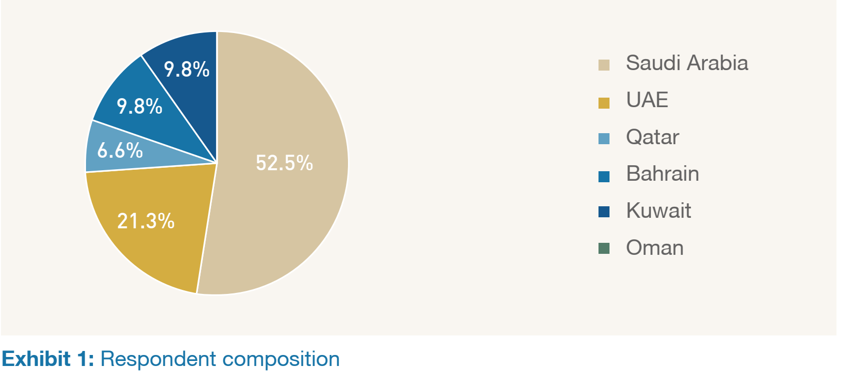

Exhibit 1: Respondent composition

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Transparency & Disclosure

With reference to Exhibit 2, disclosure in the form of published annual reports available to the public or on request has improved, evidenced by a 56.7 per cent disclosure rate of this year's survey respondents, a 14.2 percentage point growth over 2011.

The key cited reasons behind the lack of publically available annual reports were several, with the primary reason being that the respondent companies were privately held. Other reasons included recent company formation or small company size which, in the opinion of the respondents, does not warrant an annual report for the time being.

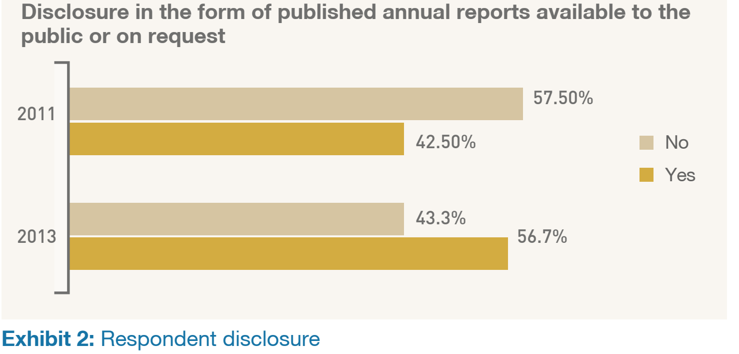


Exhibit 2: Respondent disclosure


CLUB

BOARD COMPOSITION AND DIRECTORS' CAPABILITIES

1

1 BOARD COMPOSITION AND DIRECTORS' CAPABILITIES

In each of the two previous BDI surveys, board composition and directors' capabilities were found to be the main obstacles to effective corporate governance. Despite improvements in several key areas since the last report was published in 2011, this year's survey confirms that boards across the GCC are still being impeded by inadequate skills of directors and ineffective board composition.

Knowledge and expertise

There continues to be a strong recognition of the need to develop the knowledge and expertise of boards in the region, and the idea of replacing ineffective board members has become increasingly palatable since the first survey was conducted in 2009 as shown in Exhibit 3. This is an important development for a region where business and family are often intertwined.

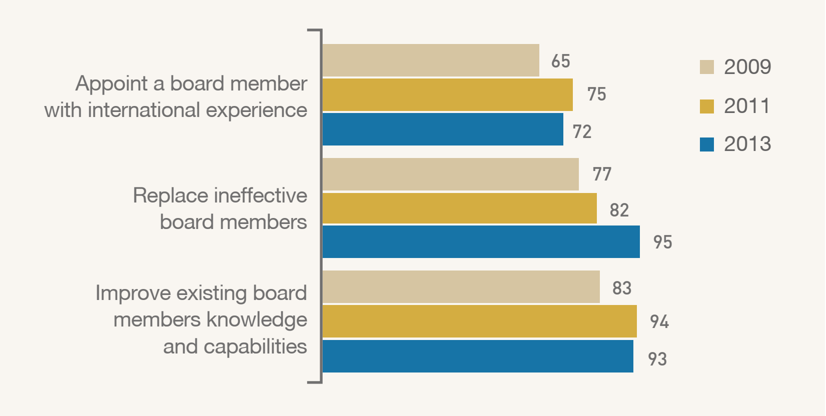


Exhibit 3: Levers for improving board composition, %

It is believed the single best way to improve boards is through access to global best practices and benchmarks. This particularly applies to the areas of essential governance and compliance, and talent and performance management as evidenced in Exhibit 4.

“We must constantly challenge ourselves to improve the skills, knowledge, and capabilities we bring to the Board”

Exhibit 4: Areas requiring strenthening on GCC boards, %

With regards to essential governance and compliance, additional ways for improvement include making presentations to local vocational groups and supporting corporate social responsibility. Regional directors feel that boards work predominantly in a way that does not “re-invent the wheel”. Innovative thinking has been identified as crucial to future governance and compliance development bolstered further by cooperation among and between regional directors.

BOARD COMPOSITION AND DIRECTORS' CAPABILITIES

With regards to further improving performance management, regional directors cited the importance of planning and tracking the implementation of key decisions and strategies through the use of dashboards and Key Performance Indicators (KPIs). The emphasis on tracking company performance and strategy realisation progression through KPIs is underpinned by a company's ability to gain an understanding of its proven capabilities and achievements as well as those of its peer group competitors all the while keeping in mind the limitations and constraints of the markets in which it operates. Subsequent rewards to employees and the empowerment of staff should follow when building an environment conducive for high performance and aggressive growth.

With regards to additional methods that can be considered to improve talent management, regional directors have cited attendance of regional HR & Human Capital conferences as important. A corporate programme aimed at attracting young talent to companies has also been identified as being another way to enhance a company's talent management.

It is also important for regional companies to coach their talent pool and conduct regular performance reviews and 360 degree feedback to ensure open communication about development requirements at all levels of the organisation.

When it comes to strengthening industry and sector knowledge, a strong understanding of customer drivers, trends and competitive conditions are seen as most important, followed by networking opportunities with regional and international peers. Regular participation in sector-related workshops is considered crucial to raising functional knowledge, while boards could also benefit from their members having greater involvement in the community, joining societies and professional bodies and working with vocational groups.

With regards to additional methods that can enhance regional board functional knowledge, regional directors cited becoming members of professional bodies, continuous and flexible education programmes as well as workshops as means for continued development.

Commitment and availability

Generally, it is believed that the size of boards in the region is effective and the tenure of board members is adequate enough to ensure accountability (see Exhibit 5). But there is a strong feeling that board members are not rotating at an adequate rate to allow new talent to join and that processes for nominating and appointing new members could be better.

Exhibit 5: Board size and dynamic consensus, %

As shown in Exhibit 6, cross-board representation is wide-spread in the region, with a third of respondents sitting on 3-5 boards, while 13 per cent of those surveyed sit on more than five boards, and several sit on up to nine boards. By comparison, the number of board members sitting on 5 or more boards was 9 per cent and 33 per cent in 2011 and 2009, respectively. This year, 29 per cent said they sat on just one board. The trend for board members to sit on fewer boards is a positive development for the region as it should decrease the potential for conflict of interest between boards and also increase the amount of time that board members can devote to an individual board.

BOARD COMPOSITION AND DIRECTORS' CAPABILITIES

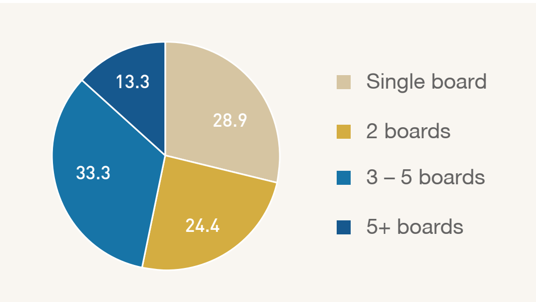


Exhibit 6: How many boards do you sit on?, %

> **"We are becoming more international – meaning our board members have to become more international as well"**

International expertise and board diversity

The average board in the GCC has six directors, with 2 independent directors* and an estimated 4 non-executive directors. This is well below the European average of 12 directors per board, according to the European Corporate Governance Report 2011 compiled by Heidrick & Struggles. But as in Europe, the number of board members varies widely between companies with some having as many as 10 and others as few as one or two. Generally, smaller board sizes are seen in privately-held companies, which do not have to comply with capital market regulations. A significant 67 per cent of those surveyed believe the number of independent board members is sufficient to ensure board independence as shown in Exhibit 7, and a third were themselves independent board members in line with regional regulations stating that boards of publically listed companies should comprise at least 2 to 3 independent members or independent directors should comprise a third of the boards members.

***Definition of Director Types**

• Independent Director: A member of a board of directors who does not have a material or pecuniary relationship with company or related persons, except sitting fees. Independent directors typically do not own shares in the company.

• Non-Executive Director: A member of a board of directors who does not have a full-time management position at the company, or who does not receive monthly or yearly salary

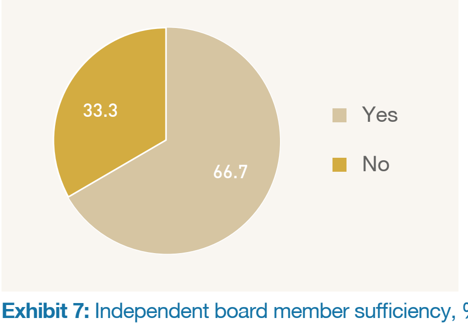


Exhibit 7: Independent board member sufficiency, %

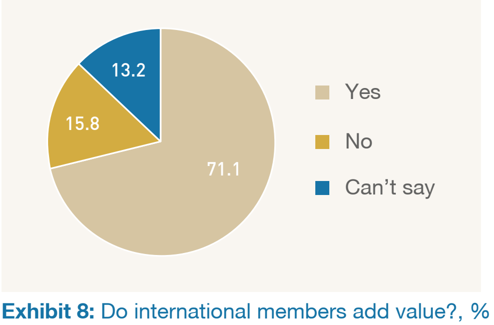


Exhibit 8: Do international members add value?, %

Those directors who felt the number of independents on their boards was insufficient said 1 or 2 additional independent members would be required. The general consensus was that 1 out of every 3 board members should be independent. There is considerable and increasing support for appointing members from outside the GCC as shown in Exhibit 8 and 9, with 71 per cent believing that non-nationals add value to the board, both in assisting overseas diversification and enhancing corporate governance, compared with 40 per cent in 2011.

Respondents said international board members bring more formality to the table, enhancing discussions and preparations for meetings. Remuneration is believed to have the main influence when it comes to attracting international board members to regional boards rather than exposure. Despite the benefits of international members, some boards are still not open to this and in some countries regulations still limit their involvement.

Exhibit 9: Why international members add value?, %

In contrast to the wide-spread support for the internationalisation of boards, gender diversity is absent. Women continue to be under-represented on GCC boards, averaging less than 1 per cent, similar to the 2011 figure. Social and religious traditions of the Arab world mean that the number of female directors will continue to remain low and the imposition of quotas to promote gender diversity on boards by governments as seen elsewhere in the world is unlikely any time soon.

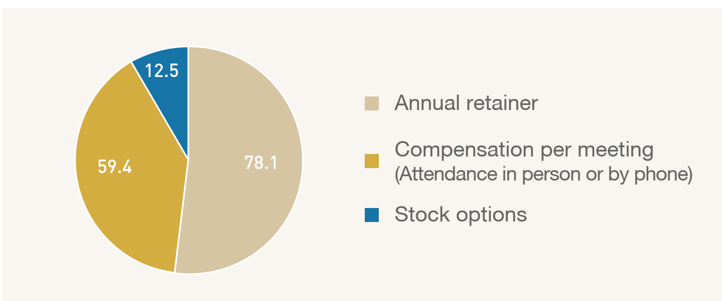


Exhibit 10: Remuneration schemes, %

“We need more workshops to get more knowledge in specific areas, new rules and regulations, we need to be aware of ”

The average remuneration for board members is $99,000 and this is generally paid on an annual retainer with compensation per meeting. As shown in Exhibit 10, stock options are less commonly used in the GCC, but it is felt they could help attract international board members. Performance-based remuneration and monthly instalment schemes have also been cited as additional modes of board compensation in the region. Average remuneration has fallen sharply since the last survey and is linked to the fallout from the global financial crisis, which has seen corporates look to reduce overheads. This is in line with global trends. Average remuneration in Europe according to the European Corporate Governance Report 2011 compiled by Heidrick & Struggles has fallen by 4 per cent in recent years. The lower average compensation this year is also a reflection of the preponderance of Saudi companies in the survey, where remuneration caps exist for local board members.






DIRECTORS' ROLES AND RESPONSIBILITIES

2

2 DIRECTORS' ROLES AND RESPONSIBILITIES

Some 57 per cent of those surveyed felt board members are more aware of their roles and responsibilities today than in 2011. This was variously attributed to greater emphasis on and awareness of good corporate governance, both within the company and across the region, together with better training and participation in international meetings and workshops, and increased enforcement and accountability. In one example, compensation was directly linked to performance.

But a significant number feel there has been no improvement in this area and that barriers to effective definition of board roles and responsibilities remain. As with the 2011 survey, inadequate skills and composition of the board were identified as the biggest hindrances as shown in Exhibit 11. Other identified barriers to effective definition of board roles and responsibilities include the ability to replace board members and lack of industry experience.

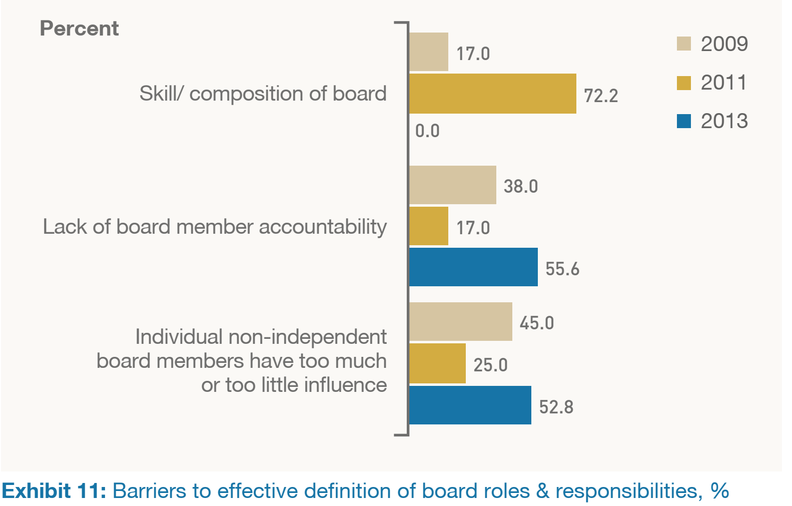


Exhibit 11: Barriers to effective definition of board roles & responsibilities, %

“Board assignments are not huge privileges [...] but rather huge responsibilities that need to be taken seriously”

GCC boards are however adopting a more balanced approach towards their duties and responsibilities, with less of an overt bias towards protecting the interests of appointing shareholders and majority shareholders as seen in Exhibit 12.

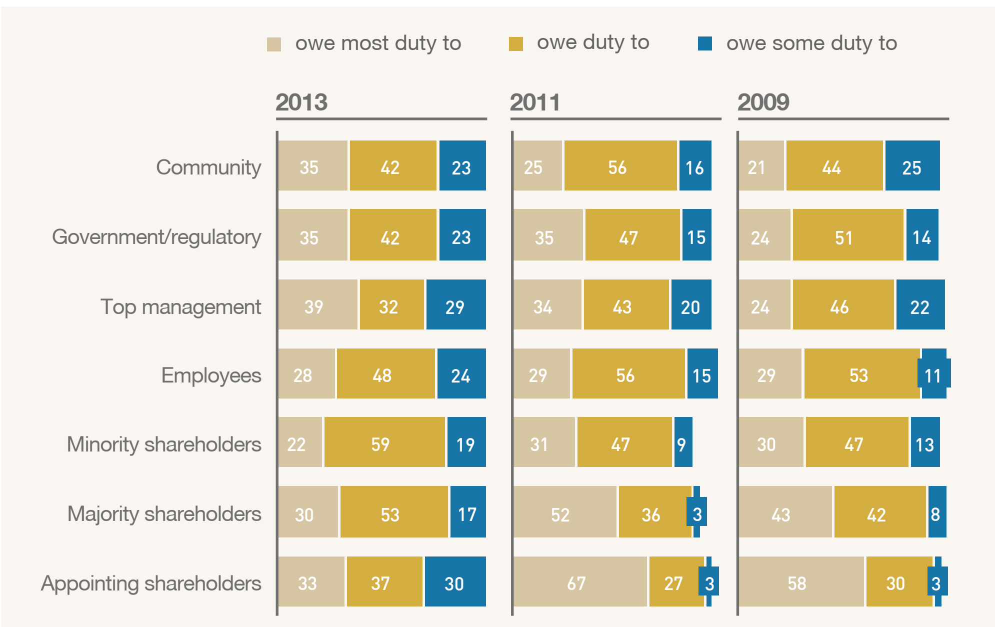


Exhibit 12: Level of board member responsibility towards stakeholders, %

DIRECTORS' ROLES AND RESPONSIBILITIES

There is much greater certainty over the relationship between the roles and responsibilities of the board versus those of senior management, with 83 per cent agreeing or strongly agreeing that there is a clear distinction (see Exhibit 13). This compares to 48 per cent in 2011 and 68 per cent in 2009.

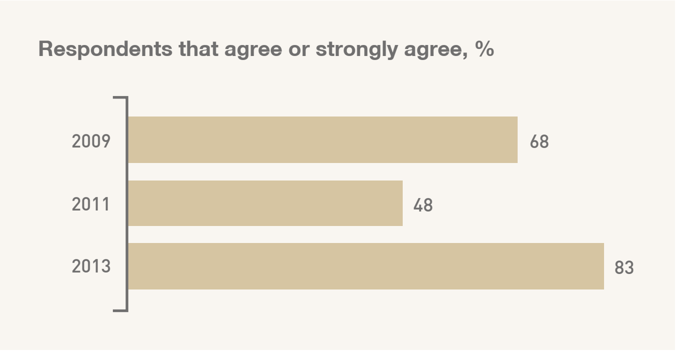


Exhibit 13: Clear distinction between the roles and responsibilities of the board versus those of senior management

These figures suggest that in the wake of the 2008 global economic crisis, regional boards have taken the necessary steps to better define executive and board member roles and the responsibilities that come with each. Boards now are emphasising more than ever that corporate success and failure traces back to individual accountability and responsibilities.

More ambiguous is whether the chairman of the board plays an active role in the day-to-day operations of the company, with few prepared to assess one way or the other the precise level of involvement as shown in Exhibit 14. What can be said of the figures in Exhibit 14 is that chairmen grew to be more involved in the affairs of their boards and the company in the wake of the global financial crisis and regional aftermath to either rectify company underperformance or ensure the proper governance, policies, and strategy were set to avoid weaker performance in an uncertain economic climate.This is evidenced by an increase in consensus that board chairmen were more active in 2011. This has since subsided in 2013 although not significantly as regional board chairmen seem to maintain clear supervision of corporate governance and daily operations.

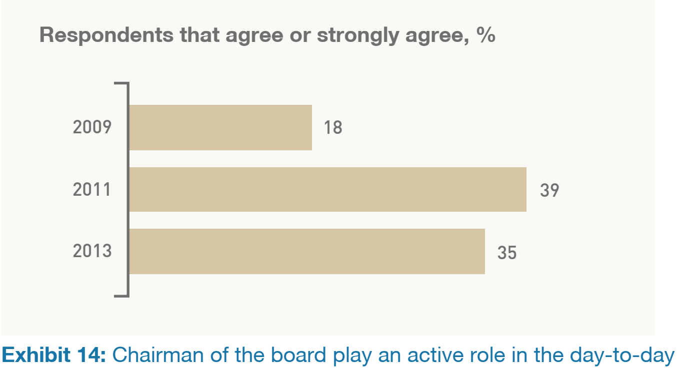


Exhibit 14: Chairman of the board play an active role in the day-to-day operations of the company






BOARD STRUCTURE, PROCESSES AND PROTOCOLS

3

3 BOARD STRUCTURE, PROCESSES AND PROTOCOLS

On average, GCC boards have three committees, in line with the 2011 European average as referenced by the European Corporate Governance Report 2011 compiled by Heidrick & Struggles. The most prevalent committees are audit and remuneration committees and this fits with global best practices. As illustrated in Exhibit 15, nearly all (93 per cent) said their boards had an audit committee, while 73 per cent said they had a remuneration committee and 60 per cent have nomination committees. They each have an average of two non-independent and two-independent committee members. It is broadly felt that the frequency of each board committee meeting is adequate. The trend in the GCC indicates that across standard board committees non-independent directors prevail. That being said, regional boards may not be effectively protected against the influence of interests in the company. This should be a priority in committees looking to protect the interests of company shareholders at large including Audit Committees, Remuneration Committees and Ethics Committees.

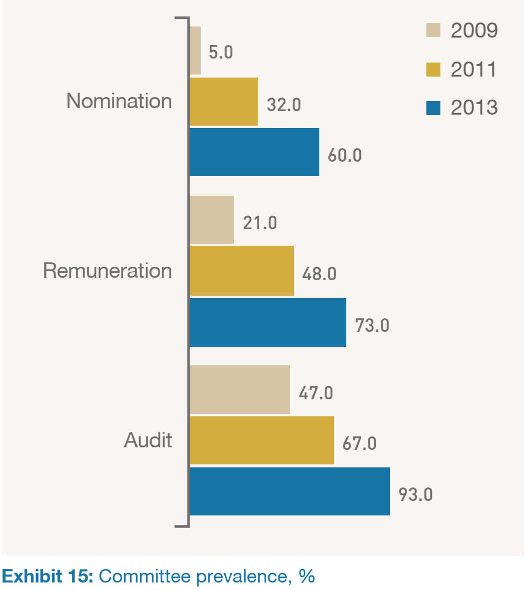


Exhibit 15: Committee prevalence, %

> **"Committees are a must as long as they are properly identified and have defined roles and responsibilities"**

As illustrated in Exhibit 16, independent chairmen are most prevalent on remuneration and audit committees with 50 per cent of respondents saying the heads of these committees are independent from the company. This is in line with the majority of regional governance codes that stipulate these committees in publically listed companies in the Gulf should be chaired by an independent director. Independent chairs are seen least frequently on strategy committees in the GCC. This can largely be explained by the need for the company strategy meetings to be led by a member of the company or by an individual with an intimate knowledge of the company, its day-to-day operations, and its strategic foundations and direction. Likewise, there are few risk committees led by independent chairs as these benefit from leadership by someone with vested interests in the company who will take additional care to identify risks to the business and mitigate any threats, thereby protecting the company's and their own interests.

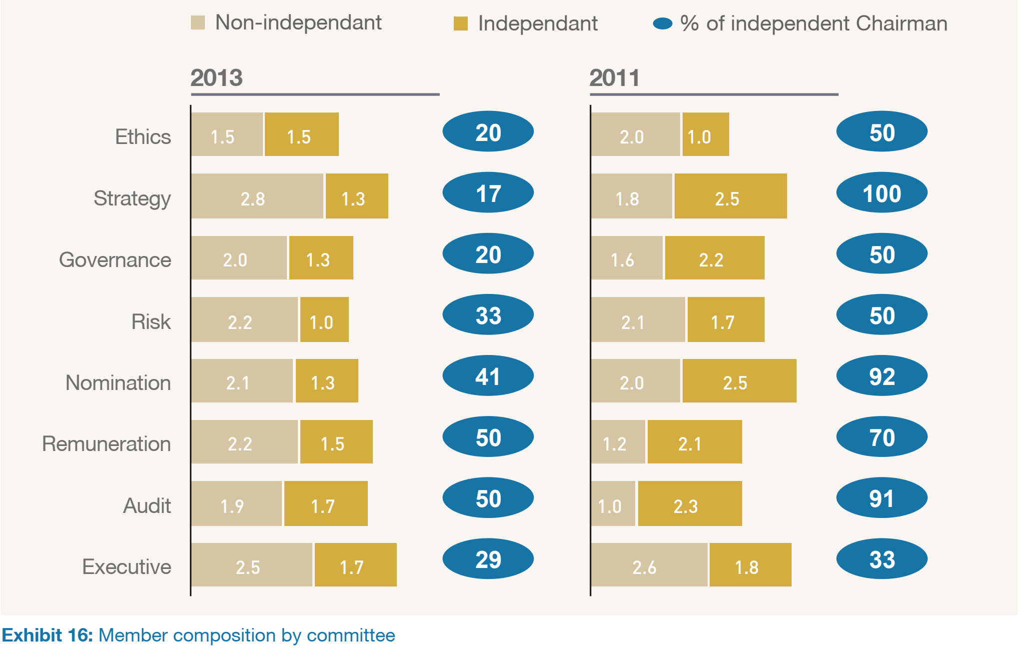


Exhibit 16: Member composition by committee

BOARD STRUCTURE, PROCESSES AND PROTOCOLS

Average committee meeting attendance for regional boards is high at 92 per cent. According to Exhibit 18, strategy committees have the highest average attendance, while risk committees have the lowest average attendance at 87 per cent. Average attendance rates have improved steadily since the first BDI survey, from 82 per cent in 2009 and 88 per cent in 2011.

As shown in Exhibit 17, executive committees meetings are held most frequently, with an average of 6.1 meetings a year. The high frequency of executive committee meetings in the region suggests that the executive committee may be becoming too involved in company operations, which may serve to undermine the role and input of the larger board of directors. Audit and risk committees follow as the second and third most frequently held meetings, at 3.6 and 3.5 a year respectively. Some 70 per cent of respondents say that executive committees play a significant role in the effective management of companies.

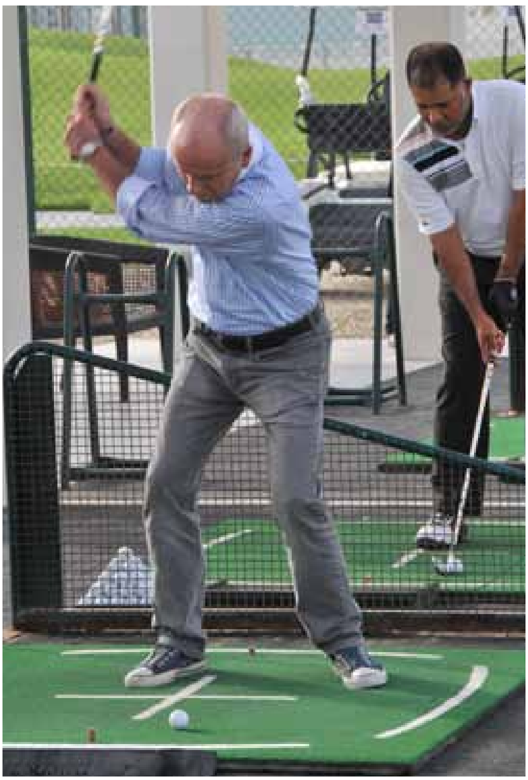
Exhibit 17: Committee annual meeting frequency, %

Exhibit 18: Committee meeting attendance, %

An examination of the codes of corporate governance in the GCC shows that clear directives on the frequency of board meetings are still lacking in some countries. The UAE and Qatar require a minimum of 6 board meetings a year as well as a minimum of 4 annual audit committee meetings, while Kuwait requires the boards of its publically listed companies to convene at least 2 to 3 times a year, with their audit committees required to meet at least 4 times annually. Oman requires the boards of its listed companies to convene at least 4 times a year with its audit committee required to do the same. Saudi Arabia and Bahrain on the other hand do not impose minimum frequencies for board meetings on its publically listed companies. Bahrain does, however, specify that audit committees should meet at least once a year.

"Board members do not know their limit of authority and responsibilities... There is no definition on the role of the directors"



DELIVERING ON ROLES OF THE BOARD

4

4 DELIVERING ON ROLES OF THE BOARD

With reference to Exhibit 19, regional directors say that the majority of board time is spent working on strategy, approvals and performance management. However, most boards still spend less than 50 per cent of their time on the aforementioned activities. Respondents would like to see boards devote more time on strategy development, talent management and ensuring the integrity of accounting and financial reports to facilitate more sound decision making as illustrated in Exhibit 20. There is also a desire to see more time spent on risk management, nomination processes and communication with shareholders and less emphasis on budget approvals and capital expenditure.

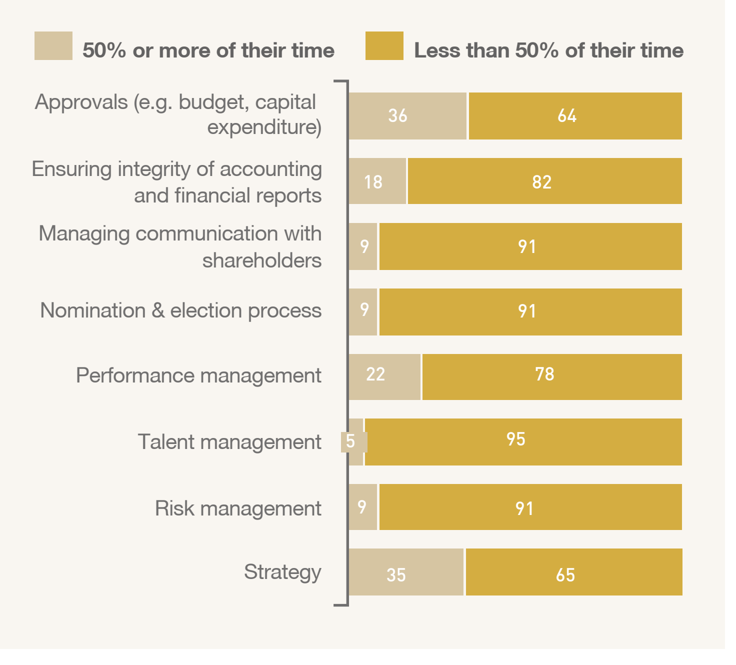


Exhibit 19: Current time distribution by activity, %

Exhibit 20: Desired time distribution by activity, %

The areas where boards are assessed as most effective is strategy, budget and capital expenditure approvals, and in ensuring the integrity of accounting and financial reports. The majority of regional board members believe that their respective companies have the right strategy in place and 50 per cent of respondents believe that their companies' KPIs are clearly defined and tracked. The difference of respondents who believe their company does not have the right strategic direction in place can be potentially explained by the lack of confidence given by interviewees who stated that their boards are mostly engaged in discussing short-term issues and reviewing monthly/quarterly performance figures, rather than debating longer term strategies. Many companies lack a coherent mid-to-long term strategy, having fallen into the habit of focusing on imminent targets. This is clearly an area that should be given attention as both the board and company would benefit from adopting a longer term view.

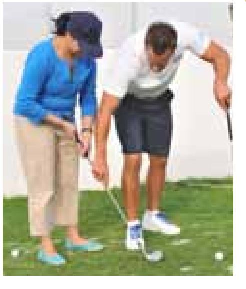
DELIVERING ON ROLES OF THE BOARD

Low effectiveness was reported in management of risk and talent, managing communication with shareholders and nomination and election processes, with 50 per cent of respondents believing that their boards do not monitor key risks regularly.

When it comes to talent management, 57 per cent of respondents said boards are not effectively involved in this area. It is generally felt that boards lack clear and proactive plans for developing and retaining senior management figures and do not have well documented process for succession planning for critical positions. Despite this, of those who felt boards are effectively involved in talent management, only 36 per cent said the board spends sufficient time discussing talent management issues. This is perhaps an indication of those discussions lacking structure and resolutions.

"We need to manage the effectiveness of the board, there needs to be a mechanism to do this."

“It’s a job of management to go out and deliver, and for the board to hold the executive management accountable for that delivery.”



The reverse was true for time spent discussing capital markets, with 32 per cent saying insufficient time was devoted to this and 26 per cent saying it was enough. Less than half said the board was effectively involved in managing capital market expectations. The reason for this appears to be a lack of clear understanding of capital markets among board members themselves, with a third of those surveyed saying the board were unaware of analysts’ views on the company's stock price.

Despite this, there is a high level of confidence in board disclosure and integrity of financial accounting and reporting systems, with two-thirds agreeing or strongly agreeing that boards spend sufficient time on this and offer best-in-class disclosure of information to shareholders in accordance with global standards.

5

EFFECTIVE BOARD DYNAMICS

5 EFFECTIVE BOARD DYNAMICS

"It is unfortunate that the vast majority of board members are reluctant to voice their opinion openly and to engage in debate"

There has been an increase in the level of satisfaction with the preparation for and participation in board meetings since the last BDI report. However, there is further room for improvement in engagement in board meetings.

Of the board members surveyed 61 per cent agreed or strongly agreed that all members participate in meetings, but more than a quarter felt this to be untrue as evidenced in Exhibit 21.

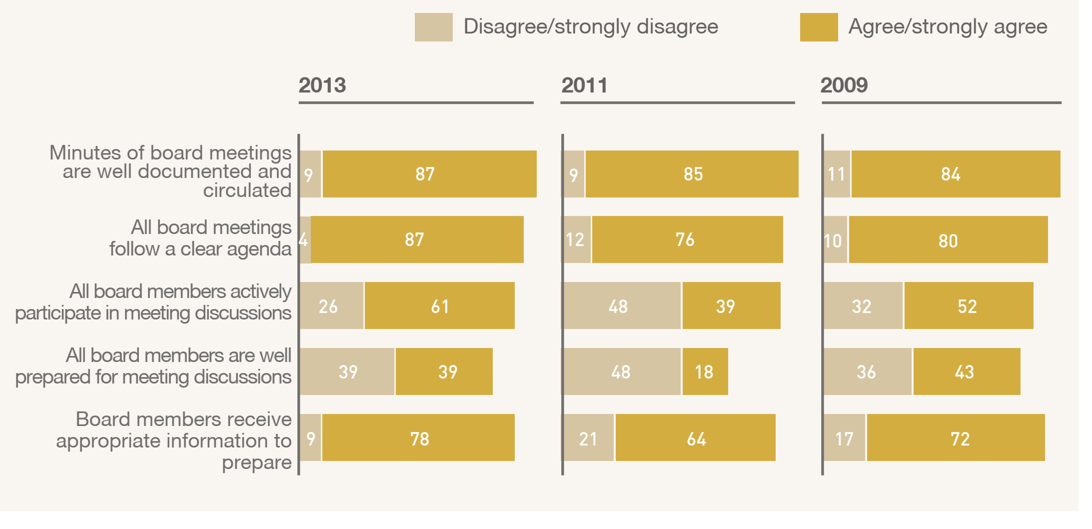


Exhibit 21: Board effectiveness across the five elements of meeting dynamics, %

The reluctance of some board members to participate can possibly be attributed to their levels of preparedness. Although it is largely felt board members receive appropriate information to prepare for meetings and these meetings follow a clear agenda, 39 per cent still feel some board members are ill-prepared for meetings. This could be down to certain individuals failing to making good use of the materials provided to them and ties in with the increased appetite for replacing ineffective board members.

Some board members still want more information to be made available to them, in particular strategic information about the company and general industry information and trends as illustrated in Exhibit 22. Better informed board members can only improve board dynamics and assist effective decision-making.

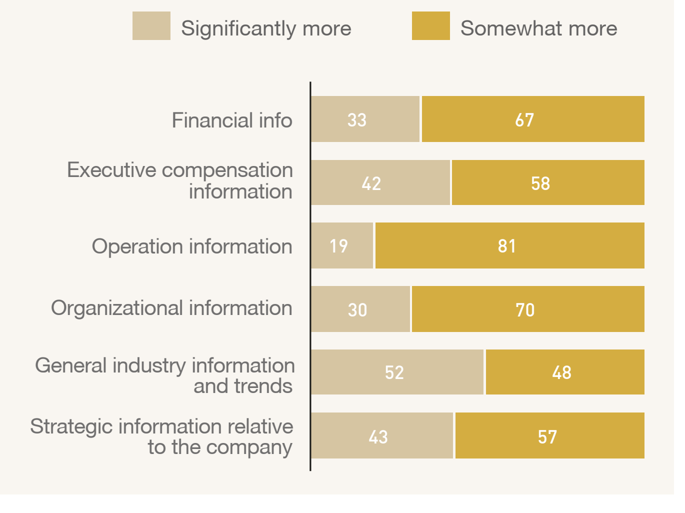


Exhibit 22: Type of information you want to receive more of in the future, %

EFFECTIVE BOARD DYNAMICS

Decision-making processes

There is generally a high level of satisfaction with the ability of boards to make decisions. More than 75 per cent of those surveyed said they believe decision-making at board meetings is effective. A similar number agreed or strongly agreed that board decisions are implemented effectively with clearly defined accountability. In the event of a consensus not being achieved in the first round of boardroom discussions, debating mostly continues until an agreement is reached. Less often does the chairman make a unilateral decision or a vote is held. In some boards it is customary when consensus cannot be achieved to form a subcommittee to study the issue or turn to an advisory body. An area that could benefit from improvement is in the follow-up procedures to ensure board decisions are implemented – 26 per cent felt them to be ineffective.

> **"The main barrier for board members to prepare effectively is simply the amount of time they have, given they are often sitting on several boards in addition to any executive responsibility"**

"The role of a chairman is really to facilitate that meeting, to allow everybody to have the discussion. To give that opportunity for the right members who have the expertise in the field to enrich the discussion with different opinions"

6 BOARD EVALUATION AND RENEWAL

6 BOARD EVALUATION AND RENEWAL

There has been an increase in the number of boards conducting a self-evaluation process as shown in Exhibit 23, with 16 per cent of board members surveyed reporting having a formal evaluation process conducted on their board, compared with 9 per cent in 2011. This can be interpreted as a sign of corporates learning the lessons of the financial crisis and the need for increased integrity and scrutiny. One interviewee from a privately-owned company said “we are taking evaluation much more seriously now.”

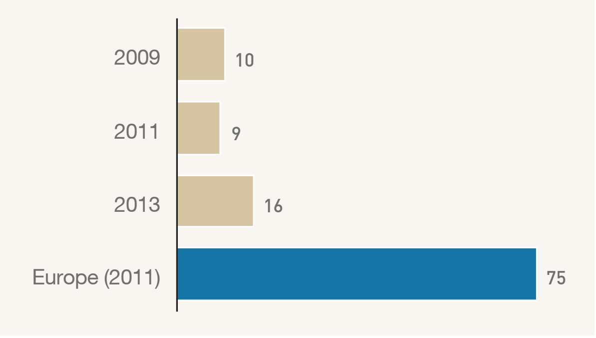


Exhibit 23: Share of boards conducting a formal evaluation process, %

But with 84 per cent still not having such procedures in place, board evaluation and renewal continues to be an area requiring improvement in the GCC. In Europe, 75 per cent of boards undertake an evaluation, according to the European Corporate Governance Report 2011 compiled by Heidrick & Struggles.

As shown in Exhibit 24, it is felt the board evaluation process should entail a review of fundamental board duties (such as attendance rates and actively participating in board discussions), the quality of interaction and personal contribution of directors on the board and a review of the structure and composition of the board along with assessment of strategy engagement and understanding.

"All the committees do a self-assessment once a year , it's part of the board performance review process"

"No one can tell us how we as management are doing"

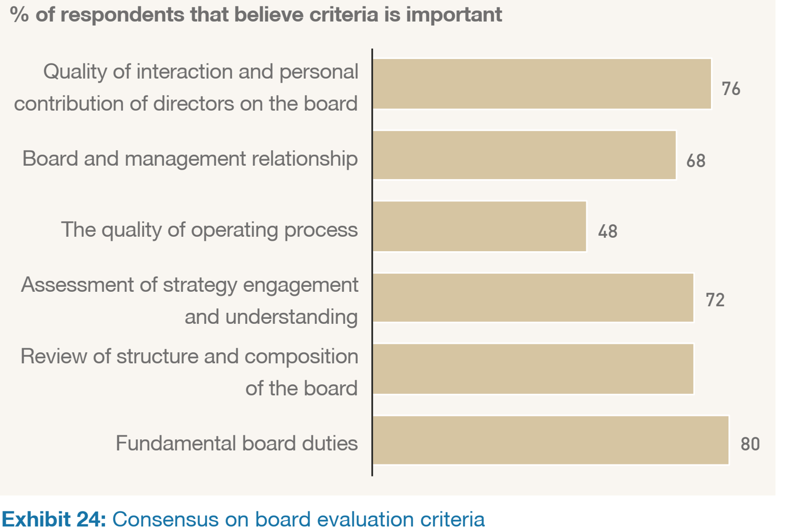


Exhibit 24: Consensus on board evaluation criteria

At present, board evaluations mostly consider the board's performance as a whole in addition to the performance and contribution of individual directors. As self-evaluation becomes more common-place in the region, certain other considerations will come into play to improve the quality of the process, such as the frequency of evaluations and whether they should be conducted internally or externally.

CONCLUSIONS AND RECOMMENDATIONS

As in the previous two BDI surveys, issues relating to board composition and directors' capabilities are seen as the principal barriers to board effectiveness in the GCC, along with the absence of formal evaluation and renewal processes as shown in Exhibit 25. Other significant impediments to the performance of boards were cited as ineffective board dynamics and director roles and accountability issues.

Difficulties in delivering against the roles of the board and ineffective structure, process and protocols were once again not seen as major issues in the region, supported by a general feeling that board sizes and the number and frequency of committee meetings is adequate.

Since the last survey, there has been a concerted attempt to address the main barriers to board effectiveness and although the number of firms conducting self-evaluation continues to be low, there has been an improvement in this area, however, the potential for further improvement remains.

The perceived areas of ineffectiveness mostly relate to the under-performance of individual board members and while there is strong awareness of the need to develop the knowledge and expertise of boards in the region, such efforts would benefit from a more formal structure.

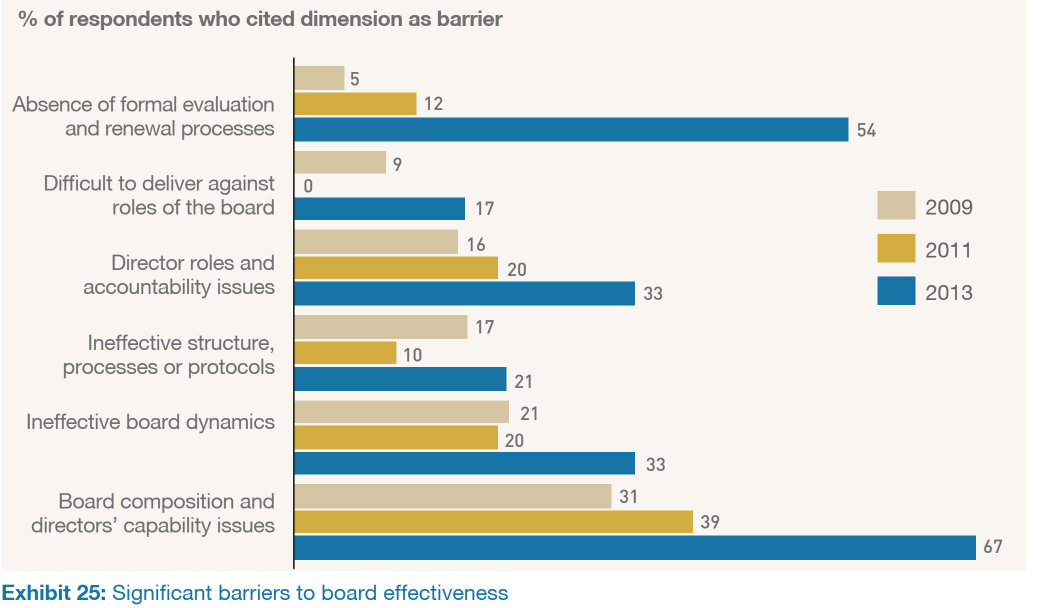


Exhibit 25: Significant barriers to board effectiveness

CONCLUSIONS AND RECOMMENDATIONS

The following recommendations would help boards address these shortcomings:

1. **Adopt global best practices and benchmark board performance against international peers**
   The GCC is a young and emerging region and by adopting global best practices, corporates can benefit from the experience of their international peers. Having an unbiased assessment of board effectiveness through benchmarking against international peers is the best way to highlight areas of weakness in regional corporate governance and where efforts to improve performance should be focused.

2. **Provide more training for board members and encourage membership of industry associations**
   With inadequate skills of board members seen as one of the main barriers to board effectiveness, a continual programme of training for directors is essential. This should take the form of participation in skills-focused or industry-focused regional and international meetings and workshops. Board members should also be encouraged to join societies and professional bodies and to work with vocational groups.

3. **Replace ineffective board members and rotate board members more frequently**
   As greater demands are made of boards and more responsibilities given to them, they are less able to carry ineffective board members. If training fails to improve their performance, where possible ineffective board members should be replaced. In practice, this can be difficult in the GCC, where business and family are often intertwined. But there are precedents and by emphasising the detrimental impact the lack of engagement among board members can have on a company's performance, ineffective family members may be helped to understand the benefits of standing down.

4. **Appoint more international and independent board members**
   Boards stand to gain much from having international and independent directors. International members can bring more formality to the table, enhance discussions by offering fresh perspectives and share global best practice. Likewise, independent board members are more dispassionate and better able to see the wider context of a situation as they do not have a vested interest in the company.

5. **Define better the role of the chairman**
   The chairman of the board is the single most important position on a board and should be a highly dynamic and effective member that leads by example and steers board decision-making. As such, the chairman should play an active part in the governance of the company. The responsibilities of the chairman should be clearly defined so that it is evident that it is not just a ceremonial position, but a role that requires commitment, preparation and diligence.

6. **Encourage board members to prepare for meetings by continuing to provide materials that are clear and easily digestible**
   Adequate and appropriate materials should be provided to directors to enable them to prepare well for committee meetings, but care should also be taken to ensure members are not overwhelmed with information. The essential details and facts should be presented clearly and succinctly with additional material for those with the time and diligence to read further. In this way, there can be no excuse for board members being ill-prepared for meetings.

7. **Seek greater board engagement in devising company strategies and visions**
An effective board needs to believe in the strategic direction of its company. Early involvement in drawing up business priorities is important to securing the buy-in of directors. This should be done through regular presentations from senior management to the board to keep members informed and to seek their feedback and input. Offsite strategy days away from the distractions of the day-to-day business are often found to be highly effective.

8. **Devote more board time to talent management and establish clear processes for retaining senior management and succession planning for critical positions**
In the present day, changing companies regularly is seen as important for gaining broader experience, personal development and career progression, so boards need to be prepared. Procedures for retaining senior management need to be reviewed periodically to ensure continued professional development and to ensure remuneration remains attractive. Discussion of career aspirations should form a core part of performance appraisals so that succession planning can begin early. Notice periods for critical positions need to be sufficiently long to make sure a vacuum is not left at the top that stalls decision-making.

9. **Make evaluation of board's performance mandatory**
To improve board effectiveness an evaluation is essential. Such processes highlight areas of strength to be further developed and areas of weakness to be remediated. A formal evaluation procedure should assess the performance of the board as a whole, as well as individual contributions. Measurable targets such as attendance at committee meetings should be set at the start of the financial year and evaluated at key points throughout the year.

10. **Develop robust follow-up procedures to ensure board decisions are implemented**
Many hours of board members' time are spent debating issues and seeking consensus decisions. That time is wasted if rigorous follow-up procedures are not in place. Every decision taken by the board should be accompanied by action points with a board member nominated as responsible for implementation and follow-up. The minutes of meetings should record these and progress updates should be on the agenda of subsequent committee meetings.

ABOUT THE GCC BOARD DIRECTORS INSTITUTE

The GCC Board Directors Institute (BDI) is a not-for-profit initiative launched by a combination of large corporations and professional advisory firms and has the support of regional regulatory authorities. It is dedicated to making a positive impact on the economies and societies of the region by promoting professional directorship and raising the level of board effectiveness. BDI works towards its vision through four mission objectives:

- **Building board member capabilities**
  - Enhancing the understanding of best practice board governance and board responsibilities
  - Facilitating pragmatic experience sharing among members of regional and international boards

- **Creating a regional network of board members**
  - Providing venues and opportunities for networking between regional board members, professional advisors, senior executives and regulatory experts
  - Supporting regular exchange of speakers and connections to similar initiatives in different parts of the globe

- **Disseminating high quality corporate governance knowledge**
  - Developing proprietary regional corporate governance content
  - Facilitating the sharing of corporate governance best practices

- **Leading the regional debate on emerging best governance practices**
  - Putting corporate and board governance higher on the region's agenda
  - Providing a collective voice for its membership among the region's leadership, policymakers and lawmakers on governance regulation

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