Lagging Corporate Governance Still The Achilles' Heel Of Gulf Companies

Article by: S&P Global Ratings

Corporate governance continues to be a critical weakness of companies in the Gulf. Yet, corporations in the region recognize that strengthening their management and governance practices could improve their access to capital markets and cut the cost of raising debt.

S&P Global Ratings' management and governance (M&G) scores, which are among the factors they use to determine their credit ratings, suggest that governance standards among companies rated in GCC countries still lag those of corporations globally. Just 6% of the GCC corporations rate have strong M&G scores, the highest of four categories, compared with 9% in Europe, the Middle East, and Africa as a whole. GCC corporates' M&G governance standards are clearly lagging behind global peers' at the same rating level.

Corporate governance among Gulf companies is relatively weak in a global comparison, according to S&R Global Rating.
· They believe Gulf companies' main corporate governance weaknesses are a lack of independence of the board, insufficient oversight and scrutiny of key enterprise risks, and weak transparency and disclosure practices.
· They think that regional shift in company cultures toward more transparency and disclosure will still take time

Lagging governance standards can deter international investors from looking for opportunities in the Gulf region. Potential investors face closely controlled company ownership, a general lack of transparency, and the vagaries of individual states' jurisdictions with respect to creditor protection. This leaves them open to the risk of weak management and, in extreme cases, fraud. Meanwhile, excess liquidity led some GCC GREs in the past to invest opportunistically in promising projects and investments at home and abroad, sometimes without adequately recognizing the risks involved. While sophistication is increasing and liquidity is currently constrained, the potential for underpricing of risk, resulting in market volatility and systemic risks, remains.

The main corporate governance weaknesses of Gulf companies are a lack of independence of the board, insufficient oversight and scrutiny of key enterprise risks, and weak transparency and disclosure practices.

Lack of independence for boards of directors
The boards of directors of GCC companies reflect their ownership structures, with a majority comprising family members or government representatives. The boards of holding companies in the region typically play less of an oversight and strategic role than those in Western Europe and other developed markets. As a result, the board's role is sometimes more representative than strategic. The board members are the ambassadors of the company and are used to gain influence and help capture opportunities, while investment and operating entities are run by their own experienced professional management teams. In some cases, however, the role of companies and their boards has evolved to become more aligned with structures in developed markets. They fulfill several functions

including strategy setting, risk management, and group internal control. They anticipate that this trend will continue in the future.

Weak transparency and disclosure

Disclosure is limited across GCC companies. Because the majority of the largest companies in the region are private, publicly available information is often limited. It is positive that companies generally prepare financial statements in accordance with international financial reporting standards. However, fully audited annual accounts and quarterly financial statements are not always publicly available, and only a select few companies organize quarterly investor calls, or otherwise provide detail and explanation to their financial performance.

Added to this, governance disclosure is most often limited to just the names of top management and board members. This makes it difficult for investors to assess how the board and management interact and how the decision-making process is handled. There is also lack of disclosure regarding direct and indirect ownership, making it difficult to know who controls a company.

According to S&P Global Rating believes that the combination of internal regional initiatives and external international investor pressures will improve disclosure levels and, more broadly, governance practices in the region to bring about a meaningful long-term change.

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