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Saudi Economic Development through Corporate Governance@ Vision 2030

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Abstract

The drive behind the Saudi transformational-economic plan is due to a variety of factors such as the drop in the crude oil prices in 2015-2016, OPEC's member's disagreement on reducing productions, the discovery of shale oil in North America…etc. In spite of the new changes on Saudi Arabia main oil- revenue generating mechanism, McKinsey's report of 2015 is suggesting that their proposed "productivity-led transformation model of the Saudi economy" is capable of: 1) diversifying the Saudi economy, 2) creating new productivity and growth venues, 3) doubling Saudi GDP, 4) inventing as many as six million new Saudi jobs by 2030. Moreover, such undertaking is estimated by McKinsey to cost $4 trillion in investments. In addition, McKinsey's report allegedly highlights eight existing sectors namely: mining & metals, petrochemicals, manufacturing, retail and wholesale trade, tourism and hospitality, health care, finance, and construction and Planning are capable of contributing more than 60 percent of the overall growth needed to double Saudi GDP by 2030. The study aims as well to review the most important criteria and different comprehensive principles of governance in light of the institutional framework that organizes its work nature & political, legal, institutional, privatization and cultural factors which might influence the implementation of Saudi vision of 2030. Consequently, This paper reviews the relationships between corporate governance (CG) and economic development in Saudi Arabia and presented descriptive analysis on the basis of secondary sources such as from Saudi Central Department of Statistics and Information & Saudi Ministry of Economy and concluded by identifying major policy recommendations and research issues that require further study.
Key words: *Corporate Governance, Cultural, Institutional, Legal, Privatization, Political factors and Saudi economy.*

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1. INTRODUCTION

The McKinsey report signifies the societal responsibility and accountability to accelerate and reach the desired goals of their "comprehensive model that integrates the Kingdom's economic, labor market, and public finance perspectives" via a collective effort. Not only that but the report also signifies the roles Saudi private companies and international companies can play in transforming the Saudi economy and "accelerate the Kingdom's modernization". In particular, the special corporate governance issues of banks, family-owned firms, and state-owned firms are not well understood; neither are the nature and determinants of public and private enforcement. Two decades ago, the term corporate governance meant little to all but a handful of scholars and shareholders. Today, it is a mainstream concern a staple of discussion in corporate boardrooms, academic roundtables, and policy think tanks worldwide. Several events are responsible for the heightened interest in corporate governance. During the wave of financial crises in 1998 in Russia, Asia, and Brazil, the behavior of the corporate sector affected entire economies, and deficiencies in corporate governance endangered the stability of the global financial system. Just three years later, confidence in the corporate sector was sapped by corporate governance scandals in the United States and Europe that triggered some of the largest insolvencies in history. And the most recent financial crisis has seen its share of corporate governance failures in financial institutions and corporations, leading to serious harm to the global economy, among other systemic consequences. In the aftermath of these events, economists, the corporate sector, and policymakers worldwide recognize the potential macro-economic, distributional and long-term consequences of weak corporate governance systems. The crises, however, are manifestations of several structural factors and under score why corporate governance has become even more central for economic development and society's well-being. The private, market-based investment process is now much more important for most economies than it used to be; that process needs to be underpinned by better corporate governance. With the size of firms increasing and the role of financial intermediaries and institutional investors growing, the mobilization of capital has increasingly become one step removed from the principal-owner. The allocation of capital has also become more complex as investment choices have multiplied with the opening up and liberalization of financial and real markets. Structural reforms, including price deregulation and increased competition, have broadened companies' exposure to market forces. These developments have made the monitoring of the uses of capital more complex in many ways, enhancing the need for good corporate governance.
The *International Finance Corporation (IFC)* defines corporate governance as "the structures and processes by which companies are directed and controlled. Good corporate governance helps companies operate more efficiently, improve access to capital, mitigate risk and safeguard against mismanagement. It makes companies more accountable and transparent to investors and gives them the tools to respond to stakeholder concerns. Corporate governance also contributes to development. Increased access to capital encourages new investments, boosts economic growth, and provides employment opportunities."

2. IMPORTANCE OF THE STUDY

The corporate governance concept has a great importance due to the financial declines and economic crises which several states have witnessed in the money markets and corporations located in a number of states in East Asia, Latin America and Russia during the 1990s of the twentieth century. Governance can be defined as the corporations' rational governance through a group of laws, rules and bases that guarantee transparency and law enforcement. Furthermore, the US economy has lately witnessed financial and accounting declines and the world financial crisis of 2008-2009 whose one of its most important reasons is related to the lack of transparency and disclosure of the financial and accounting data of a number of corporations and economic units of the money markets.

3. NEED FOR THE STUDY

Saudi Arabia's Strategic vision 2030: the leaders, the public and those in charge of administering the corporations should possess long- term vision for good governance and development in parallel with the requirements of the development. There is a close relationship between good governance and economic development process. The good governance has become in its all dichotomies a main condition to achieving the continued development through creating the political, legal, economic and social circumstances necessary for liberating these human abilities and hence reinforcing the human welfare through eliminating poverty, creating job opportunities, preserving environment and elevating the position of women empowerment.

4. OBJECTIVE OF THE STUDY

- To review the literature of the corporate governance with reference to GCC economy
- To address the corporate governance structure & theoretical frame-work in Saudi towards Saudi vision 2030
- To address the Factors Influencing the CG Regime of Saudi Economy
- To address the economic development through corporate governance
- To offer suggestions for better implementation of the corporate governance

5. HYPOTHESIS

H0: There is a significant gap between the nature of capitalism and the crisis of control over the business in Saudi Arabia.

6. RESEARCH JUSTIFICATION

This study comprehensively addresses the knowledge gap by devising a conceptual framework, incorporating political, legal, institutional, privatization, and cultural factors, capable of unveiling the challenges vision 2030 might from a CG perspective. Hence, this framework will contribute to a greater understanding of the influence of McKinsey 2015 report on Saudi CG practice and propose corresponding resolutions to overcome potential challenges.

7. RESEARCH METHODOLOGY

The data has been gathered through secondary source i.e., reports, statistical abstracts, websites of OECD and other useful sources, reputed journals & newspapers and the present study is descriptive analysis in nature, for analysis, all the condensed data being presented in two-way tabular form with cross-sectional comparative analysis for drawing the inferences.

8. SCOPE OF THE STUDY

The scope of the present study is limited to economic development through corporate governance

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and its influencing factors for the conceptual frameworks stemming in Saudi from the literature reviewed.

9. Review of Literature

In order to clearly understand the gravity of the Economic Development through Corporate Governance with special reference to vision 2030 Saudi economy & CG topic, extensive reviews of various reports, working papers, dissertations and academic journals were reviewed on the political, legal, institutional, privatization and cultural factors to assess the challenges of vision 2030 from a CG perspective of Saudi, few of them have been listed here.

Al-Zahrani (2013), In Saudi Arabia, corporate governance is a newly introduced regime. Its set of CG principles was initially issued in 2006, after the first market crash in 2006, as such crash has signified the need for appropriate CG standards in Saudi Arabia. After the first and second market crashes in 2006 and 2008, adherence to CG principles was made obligatory in 2010.

Morland (2013) arguably views capitalism as striving on flows; hence, in the process, most of the humanitarian values escape as the focus is on production and efficiency rather than on the sovereignty of the workforce. Contestably, Morland views the outcome of that to be the enlargement of social classes leading to a confrontation with the problems of inequality, disenfranchisement, and poverty.

Addressed by **Al-Zahrani (2013),** Minority shareholders have suffered catastrophic losses from initial Public Offers in 2006 and 2008, and Saudi CG regulations are still adhered to on a comply or explain basis.

Argued by **Koldertsova (2010)**, in his study, CG legislations in Saudi Arabia is still slowly moving from voluntary to obligatory as family-owned firms, are stifling corporate growth by their reluctance to open their equity to outside shareholders. The dominant form of incorporations, in Saudi Arabia, is a family-controlled block holding and they are slowing the growth of the CG's regulatory compliance framework.

According to **Dean, (2006),** "We needed people with vision prepared to make investment in governance because the long-term returns are worth it".

Rossouw and Sison. (2006), state, "Corporate governance regimes around the world shaped by different sets of cultural values are also divided with regard to the question: for whose benefit should corporations be governed?" Therefore, political, legal, institutional, privatization, and cultural factors are very crucial to consider when assessing the strength of any CG regime world-wide.

La Porta, Lopez-de-Silanes, Shleifer, and Vishny. (2002), Where minority rights are strongly protected in law, then, this framework illuminates many of the problems confronted by firms and their investors and world-wide comparative work empirically shows that higher dividend pay outs, high compliance with international accounting standards and the open disclosure required of listed companies are effective indicators of a strong CG regime. Their analysis also confirms the proposition that shareholders are better served when compliance and disclosure are transparent. However, Agency Theory breaks down where there is a lack of homogeneity in the interests of individual stakeholder groups.

The scholar **Al-Zuhair (2008)**, sketched nicely CG, agency cost is very recognizable in listed Saudi corporations as their issues of CG compliance and disclosure partially stem from a highly concentrated ownership structures found within these corporations. Moreover, the determinants promoting or influencing that concentrated ownership structure are not clear: families own 75% of listed companies, while government and individual founders own just 25% of listed companies.

Therefore, **Berle's and Means's (1932)** assumption of listed corporations' shares being massively dispersed in the long run has been challenged by researchers in CG specializing in the law area. In a study aimed at identifying the ultimate shareholders of large corporations in 27 countries, findings suggest a whole different picture than the one predicted by Berle and Means. (**La Porta et al., 2002)**. Firstly, in countries where there are weak shareholders' protections, most large corporations are found dominated by controlling shareholders such as states, or families. Secondly, these controlling shareholders are found to have excessive control over large corporations exceeding their cash flow rights through pyramidal structures and other controlling means. Hence, large corporations in these weakly legislated investors' protection countries are found to have a dilemma of separation of ownership and control but it is far from what was predicted by **Berle and Means (1932)**. Thirdly, these controlling families are found set to monitor top management which are found to be members of controlling families. Thus, these controlling families are found to have the power and interest to expropriate minority shareholders. Fourthly, controlling families are found not to support neither encourage legal reforms enhancing minority shareholders' rights. Instead, these families are found to lobby against such reforms **(La Porta et al., 2002).** Fifthly, La Porta et al., state, "ownership concentration is a consequence of poor legal protection of minority shareholders"(1999).

In addition to that the political literature on CG is seen as the bridge between the legal rules and economic developments. Hence, some political theories have been proposed to explain CG. For instance, **Pagano and Volpin (2005)** explain the rational of their proposed model as, " company law can be changed by politicians easily any time: having a political economy model can formalize the behavior of voters and politicians in response to the economic interest as well as their ideologies".

Coffee (2001), presented the concentrated ownership structure transforms into Crony capitalism, uniting both the political and the economic powers, the effect of the law becomes minimal.

According to **La Porta et al., 2008; Gourevitch. (2008)** other factors such as political, legal, institutional, privatization, and cultural factors are very crucial to consider as they are found significantly reflective of cultural hierarchies in world-wide comparative studies of CG, especially when assessing the Saudi Vision of 2030 in terms of the needed CG framework reform upon which such vision can be carried forward.

10. THE CORPORATE GOVERNANCE STRUCTURE & THEORETICAL FRAME WORK IN SAUDI TOWARDS SAUDI VISION 2030

The corporate governance structure upon which Saudi 2030 vision, based on McKinsey's report of 2015, will be guided suffers from certain western biases implanted by the international accounting standards such as the IFRS and OECD principles of CG.

10.1 Ownership Structures

H0: There is a significant gap between the nature of capitalism and the crisis of control over the business in Saudi Arabia.

Under this hypothesis, Morland extensively reviews the CG literature and concludes that the literature is heavily concentrated on the fiduciary duty of directors and managers to guarantee the growth of shareholders' values. Hence, the focus of such literature arguably is on 'money', rather than on the welfare of the society, which is affected as a 'side-product' of this pursuit.
In Saudi Arabia, the dominant form of incorporation is a family-controlled block holding and such corporations are slowing the growth of the CG's regulatory compliance framework. Moreover, most Saudi Listed companies' executives' boards' members who own fiduciary duties to all stakeholders come from dominate controlling families in the economy. For instance, three Saudi families dominate more than 41% of executive board positions in listed Saudi corporations trading on the Saudi Stock Market **(Saad, 2015)**. In addition, these three families occupy the boards of 68 listed corporations out of 168 listed Saudi corporations trading in the stock market. In addition, 17 other families dominate other boards of Saudi Listed Corporations. These families are:

Table 1: Saudi Families Dominating Executive Board Positions

Family Name	Number of Listed corporations present in	Economic Sector involved in	Number of Board members
Al-Aissa	25	13	28
Al-Rajhi	19	9	28
Al-Zamil	8	4	14
Aba Alkhail	11	7	11
Al-Quaiz	11	7	11
Al-Rashed	10	6	11
Al-Gammdy	10	8	10
Al-Saif	9	7	10
Al-Suilm	9	5	10
Al-Turki	9	7	9
Al-Shiekh	9	7	9
Al-Twaijri	9	6	9
Al-Amran	9	6	9
Al-Muhidib	8	6	9
Al-Rasheed	8	5	9
Al-Saleh	9	5	9
Ali Rida	8	5	9

Source: *Saad (2015) Maaal Economic Newspaper on the 18th of March 2015*

The determinants promoting or influencing these concentrated ownership structures in Saudi Arabia shall have been taken into account by McKinsey's report of 2015 which positively relies on the roles of the private sector to accomplish a major part of its proposed economic model: families own 75% of listed companies, while government and individual founders own just 25% of listed companies. Thus, controlling families in Saudi Arabia have the power and interest to expropriate Minority shareholders. Hence, these families are more likely to continue to persist in doing so under the direction of Saudi 2030 vision. Because Vision 2030, as it stands, has not taken into account the nature of the networked economy into account when, in fact, controlling families are found to neither support nor encourage legal reforms enhancing Minority shareholders' rights. Instead, these families are found to lobby against such reforms due to their prime focus on money, rather than on the welfare of the society, which is affected as a 'side-product' of their pursuit. Hence, the legal effect becomes minimal in such an environment. Therefore, the Saudi vision of 2030 is highly advised not to commit to a CG structure that is highly focused on flow at the expense of sovereignty, as one of the side products of the vision is to transform the Saudi government from a sovereign government into an efficient, self-sufficient government. The rationale behind such recommendation stems from the fact that, as it stands, 75% of the listed Saudi corporations are family owned **(Al-Zuhair, 2008)** and they are more likely to continue to manifest themselves in the governance of emerging economic systems such as Saudi Arabia's as their survival is dependent on the institutional context, which needs a major reforms.

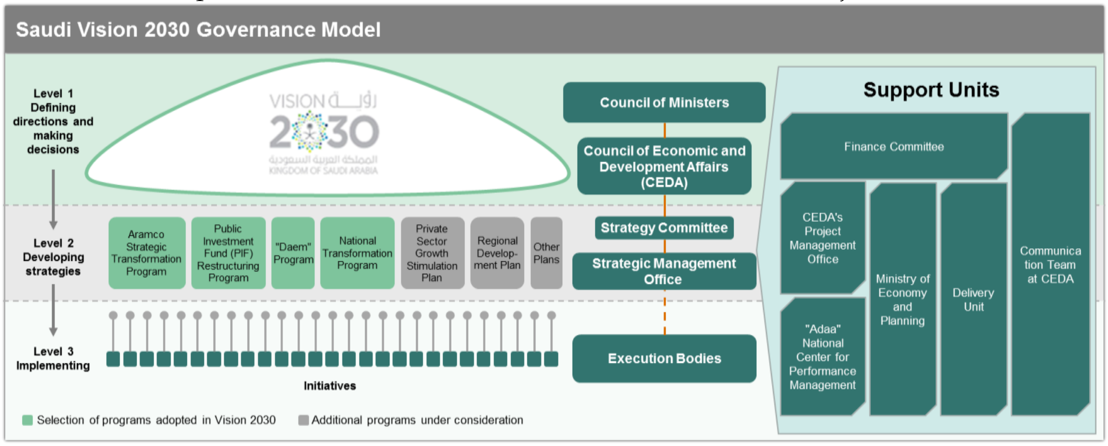

Figure 1: Hierarchical governance and the crisis of structure

"In biological terms, a 'rhizome' refers to a form of plant that extends itself through horizontal tube-like root system and can in this way create endless new plants" **(Morland, 2013).** Hence, exploring CG in a rhizomatic way might arguably lead to a mind-shift. Such shift might be capable of directing attention away from delineating units that operate in accordance with certain foundational principles to be open to ''dimensions or rather directions in motion''.

As the figure 2 depicts, cultural factors in terms of **Hofstede (2010)** CVD model, as confirmed by this paper, do have an effect on the application of CG principles. Specifically, the effect of these CV dimensions can be seen on their influences on the broad constructs derived from the literature review phase such as 1) Rights of Shareholders, 2) Transparency, 3) Accountability, and 4) Disclosures. In addition, a positive effect as depicted by the green arrow in the diagram shows how these CV dimensions can aid the functional convergence in terms of the broad constructs resulting in the development of such capital market that is characterized of an audit-oriented performance. Hence, a higher level of compliance and dividends pay-out is expected.

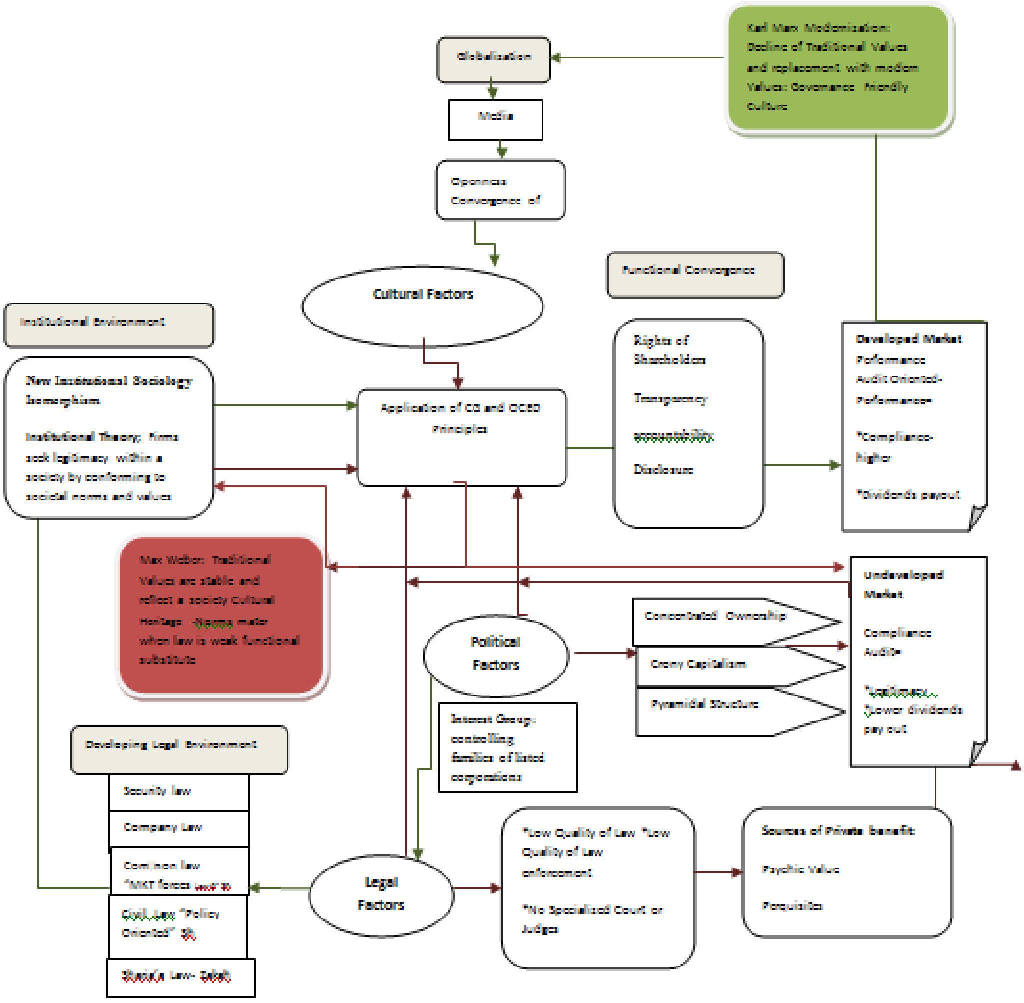

Figure 2: Proposed Multi-Dimensional Model

Source: *Secondary data Alfordy, Faisal (2016).*

11. POLITICAL FACTORS INFLUENCING THE CG REGIME OF SAUDI ECONOMY

In terms of the Government Restructuring program, the Saudi government is planning to "organize itself with agility, continuously restructuring and aligning their systems to national priorities. We have already started moving along this path by eliminating supreme councils and establishing the Council of Political and Security Affairs and the Council of Economic and Development Affairs. These reforms have helped to speed strategy development and decision-making, as well as enhance performance.

There are a few challenges the new reformed government agencies will face in implementing vision 2030: Saudi Government should be aware of members of listed-Saudi corporations' controlling families at the Saudi House of Ministers and Saudi House of Consultancy. These members of listed-Saudi corporations' controlling families are more likely to cultivate a conservative agenda that protects established forms of organized capitalism embracing the concentrated ownership choices of corporate structures.

12. INSTITUTIONAL FACTORS INFLUENCING THE CG REGIME OF SAUDI ECONOMY

According to Vision 2030, "Government adopted the principle of performance measurement, and made sure it is properly used in for evaluation of all government agencies, their programs, initiatives and executives. Government established the Center for Performance Management of Government Agencies to institutionalize these efforts for the long-term and built performance dashboards to promote accountability and transparency. To ensure the realization of Saudi Arabia's Vision for 2030, Saudi preparing to launch a group of executive programs that will have a significant impact on implementation. Identifying opportunities for partnering with the private sector, as well as innovative administrative and funding approaches. We are detailing specific initiatives that have clear performance indicators."

13. PRIVATIZATION FACTORS INFLUENCING THE CG REGIME OF SAUDI ECONOMY

According to vision 2030, "We are in the process of determining additional sectors suitable for privatization. Our goal is to create a comprehensive privatization program. We will make use of international best practices, transfer knowledge and achieve our goals in a balanced and scientific manner". Due to the increasing evidence that newly privatized markets have failed to set up viable securities, legal scholars are focused on the dichotomy between dispersed and concentrated ownership structure.

14. CG AND ITS APPLICABLE SHARIA LAWS IN SAUDI ARABIA

CG regulations in Saudi Arabia have been relatively premature due to the late significance attached to adopting a sound CG system after the first market crash of 2006. A few governmental agencies have played key roles in setting the stage for implementing appropriate CG standards in Saudi Arabia such as SCC, SMCI, SOCPA and SHEC**.** Nevertheless, it can still be said that the main legislative sources of CG in Saudi Arabia stem from.

- The Companies Act of 1965: initially considered the first legislative attempt at establishing general CG guidelines.
- The Saudi Capital Market Law of 2004 (SCMA): practically, the first legislative attempt to organize the Saudi Capital Market's operations of listed corporations.
- Nevertheless, the Saudi Company Law of 1965 does not effectively protect minority shareholder's rights. In fact, the SCL of 1965 is rather found to empower majority shareholders with unrestricted control over their companies to the point where majority shareholders are capable of causing abuses and injustice.

Moreover, the board of SCMA, which was created via the Saudi Capital Market law of 2004, has utilized its powers, granted by the King, to legislate the issuance of CG regulations in 2006 after the first market crash. Nevertheless, adherence to Saudi CGRs was made obligatory in 2010 and listed Saudi corporations still adhere to CG regulations on a 'comply.

15. RECOMMENDATIONS & IMPLICATIONS FOR POLICY MAKERS

The implementation of a concrete legal system is crucial for the development of a strong CG regime that ultimately capable of protecting and monitoring Saudi Arabian economy. Hence, some of this present study's findings have potentially important policy implications, which are:

- Saudi legislators should realize that members of controlling families of listed Saudi corporations at the legislative level are partially responsible of the current state of weak Minority protections.
- In addition, Saudi legislators should take into account how the existence of a persuasive political voice has become essential for the success of some listed Saudi corporations owned by controlling families. Hence, it is really difficult for potential entrepreneurs seeking external capital to succeed in the Saudi Market without a persuasive political voice. As such, this effect has highly contributed to an immature capital market in Saudi Arabia.
- The policy makers should ensure the existence of the necessary authorities to address all of the above obstructive issues to the growth of a strong CG regime in Saudi Arabia.
- Policy makers should realize the fact that the 'civil law effect' can be seen in the distribution of power within CG laws in Saudi Arabia. Evidence from the Saudi legal environment shows that major shareholders possess the ultimate power in listed corporations because the law empowers them to appoint the boards and hold them accountable. Hence, current CG laws should be carefully examined with the aim of protecting the weakest link: Saudi Minority shareholders.
- Policy makers should be aware of the fact that Saudi legislation has historically contained 'a civil law' tendency guided by pre-condition-strong mandatory rules stemming from a political view as opposed to a market need. Hence, policy makers should ensure that new CG legislation reflects a need for the market to re-organise its activities.
- The high score of the Saudi culture value dimension of Uncertainty Avoidance is indicative of the excessive amount of CG laws put in place in Saudi Arabia to avoid the unknown, covered by the institutions of SCC, SMCI, SOCPA, and SHEC. Moreover, the dual legal system complicates the CG process and not only makes it problematic but also affects audit performance. Therefore, policy makers should take into account how such culture value dimensions have caused the accumulation of excessive amount of laws guiding the CG regime in Saudi Arabia, which eventually has contributed to the low level of CG compliance by listed Saudi Corporations.
- Policy makers should take notice of institutional investors' increased power to influence management so that they could increase the value of their shares in the short run. Therefore, future legislation should place institutional investors under scrutiny to ensure no privileges are lawfully given to them to excessively exercise influence against Minority shareholders.

16. CONCLUSION

Despite of the recent practical attempts undertaken by SCMA, the current status of the Saudi CG framework does not constitute effective legal, regulatory and institutional foundations capable of carrying Saudi vision of 2030 forward. Moreover, the current status of CG in the whole Middle East and North Africa (MENA) region, consisting of countries sharing the same culture, oil based economies, and religion as Saudi Arabia, is very similar to Saudi Arabia. As indicated by the OECD report of 2011. Therefore, such integration, based on the positive results of the empirical and qualitative evidence found in other studies and presented through this paper. Hence, this proposed multi-dimensional framework contributes a greater understanding of the political legal, institutional, privatization, and cultural factors which are very crucial to consider when assessing Saudi Vision 2030 in terms of the needed CG framework reform upon which such vision can be carried forward.

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