

# Urgent need for the industry to have a corporate governance system in place



THE HEADLINES in the UAE media several weeks ago regarding Deyaar were shocking, to say the least. Top executives were arrested for financial irregularities, and these have been the source of many conversations in the property industry since then.

Such headlines have also been the source of much concern for top executives with respect to executive criminal and civil liability. A few similar, but far less high-profile, cases have also occurred over the past few years in Dubai, requiring the resignation or replacement of all or part of the management team at property companies.

All of the above suggests that the inter-

nal reporting systems and controls in some — or all — of the above property companies were broken or were in dire need of reform. Such a problem is not unique to the property industry.

We have witnessed it in other industries, some noteworthy examples are Enron, Worldcom, Barings, and Parmalat. The failure to successfully implement systems by which businesses are directed and controlled can ultimately result in the complete failure and the devastating loss of capital of such companies.

Fortunately, there is a solution that can assist them: its called corporate governance and it has proven itself in other fields of business.

Corporate governance has been defined as the system by which business corporations are directed and controlled.

The commonly accepted principles of corporate governance include: defining the roles and responsibilities of the board of directors; requiring corporate behaviour that is ethical and infused with integrity; timely and balanced disclosure of

material matters to shareholders; and independent verification and safeguard of the corporation's financial reporting.

This facilitates the exercise of shareholder rights and equitable treatment of shareholders, as well as recognition of interests of the other stakeholders.

Good corporate governance has been shown to enhance confidence in the economy and attract capital investment, protect shareholders, enhance long-term value in corporations, and build competitive businesses that are able to compete in the global marketplace.

There has been renewed interest in corporate governance practices since 2001, particularly due to the high-profile collapses and problems of Enron, Worldcom, Barings, Parmalat and others.

In the Middle East, strong economic growth and liquidity have resulted in the exponential expansion of its capital markets and of investments generally. As a result, certain countries have implemented corporate governance codes since as early as 2002.

Given the failures of certain developers in corporate governance measures in recent years, it is about time to introduce it to the industry.

In the UAE, the Emirates Securities and Commodities Authority (Esca) issued a corporate governance code for joint-stock companies and criteria for institutional discipline (the 'Corporate Governance Code') on March 9, 2007. This is not applicable to most developers which are private companies and not joint stock companies.

However, I propose that a Corporate Governance Code be adopted and voluntarily complied by the developers. Note that the UAE has also witnessed the launch of Hawkamah — the Institute for Corporate Governance — in the second quarter of 2006 to address the growing interest of the corporate sector, regulatory agencies and the media in the practice.

Hawkamah can also be an invaluable

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partner in assisting with the voluntary adoption of corporate governance practices by the property industry.

#### Review of certain important provisions of the ESCA Corporate Governance Code

By way of introduction and understanding for the reader of the principles of corporate governance, I review below certain important provisions of the ESCA Corporate Governance Code. I propose that such a Code (or one similar to it), amended to suit the requirements of the property industry, be voluntarily adopted by developers and other market participants.

#### Certain important definitions of the Code

An 'Independent Director' is one who either himself or his spouse or relative, during the last two years, was neither a member of the executive management of the company nor had any relationship that resulted in any significant financial transactions with the company or its parent, affiliated or related company.

An 'Executive Director' dedicates his activity on a full-time basis to the management of or receives a monthly or yearly salary from the company.

A 'Non-Executive Director' neither dedicates his activity on a full-time basis to the management of nor receives a monthly or yearly salary from the company.

'Corporate Governance' is defined as the set of regulations, criteria and procedures that ensure institutional discipline in managing companies in accordance with international practices by determining responsibilities and obligations of the directors and executive management. It also takes into consideration the protection of shareholders' rights and other stakeholders' interests.

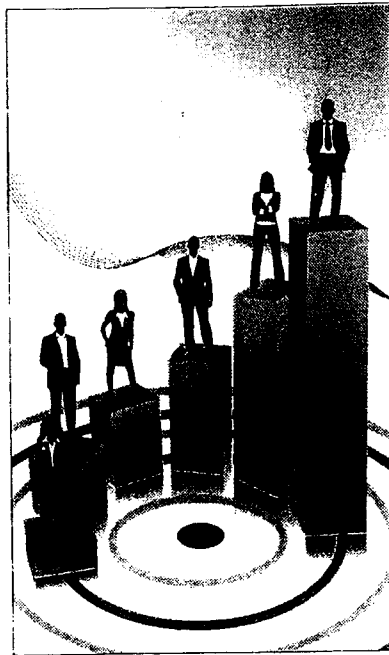
#### ■ Board of Directors

In forming the Board of Directors, suitable balance between the numbers of executive, non-executive and independent directors shall be maintained. At least one-third of directors shall be independent, while the majority shall be non-executive directors...[whose] directorship shall not conflict with any of their other interests (Article 3).

A meeting of the Board of Directors shall be valid only with the presence of the majority of the directors. Decisions of the board shall be taken by the majority of those present. The Chairman shall have a casting vote in the event of equal votes (Article 3).

If a Director has a conflict of interest with any matter to be considered before the Board, and the Board determines that such matter is significant, then such a decision shall be made with the exclusion of the interested Director (Article 3).

A Director shall exercise his powers and undertake his obligations with due care, diligence and skill; and consider the interests of the company's and the share-



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holders' interests (Article 5). The Board shall establish rules for dealings of Directors and employees with shares issued by the company, its parent or affiliates (Article 5).

A Director must disclose to the company all of his other positions in public companies and any other significant obligations (Article 5).

The position of the Chairman of the Board and the Managing Director may not be held by the same person (Article 3).

#### ■ Committees of the Board of Directors

The Board shall form the following permanent committees: the Audit Committee and the Remuneration Committee. Each shall be formed with not less than three non-executive directors, at least two of which shall be independent directors, including one as the head of such a committee (Article 6).

#### ■ Implementation of the Corporate Governance Code

An internal control system shall be established to evaluate the means and procedures for risk management and the implementation of the Corporate Governance Code. An annual review of the company's internal control system shall be undertaken by the Board and reported to shareholders in a Governance Report.

In such report, the Board shall disclose to what extent the company has complied with the Code (Article 8).

#### ■ Delegation of certain responsibilities by the Board to Management

The Board may delegate certain of its responsibilities to management of the company pursuant to clear instructions and limits (Article 11).

#### ■ Shareholders' rights

Shareholders share-related rights (such as dividend rights, liquidation rights, voting rights, sale of share rights, and information rights) shall be stated in the Articles of Association of the company. In addition, the Articles shall contain provisions to ensure shareholders are provided with full and accurate information to enable them to enjoy their rights; and to provide shareholders with the opportunity to participate and vote at the annual general assembly meetings (Article 12).

#### ■ Conduct rules

Conduct rules and other internal policies shall be adopted by the company as to fit its objectives and purpose to comply with applicable laws and regulations. Directors, managers, employees and internal auditors shall comply with such rules and policies (Article 13).

#### Conclusion

The UAE property industry faces an important threat: the lack of transparency and the lack of proper corporate systems and controls. Such a threat has already resulted in the highly publicized arrests of several top property executives and certain other management firings. This can undermine investor confidence in the property market and downgrade the industry's reputation. It can ignore such threat and await the inevitable further corporate governance failures of some developers.

Such failures could result in the government mandating further controls and restrictions (in the form of mandatory laws from the government) on the property industry, thus squeezing profits and limiting business flexibility.

On the other hand, the industry has the option of being proactive. It can follow the route of voluntary adoption and the use of a corporate governance code (similar to that used by the Emirates Securities and Commodities Authority) to demonstrate due diligence and responsibility.

Research has shown that such voluntary adoption of corporate governance even has several financial upsides: it enhances confidence in the property market; it attracts further capital investment; it protects shareholders; it enhances long-term value in developers; and it builds competitive businesses that are able to compete in the global marketplace.

The choice is clear (and transparent).