

Regional Agenda

# Accelerating Economic Reforms in the Middle East and North Africa A Private-Sector Perspective

Middle East and North Africa Regional Business Council

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# Preface



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The Middle East North Africa Region suffers from the world's highest average youth unemployment rate at 30%, a major driver of continued instability. With tighter state budgets and an over-dependence on public sector employment, governments across the region have pledged themselves to much needed economic reforms while calling on the private sector to drive new growth and job creation.

This new momentum for reforms in many countries is creating a unique opportunity for business, civil society and government to jointly boost inclusive growth, job creation and sustainable development. Yet current responses are either fragmented with limited impact or not adapted to the scale of the structural changes needed.

Building on the World Economic Forum's network of experts and following its pioneering multistakeholder approach, top executives from the Middle East and North Africa Regional Business Council (RBC) have launched an initiative that aims to accelerate the policy reform agenda in the region. The initiative serves as a platform for public-private cooperation to:

- Enhance the efficiency of the labour market
- Modernize bankruptcy and insolvency regulation
- Simplify the process of creating a company
- Reduce bureaucracy and strengthen government capacity to reinforce contracts
- Build functional mediation and arbitration methods
- Promote systems of good corporate governance

As part of the initiative, RBC members have prepared a set of actionable policy recommendations covering top priority reform areas. This compendium of perspectives by business leaders showcases these recommendations, along with additional contributions from members of the 2016 Global Agenda Council on the Middle East and North Africa, the Forum's network of senior advisers on the region's most pressing issues.

The current momentum and the determination of the region's premier group of companies present a major reform opportunity that we hope will contribute to boosting growth and achieving prosperity for all.

# Six Priority Reforms to Boost Private Sector Investment



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While each country in the Middle East and North Africa (MENA) region and economic sub-region (North Africa, the Levant and GCC countries) has their own specific needs, there are common trends when it comes to obstacles to private sector development.

A multistakeholder consultation, with executives from business, industry, law and academia, led to the identification of six actionable policy reforms that would stimulate private sector investment in the MENA countries.

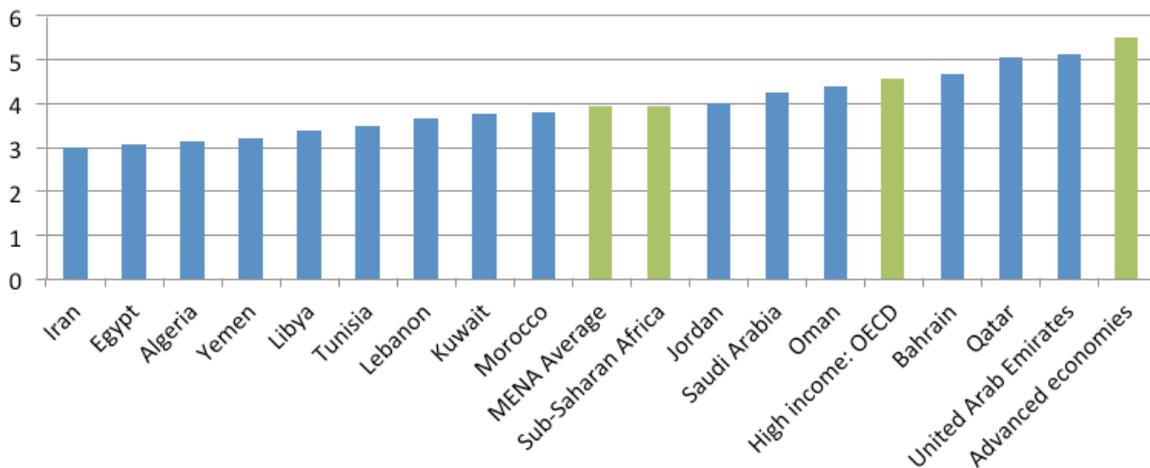
## 1. Enhance the efficiency of the labour market

The World Economic Forum *Global Competitiveness Report 2015-2016* ranks MENA as one of the least competitive regions in terms of labour regulation (regional average). In terms of labour market efficiency, all countries of the region score below the average score of advanced economies, even though the United Arab Emirates, Qatar and Bahrain score higher than OECD countries.

Rigid labour regulation is a significant constraint on private sector investment and growth, and thus to the creation of jobs. Labour market regulation has to allow workers the flexibility to move from one economic activity to another, quickly and at low cost. There is an imperative to align labour market regulation to international standards, especially in the area of redundancy.<sup>1</sup> This makes it important for governments and the private sector to engage in a consultation aimed at revising redundancy laws and practices to provide more flexibility.

<sup>1</sup> The World Bank's *Doing Business 2015* report evaluates the rigidity of labour regulation in the following areas: difficulty of hiring, rigidity of hours and difficulty of redundancy.

Figure 1: Labour market efficiency – Competitiveness Index of MENA countries



Source: World Economic Forum Global Competitiveness Report 2015-2016

## 2. Modernize bankruptcy and insolvency regulation

Entrepreneurs in MENA are frequently at a risk of penal proceedings for management decisions, which increases the fear of business failure, commonly seen as an additional obstacle for entrepreneurship in the region.

In most countries in the region, bankruptcy regulations are characterized by inappropriate procedures for asset liquidation. Frequently, assets are dismantled and sold off cheaply. In addition, the stigma of bankruptcy and insolvency makes it difficult for entrepreneurs to start up again. There is also a lack of support and processes to rehabilitate distressed companies.

Effective insolvency systems should be based on well-designed legal frameworks, relying on a sound judicial system, with competent and impartial judges, lawyers and accountants experienced in insolvency proceedings. It is, thus, critical for governments to adopt best international practices on insolvency.

## 3. Simplify the process of creating a company

Among the obstacles to entrepreneurship in MENA is the cumbersome process for starting a business. Some countries such as Morocco and the UAE are relatively well ranked (54 and 58, respectively) in the World Bank's *Doing Business Report*, while the majority of the countries rank above 100.

**Table 1:** Selected key indicators for starting a business

Economy	Procedures (number)	Time (days)	Cost (% of income per capita)	Paid-in min. capital (% of income per capita)
East Asia & Pacific	7.3	34.4	27.7	256.4
Europe & Central Asia	5	12.1	5.3	5.8
Latin America & Caribbean	8.3	30.1	31.1	3.2
<b>Middle East &amp; North Africa</b>	<b>8</b>	<b>18.9</b>	<b>28.1</b>	<b>45.6</b>
OECD high income	4.8	9.2	3.4	8.8
South Asia	7.9	16	14.6	14.2
Sub-Saharan Africa	7.8	27.9	56.2	95.6
New Zealand	1	0.5	0.3	0
Morocco	5	11	9.2	0
United Arab Emirates	6	8	6.3	0
Libya	10	35	19.9	33.8
Algeria	13	22	11	24.1

Source: World Bank Doing Business 2015 report

To stimulate entrepreneurship, MENA countries should adopt the following World Bank best practices:<sup>2</sup>

- Use information and communication technology to complete registration formalities (target countries: Algeria, Egypt, Iraq, Kuwait, Lebanon, Libya, Morocco, Oman and Yemen)
- Create an efficient single interface as a one-stop-shop for completing registration formalities (target countries: Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Tunisia and Yemen)
- Reduce or eliminate the minimum capital required for registering a company (target: Algeria, Iraq, Kuwait, Lebanon, Libya, Oman and Qatar)

## 4. Reduce bureaucracy and strengthen government capacity to reinforce contracts

Inefficient government bureaucracy is reported by businesses to be one of the main obstacles to their competitiveness and growth in the MENA region. Addressing bureaucracy is a significant challenge as it is endemic in every aspect of institutional and economic environments. Reducing it will be an ongoing challenge for governments in all areas of the economy.

Notwithstanding that bureaucracy is a challenge for all types of companies regardless of their size, countries in the region could become more competitive by creating dedicated administrative units as an interface between the private sector and government for large corporations and projects of national interest. Such units should have the capacity and appropriate delegation of authority to enable positive interaction with the private sector.

<sup>2</sup> Based on best practices from the World Bank's *Doing Business 2015* report.

## 5. Build functional mediation and arbitration methods

Among the different types of alternative dispute resolution (ADR) processes, the most common are mediation, arbitration and conciliation.<sup>3</sup> While mediation is commonly recognized as the most time- and cost-effective ADR method, parties in the MENA region are frequently restricted to arbitration for conflict resolution due to the lack of optimal conditions for mediation, including trust. There is also a lack of a commercial court of first instance that could be used as a first go-to step for a quick conflict resolution.

Mediation is a flexible, non-binding dispute resolution process in which a neutral third party (the mediator) assists two or more disputants to reach a voluntary, negotiated settlement of their differences. Unlike arbitration, parties have ultimate control of the decision to settle the terms of resolution. In addition, many international firms do not consider MENA commercial arbitration friendly, making foreign investors reluctant to hold their arbitrations in the region. In this context, there is need for an increased public-private collaboration to build trust and promote mediation as a recognized ADR method.

Should arbitration be the only recourse, it is important that the process is based on international best practices. Since the 1990s, few countries in MENA (Egypt, Bahrain, Dubai and Qatar) have changed their laws and regulations on arbitration, either by following the Model Law of the UNCITRAL, or by incorporating principles and rules from French law or the law of England and Wales. Adoption of worldwide arbitration conventions, such as the New York Convention and the ICSID Convention, has been solidified, most recently, with the UAE's adoption of the New York Convention in 2006 and Qatar's adoption of the ICSID convention in 2011. However, some countries in the region have been reluctant to use international commercial arbitration as it is perceived to be biased towards Western interests.

The lack of trust in the ability to enforce contracts together with an inadequate ADR process significantly impact investment and growth. It is highly recommended that countries in the region adhere to international methods such as the New York Arbitration Convention of 10 June 1958.

<sup>3</sup> Arbitration involves using a neutral arbitrator to make a decision about the outcome of the dispute. Once the parties have agreed to the process, arbitration is binding (the decision is final and can be appealed only on very narrow grounds). Mediation is a process in which a neutral mediator helps the parties discuss and find a mutually acceptable solution. Conciliation is a variation of mediation in which a conciliator meets with the parties separately (rather than jointly, as in mediation) and seeks concessions from the parties that would help resolve the dispute. Source: The World Bank Group financial and private sector development vice presidency, October 2011.

## 6. Promote systems of good corporate governance

Besides the UAE (25) and Qatar (26), other Arab countries rank low on Transparency International's 2014 Corruption Perceptions Index – Saudi Arabia, Jordan and Bahrain at 55, Oman at 64 and Kuwait at 67.

Anti-corruption laws are necessary to provide a conducive climate for businesses to succeed through competitiveness, attracting greater foreign investment and boosting investor confidence, especially in the context of SMEs. To ensure that entrepreneurial ventures are built on strong foundations, it is crucial that proper basic corporate governance frameworks are put in place. Without those, entrepreneurs risk building fragile businesses that stand a lower chance of becoming scalable and/or sustainable.

A public-private action is important to promote a code that links appropriate corporate governance standards within entrepreneurial ventures with their ability to attract investment. This would encourage lower cost and more accessible investment, venture and loan capital through the demonstration that the start-up or SME is built on a strong corporate governance foundation. Aside from preventative action by companies themselves, the following actions should be advanced: strengthen anti-corruption laws; promote more rigorous enforcement; and ensure an independent empowered anti-corruption agencies and an efficient administration.

# Labour Market Regulation Reform in the MENA Region



Patricia McCall, Executive Director, Centre for Economic Growth, INSEAD, United Arab Emirates

The demographics of the Middle East and North Africa (MENA) region pose both a challenge and tremendous opportunity. Meeting the expectations of the region's youth for jobs and economic prosperity will take serious reform and discipline, but also provides room for growth in human capital, productivity and innovation.

With youth unemployment levels at nearly 30% in the region and with an estimated 100 million new jobs needed by 2025, economic and regulatory reform that supports private sector-led growth and that attracts global investment and human capital is paramount. Furthermore, improving the region's investment climate, including improving the ease of doing business and increasing transparency, is critical as well as promoting an efficient and dynamic labour market that is adaptable to the needs of the 21st-century workplace. Being competitive in today's workplace requires flexibility, good governance and adherence to global best standards.

The MENA region has progressed in several indicators of doing business, but almost across the board countries in the region need to enhance labour market reforms to increase

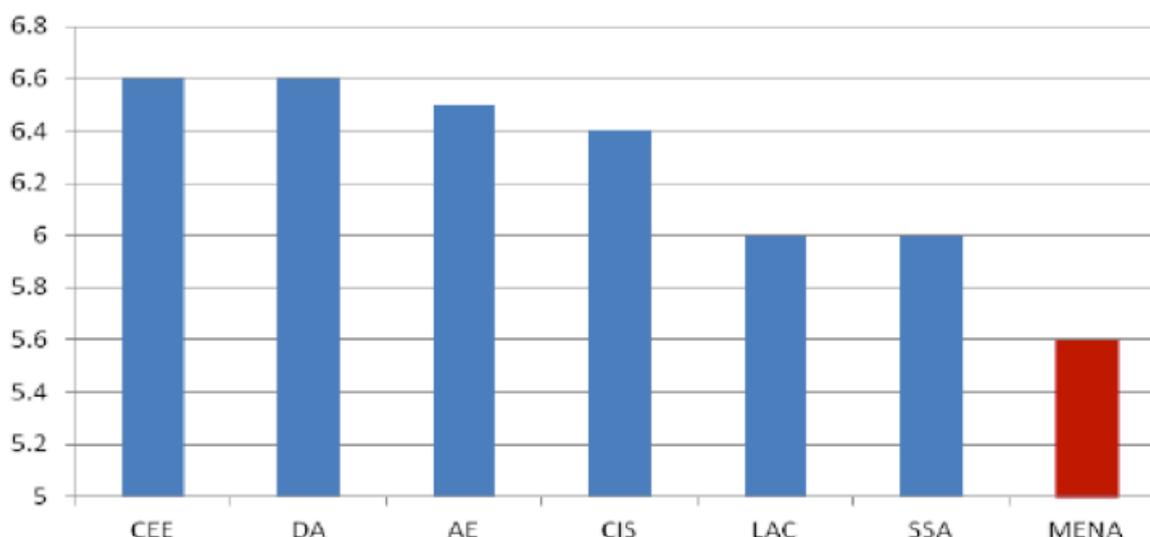
productivity and efficiency. According to a World Bank Enterprise Survey, the MENA region has the second highest percentage of firms (12.3%) that identify labour regulations as a major constraint on business operations.

The recent World Economic Forum Global Competitiveness Report 2015-2016 rankings find the most competitive countries – such as Switzerland, the United States and Singapore – share highly efficient, transparent and collaborative labour markets where employers work closely with employees and labour organizations as well as universities to foster talent development, promote flexible hiring and firing practices, and provide an enabling environment that attracts the best talent globally. In this report, for the MENA region, only Qatar, Bahrain and the UAE fall in the top 50 in terms of labour market efficiency, which includes indicators that account for cooperation between employers and employees, wage determination, female participation in the workforce and a country's ability to develop and attract talent.

The urgency for such reform is clear, for example in Egypt, where figures indicate that between 700,000 to 800,000 new job seekers are entering the job market every year, some of whom will add to the already large pool of unemployed standing at 3.6 million.<sup>4</sup> Additionally, youth unemployment rates in the region have risen since the Arab Spring and are projected to continue to rise.

<sup>4</sup> World Bank, *Economic Brief*, 2014.

**Figure 2: Labour Market Flexibility 2008 (0=least flexible; 10=most flexible)**



Source: Economic Freedom of the World Database, IMF, <https://www.imf.org/external/np/vc/2012/061312.htm>.

## Redundancy reform

A key factor in enabling efficient labour markets is fair and transparent redundancy regulatory frameworks. In a market where workers and employers have clear and reasonable expectations of hiring and firing practices and where employers are able to allocate capital freely to the most productive labour and where workers are able to move easily and at a low cost between employers, will enable higher productivity and efficiency in that market. In the MENA region, reforming antiquated and state-centric redundancy regulatory frameworks have been a significant challenge and thus have been a lag on job creation and economic growth. Furthermore, the female participation rate in the workforce ranks the lowest globally. For this to improve, flexible regulatory environments are an imperative, coupled with an adequate social protection system for those that require it.

Studies have indicated that the effect of strict regulation regarding termination of permanent employees for economic reasons leads to higher informal employment, somewhat lower employment levels, and lower job creation and destruction, thus lowering economic growth and productivity.

According to a World Bank report, more flexible hiring and dismissal procedures are the most relevant policy issues in the reform of labour market regulations in MENA, where low job creation and long-term unemployment are major problems.<sup>5</sup> The report highlights that firms are less likely to hire employees when the uncertainty and costs associated with terminating them are high. It states that Egypt, Tunisia and Morocco have made gains in supporting hiring of short-term contracts versus permanent contracts, which can help address this issue. But, it also highlights that while some countries have begun to address the hiring of workers, the firing of workers is still a cumbersome and difficult process and often illegal for purely economic reasons.

While each country has its own unique circumstances and are at differing levels of reform, there are certain aspects of process that are critical to allowing the private sector to attain and terminate employees to ensure proper allocation of capital and investment, as well as for employees to leave a firm and find employment elsewhere. These include the ability to terminate employees based on changes in economic conditions and demand for product areas, transparent contracts and notification period for termination, ability for workers to switch visas and look for employment elsewhere (promoting high mobility) upon leaving a job with minimal penalties, and provision of an adequate social safety system to complement labour reforms.<sup>6</sup>

Several GCC countries have enacted labour reforms recently and can be an example to other countries in the region. The UAE recently announced reforms to be enacted in 2016 that require a standard template for worker contracts that acts to protect specifically foreign workers that enter the UAE and allow for more labour mobility and flexibility. Both employers and employees now have the option to terminate the

<sup>5</sup> World Bank, *Unlocking Employment Potential in Middle East & North Africa*, 2015.

<sup>6</sup> *Ibid.*

employment, and employees are free to find employment elsewhere.

In another example, in 2015, Saudi Arabia announced a series of reforms<sup>7</sup> that in part recognized the need for redundancy reforms and took some steps towards best practice, but further progress is needed to allow for more flexibility in termination due to unfavourable economic circumstances.

## A multistakeholder approach to labour reform

Given the urgency and importance of labour reform in providing much needed employment for millions of citizens in the region, a multistakeholder approach is required for both efficiency and expediency. The private sector, academia and civil society must work closely with governments to address inadequacies in the systems and address the skills mismatches, misallocation of human capital and misalignment of curricula for today's workplace.

Specific examples of multistakeholder collaboration could include:

- The private sector outlining more clearly specific skills required for vacancies and projected requirements going forward
- The private sector to work more closely with higher education institutions to develop specific courses to meet their expected employment needs
- Core education reform that includes basic skills such as critical thinking, problem-solving and teamwork as well as STEM and IT skills
- The private sector could lead the development of internship and apprenticeship programmes with secondary, university and vocational training partners, and sponsor or create cluster-based training programmes in partnership with universities or academies, and promote flexible approaches to career-building to support re-skilling and continuing education (*MENA Talent Competitiveness Report 2015*)
- Ministries of Labour as well as other governmental agencies and ministries should support consultations with civil society, unions, employers and citizens in regards to expected and projected labour reforms; they could form working groups and/or task forces with stakeholders to ensure comprehensive participation and adequate buy-in.
- An increased private sector role throughout region in terms of providing employment, moving away from state-led growth and public sector employment, especially given fiscal constraints; this will require further private sector development and reform and wage reform as in many countries in the region the private sector is unable to compete with public sector salaries.

<sup>7</sup> "It is now expressly recognized in the amendments that an employment contract can be validly terminated where the employer is (i) closing down the establishment completely; or (ii) terminating the business activity where the employee is employed. This recognition of a redundancy does not go as far as to extend to situations where there is a reduction in work requirements that requires a reduction in the workforce or a reduction in a particular role. It may therefore be difficult to justify individual redundancies or smaller scale restructures." *Source: DLA Piper, June 2015.*

# The Urgency of Bankruptcy and Insolvency Reform in the MENA Region



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*Patricia McCall, Executive Director, Centre for Economic Growth, INSEAD, United Arab Emirates*

On the back of moderate global growth, declining oil prices and weakening fiscal balances, it is imperative that the Middle East and North Africa (MENA) region undertake comprehensive economic reform to underpin regional economic growth and prosperity. Almost five years after the Arab Spring, the region is suffering from geopolitical instability, low economic growth and high unemployment, especially among youth. Given the strong demographic pressures and a restless population, delivering economic opportunities and hope is critical to ensuring stability.

The core demand of the Arab Spring – ignited by a Tunisian fruit-cart seller who wanted to be able to operate his business and support his family – was one of “bread and dignity”. More often than not, young people who are eager to participate in their societies are unable to find suitable employment despite high education levels. To support job creation through sustained and inclusive economic growth, a comprehensive regulatory reform programme needs to become a priority. Such reforms range from trade and investment climate regulations to legal, governance and transparency frameworks.

While the region varies greatly in terms of economic development, from oil exporters to oil importers, most MENA countries have not yet met global standards in bankruptcy and insolvency regulation. Progress in this area is key to unlocking credit, growth and the untapped youth potential. Bankruptcy and insolvency reform not only impacts existing businesses and creditors, but also young entrepreneurs who are often constrained by regulatory frameworks that do not support risk-taking.

## Regional economic context

The outlook for economic growth in MENA continues to be below the level needed to generate strong employment growth. In 2016, the IMF estimates MENA GDP growth to be a moderate 3.2%, up from 2.1% in 2015, but with little growth for 2017 at 3.2%. Even at these levels, growth is well below the 6-7% GDP growth needed to drive significant

employment growth and reduce unemployment levels substantially.

To generate these higher levels of growth, the MENA region needs to make significant economic reforms that support transparent and dynamic growth in the private sector, attracting both domestic and international investment. The last cycle of high economic growth in the region did not lead to sustained employment growth but rather “trickled up”, leaving many out of work, disillusioned and hopeless. Transparent and inclusive growth is critical to addressing structural economic issues within the region. Adding to this urgency is a refugee crisis that threatens to destabilize MENA populations. Handling the burden of a huge refugee population will only increase the economic pressures in countries such as Jordan, Lebanon and Egypt. This further emphasizes the need for a vibrant private sector that can generate growth and jobs, leaving the public sector to focus on the enabling environment.

Arab states’ youth unemployment levels remain stubbornly elevated and the highest globally. According to the recent ILO publication World Employment Social Outlook Youth 2016, youth unemployment in Arab states for 2016 was at 30.6%, with a slight improvement expected for 2017 at 29.7%. Furthermore, the ILO reports that in the region fewer than one youth in four is working.

With more than 1 million young people entering the job market every year, the region is estimated to need 60-100 million new jobs in the next decade, far above the levels of job creation that exist now. Additionally, the gender gap in employment is the highest globally in the MENA region, with the unemployment rate of young women exceeding that of men by over 20%.<sup>8</sup> Interestingly, in many parts of the region, the more educated one is the more likely he or she is to be unemployed. This underscores the need to address the supply of jobs for educated youth through private sector development and reform.

## Structural economic reform: Bankruptcy and insolvency benchmarks

As part of a comprehensive programme of structural reform, bankruptcy laws and insolvency regulation are critical to a functioning economy. Proper insolvency regimes allow for functioning creditor systems and rights without which companies cannot properly access credit and economies cannot grow. Access to credit in MENA is already difficult. Banks function as the main source of credit given undeveloped venture capital and private equity markets. Banks systemically limit loans to SMEs, often as a result of

<sup>8</sup> International Labour Organization, *Global Employment Trends for Youth*, 2015.

perceived and actual increased credit risk due to poor legal frameworks for insolvency and bankruptcy. Implementing strong and functioning bankruptcy and insolvency regimes will give companies better access to financing while providing creditors with tools to resolve commercial issues in advance of an unforeseen bankruptcy. It also allows for a more efficient and accurate credit system, which will enhance financial sector development and penetration.

The MENA region ranks among the lowest in the world, according to the World Bank's Doing Business survey for

bankruptcy and insolvency. According to 2014 data, MENA has the lowest rate globally, outside sub-Saharan Africa, on recovery rates, and takes the longest time to process insolvency globally, at 3.1 years on average. It also has the lowest rating globally on commencement of proceedings index, which indicates the difficulty in commencing bankruptcy or insolvency claims. In addition, the MENA region also has the lowest rating globally on Reorganization Proceedings at 0.1. There are effectively no legal regulations that provide for reorganization of a company during the process.

**Table 2: Regional comparison of resolving insolvency**

Region	Time	Cost (% of estate)	Recovery rate (cents on the dollar)	Commencement of proceedings index (0-3)	Mgmt of debtor's assets index (0-6)	Reorganization proceedings index (0-3)	Creditor	Strength of insolvency framework index (0-16)
East Asia & Pacific	2.6	21.8	36.8	2.2	3.2	0.9	1.6	8.1
Europe & Central Asia	2.3	13.3	37.7	2.4	3.7	1.4	1.6	9.2
LatAm & Caribbean	2.9	16.4	36	2.2	3	0.5	1.9	8.2
<b>Middle East &amp; North Africa</b>	<b>3.1</b>	<b>13.9</b>	<b>34</b>	<b>2.1</b>	<b>3.1</b>	<b>0.1</b>	<b>1.2</b>	<b>6.6</b>
OECD high income	1.7	8.8	71.9	2.8	5.4	1.8	2.2	12.2
South Asia	2.6	10.1	36.2	2.1	2	0.2	1.3	5.6
Sub-Saharan Africa	3.1	23.3	24.1	2.2	4	0.4	1.3	7.9

Source: World Bank Doing Business 2015 rankings

### Global best practice: World Bank and UN guidelines

MENA countries are at various stages of regulatory reform in regards to bankruptcy and insolvency. However, there are two widely recognized guidelines on bankruptcy and insolvency: the World Bank Principles for Effective Insolvency and Creditor/Debtor Rights Systems<sup>9</sup>, and the UNCITRAL Model Law on Cross-Border Insolvency, which the MENA countries can look to when developing their frameworks.

### Why is reform important for MENA?

Driving economic growth and job creation is critical for the region's stability. With nearly 1 million new job entrants a year, and 30% youth unemployment rates, the prospect of higher rates are significant unless major economic reforms are implemented. Public sector jobs are decreasing due to fiscal restraints across the region and youth are increasingly looking to the private sector and entrepreneurship for a solution. Without proper frameworks, the power of entrepreneurship will be muted.

<sup>9</sup> World Bank, *Principles for Effective Insolvency and Creditor/Debtor Rights Systems*, 2015, [http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015\\_Revised\\_ICR\\_Principles\(3\).pdf](http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf).

Studies indicate that strong insolvency laws not only influence ongoing entities, but also can be an effective tool to promote entrepreneurship.<sup>10</sup> Youth are increasingly turning to entrepreneurship as an alternative to public sector jobs. A recent EY study found that 76% of youth surveyed in the MENA region want to run their own businesses.<sup>11</sup> Many entrepreneurs are forced into the informal sector or discouraged before they even start. Archaic bankruptcy laws also have created a stigma of failure and in many countries it is a criminal act. Reforming the legal framework can remove the fear of failure for many entrepreneurs and encourage them to start their own businesses.

<sup>10</sup> EBRD, *Revolutionizing jobs: Can insolvency reform reduce credit risk for investors and help address unemployment in the Middle East & North Africa region?* 2014.

<sup>11</sup> EY global job creation and youth entrepreneurship survey 2015.

## How inadequate regulatory frameworks feed instability



### Specific country reforms and stakeholder engagement

Comprehensive bankruptcy reform is a significant undertaking for any government; it includes participation not only from government agencies, but also the local financial institutions, corporates and civil society, and cuts across all industries. Given the complexity of the reform, any regulatory reform initiative needs to be led by the host government to ensure leadership and engagement by all actors, but supported by active participation from the private sector and other stakeholders including private sector representatives (such as business associations, working groups or task forces), and international institutions (such as the EBRD, UN and World Bank for technical capacity-building).

Jordan provides a useful example of the need for insolvency reform and illustrates the myriad regulatory processes that need to be undertaken to address this issue. In the World Bank's Doing Business 2015 rankings, Jordan ranked 146 in the resolving insolvency category (out of a total of 189). For a country struggling to generate economic growth strong enough to address its high youth unemployment levels (at almost 30%), insolvency reform is critical. On almost all sub-categories Jordan ranks among the lowest globally, including time in years (3), recovery rates (27 cents on dollar) and cost of estate (20%).

Jordan has no specific insolvency law and sets standards for bankruptcy and insolvency coded in its commercial laws. According to the European Bank for Reconstruction and Development (EBRD), there is no single, unified insolvency law in Jordan. Instead insolvency-related legislation is found in two sources: the Commercial Code and the Companies Code.<sup>12</sup> The insolvency law framework is liquidation-focused

and offers limited opportunities for business reorganization within an insolvency context. In particular, there is no possibility of including secured creditors in a compromise or settlement procedure without their consent. Secured creditors rank behind taxes and amounts owed to employees in any liquidation of legal entities.

The process of bankruptcy reform in Jordan has been lengthy; a temporary law was put in place in 2002 with a new comprehensive law pending. Jordan, like many MENA countries, depends on small firms to drive job creation. In Jordan, however, recent studies indicate, although young firms generate more than 40% of jobs creation, small firms are not growing.<sup>13</sup> The World Bank points to several key factors: start-up creation is low due to barriers to starting and closing a business; low productivity improvement; and discriminatory policy implementation

Among its top policy recommendations, the report cites administrative barriers to firm entry such as “cumbersome bankruptcy laws” and policies that support entrepreneurship as top priorities. Additionally, the report suggests that including citizens in the consultation and drafting process is critical to the success of policy reform.

<sup>12</sup> EBRD, *Commercial Laws of Jordan: An Assessment by the EBRD*, July 2013, <http://www.ebrd.com/downloads/sector/legal/Jordan.pdf>.

<sup>13</sup> World Bank, *Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa*, 2014, <https://www.worldbank.org/content/dam/Worldbank/document/MNA/jordan-issue-brief-jobs-or-privileges.pdf>.

# Modernizing Bankruptcy and Insolvency Regulation



*Rola A. Dashti, Chairman, FARO International, Kuwait; Chair of the 2015-2016 Global Agenda Council on the Middle East and North Africa.*

The MENA region needs to pass or revisit regulation on bankruptcy and insolvency laws to keep pace with modern laws and best international practices. For adoption of effective bankruptcy and insolvency, useful guidelines are the World Bank Principles for Effective Insolvency and Creditor/Debtor Rights Systems, and Model Law on Cross-Border Insolvency, promulgated by the United Nations Commission on International Trade Law (UNCITRAL).

Bankruptcy and insolvency laws are an important step to support economic growth and increase foreign direct investment. In addition, the presence of such laws will enhance growth in entrepreneur start-ups and increase employment rates. It will provide entrepreneurs with a safety net that enables and encourages them to take economic, investment and career risks that lead to innovation and progress from which society will benefit. Also, it will mitigate the risk of penal proceedings on business failure.

Modern bankruptcy and insolvency laws enhance governance and transparency, and increases investor confidence in markets. They also improve ease of doing business, thereby raising competitiveness. They allows resources to be quickly returned to productive use, and increase efficiency in dealing with distressed companies through organizing and restructuring the accumulated debt repayments, along with appropriate asset liquidation procedures, which help to maintain market vitality.

When adopting bankruptcy and insolvency laws, it is important for governments to apply transparent regulations on the procedure for restructuring and winding up companies. Policy-makers need to consider the following three components of bankruptcy procedures:

## 1. Duration

Policy-makers need to consider strategies to encourage fast-moving and timely liquidation or reorganization of a business to improve the efficiency and effectiveness of bankruptcy proceedings. Also, an efficient and swift insolvency regime ensures greater availability of credit or funds for businesses by freeing up capital, and is thought to boost innovation and productivity. Countries such as Ireland and Canada, for example, take less than a year to wrap up an average bankruptcy case.

## 2. Cost

Lowering the direct cost of bankruptcy will enhance the effectiveness of bankruptcy and insolvency laws. High costs can discourage firms from filing for bankruptcy even when, at the societal level, it would be more valuable for them to shut down so their resources can be diverted into more profitable opportunities. High costs can also deter some entrepreneurs from starting a business. Countries such as Singapore and Finland have a minimum bankruptcy cost of about 4.5% of a firm's assets.

## 3. Debt relief and restructuring

Bankruptcy and insolvency laws need to provide clear and easy procedures to allow flexibility in debt restructuring in ways that strike a meaningful and appropriate balance between creditors and debtors, and guarantee the rights and obligations of all parties. They also need to take into account the importance of supporting the debtors in developing a plan to restructure the business, protecting them from prosecution and helping them to meet their obligations – liquidation of assets should be a last resort. The salvage of an enterprise in financial difficulties has become the principal focus of bankruptcy legislation, with particular concern for the protection of workers, maintenance of employment opportunities and impact on the broader economy.

Bankruptcy and insolvency laws require an entire legal infrastructure, effective insolvency systems, speedy court ruling, honest courts with competent and impartial judges, lawyers and accountants experienced in insolvency proceedings, and clear methods for efficient enforcement. It should be highlighted that without adequate legal protection and enforcement, effective insolvency systems and transparent procedure, the economy will not reap the benefit of bankruptcy and insolvency laws. The issue is especially important when the owner is the government, as most bankruptcy laws are silent about insolvency of government-related firms.

# Simplifying the Process of Creating a Company in Kuwait



Scott Gegenheimer, Group Chief Executive Officer, Zain Group, Kuwait

In an era where innovation and entrepreneurship ecosystems are critically important to the development of a knowledge economy, it is necessary to create an enabling and supportive environment that allows entrepreneurs to rapidly convert their original ideas into well-managed operational start-up businesses and subsequently into early-stage and growth stage companies.

A fast-track company formation process, incubation and access to smart capital through “angel” investors, as well as operational guidance and strategic mentorship throughout the business development cycle, are the support tools and processes entrepreneurs need to establish and then to scale their businesses.

## Hurdles to forming a company

Although Kuwait has already included a number of strategic objectives in its Kuwait 2035 vision, a plan to transform the country into a regional finance and trade hub, with a key focus on private sector development and entrepreneurship – one of the country’s main impediments – starts with the registration and establishment of companies.

Several research reports<sup>14</sup> highlight that the registration and establishment processes for a business in Kuwait currently involve up to 13 procedural steps (depending on the type of business), with an average duration of 31 days. In other GCC countries, the processes can take as little as one week. In general, the average length of time for business registration in Kuwait is higher than the MENA average of 18.8 days, and anecdotal evidence suggests that it could take a few months. Furthermore, although steps have been taken to reduce the minimum registered capital requirement (MRCR) for various forms of entities, including the passing of Ministerial Decision No. 234 of 2015; the MRCR is still relatively high.

The Kuwait Direct Investment Promotion Authority (KDIPA), an independent public authority established in accordance with Direct Investment Law No. 116 and with representation from the public and private sectors, is focused on initiatives

designed to remove hurdles encountered by investors by providing various means of assistance and support. For example, the KDIPA has established the Investors Service Centre (ISC), which will be the future one-stop shop for company establishment and registration and the issuance of trade licences. KDIPA is actively taking steps to reduce the time of business formation and improve efficiency by bringing representatives from relevant arms of government under one roof to streamline the processes. KDIPA has established a Permanent Committee for Streamlining Business Environment in the State of Kuwait (PCK). Furthermore, KDIPA signed an agreement with the World Bank last year to develop approaches and identify priority reforms for streamlining business formation in Kuwait.

Within this paper, we set out a number of reforms for consideration by KDIPA and other arms of government to alleviate some of the challenges that still persist with company formation processes, as well as subsequent business development and growth.

## Suggested reforms

### *Reduction or elimination of the MRCR*

Today, the MRCR in Kuwait ranges from 1,000 Kuwaiti dinar (\$3,300) for limited liability companies to 25,000 Kuwaiti dinar (\$82,675) for public shareholding companies. The MRCR amount depends solely on the legal form of the entity rather than the actual business size, economic activity or sector. Given that most entrepreneurs may not have access to the requisite levels of capital and would have to cover the actual cost of registration as well, the high levels are more than likely to impact entrepreneurship and business development. Typically, MRCR is lowest in Europe and Central Asia.

Research indicates that in recent years many governments have stopped requiring new businesses to deposit minimum capital in banks or with notaries before they can begin operations. Of the 189 economies studied in the World Bank *Doing Business 2014* report, 99 have no minimum capital requirements – with 39 countries having eliminated MRCR in the past seven years. Specifically in MENA, the MRCR has been reduced from \$14,000 to less than \$2 in Jordan, while the MRCR has been eliminated altogether in Morocco, Saudi Arabia, the United Arab Emirates and Egypt. Today, Kuwait MRCR is at 8.2% of per capita income, a reduction from 74% of per capita income in 2014.<sup>15</sup>

<sup>14</sup> World Bank *Doing Business 2015* report; 2015 Oxford Business Group *Report on the State of Kuwait*; and 2011 Kuwait Financial Centre (Markaz) *Review of the Kuwait Development Plan*.

<sup>15</sup> World Bank, *Doing Business 2016: Measuring Regulatory Quality and Efficiency*, 2016.

## **We advocate a further reduction in the MRCR beyond levels proposed in 2014-2015 or complete elimination.**

Eliminating or lowering the MRCR will foster a more inclusive entrepreneurial environment by removing an unnecessary barrier to starting a business. This will lead to a direct increase in registered businesses, which means new jobs and better prospects for economic growth.

### *Reduction of time for company formation*

Among the six GCC countries, it takes longest in Kuwait to form a company. Kuwait currently stands at 31 days compared with Oman (7), UAE (8), Qatar (8.5), Bahrain (9) and Saudi Arabia (19). The MENA average is 18.8; the OECD average is 4.7.

## **We advocate that in the next 12 months, Kuwait should aim to achieve at least the MENA average of 18.8 days. Within 36 months, Kuwait should aim to achieve the OECD average.**

The length of time for company formation should be an overarching key performance indicator (KPI), which will be a measure of the success of the implementation of all initiatives set out in this paper.

### *Development of a complete online system for business registration*

Kuwait does not have an online portal for business registration and establishment documentation filing. Instead, all procedures involve the retrieval and submission of hard-copy forms. The introduction of an online system will streamline the registration process, eliminate waiting times, improve transparency, reduce the cost of serving investors and ultimately lead to a reduction in the time needed to complete the process.

## **We advocate the deployment of a complete online system which will serve as a virtual one-stop shop.**

It will not be enough simply to deploy a web page setting out a text-based description of the registration process. Instead, the set-up of a complete digital ecosystem that will appeal to today's entrepreneurs who, for the most part are digital savvy, is needed. The ecosystem should consist of an online interactive, multimedia, web-based portal, combined with matching social media pages and profiles (Facebook, Twitter, LinkedIn, Instagram, Google+ and You Tube). The portal should provide access to:

- Instructional/education, step-by-step videos that will guide users through the registration process
- Electronic "e-book" newsletters that will outline regulatory policies and frameworks and case studies of company formation
- An IVR-based contact centre, help desk and live chat facilities to help users of the service
- A smartphone app for tracking registration

This is, of course, should be alongside standard features that include company and trademark name search, which will require digitization of existing records, registration form-filing

and submitting, payment of fees, etc. The portal should also support at least two languages: Arabic and English.

Stakeholders can undertake the following steps to enhance online capabilities:

- Examine best practices adopted in the top 10 countries ranked by the World Bank's Ease of Doing Business Index
- Co-opt and develop an advisory committee consisting of public and private entities to advise on additional requirements to be addressed by the online system, as well as to provide advice and actual support on payment gateways, connectivity, mobile applications, etc.
- Outsource to a managed services provider to develop the digital strategy, implementation and management of the online system
- Adopt additional means of original idea generation to improve services such as launching a competition or forum for in-country entrepreneurs and industry participants to provide ideas

All services can be outsourced to a managed services provider who will ensure that the full potential of digitization and electronic data interchange are fully realized. The goal is to provide a complete and rich online experience at a standard expected by the current generation of digital natives who constitute the largest number of entrepreneurs wanting to launch new businesses.

### *Development of business registration support ecosystem*

Research has shown that the complexity of business registration in most countries almost always forces entrepreneurs to use third-party professionals, such as registration agents, notaries and law firms, to navigate the complexity. Some entrepreneurs even choose to avoid the incorporation process altogether and to operate in the informal sector. Third-party services are used in 53% of the 189 economies surveyed in the World Bank's 2016 report. In Kuwait, virtually all incorporation processes require third-party support, partly to navigate through the various channels and arms of government that must approve forms and the complex nature of the process and to ensure compliance with the regulatory requirements of filing to incorporate a business. The high and prohibitive costs of starting a business often arise from the fees of third-party professionals.

## **We advocate the establishment of a regulated business registration support ecosystem and recommend that entrepreneurs/investors should have the option – rather than the mandatory requirement – to use these services.**

Some of the steps which can be employed include:

- Publication of regulatory guidelines and policies governing the role, responsibilities and accountability of third-party services – including price caps and expected service levels
- Registration and certification of third-party services by KDIPA

- Publication of the approved and regulated third-party professional services on the KDIPA website
- Regular workshops and seminars to educate third-party professionals on changes to policies and laws governing company registration

## Building blocks for success

Once companies are established, it is critically important to provide additional support and an enabling environment which will facilitate success. Some of these approaches include: establishing incubator and accelerator programmes, and providing access to smart capital.

### *Incubators and accelerators*

A 2010 Global Business Review article published by researchers looking closely at business enablers in the GCC region, defines an incubator programme as follows:

*A business incubator programme consists of a controlled work environment distinguished by particular characteristics that are all intended to create a collegial climate for the training, support and development of successful small entrepreneurs and profitable businesses. These characteristics may include the initial selection of early-stage or start-up entrepreneurial firms with potential for growth; designated work spaces provided for each tenant; shared facilities necessary to operate the business; shared support such as communications and administrative assistance; a small management team which can train, develop and assist the new entrepreneurs; access to critical professional services such as legal and financial assistance and affordable rent and fees for services.<sup>16</sup>*

Start-up incubators help entrepreneurs translate their ideas into sustainable and functioning businesses by guiding them through each stage of starting up and developing a thriving business. Incubators also reduce the risk of small business failures.

In Kuwait, the number of privately-owned and public incubator programmes is still quite low compared with other economies. Although steps have been taken by the government – the establishment of the Kuwait National Fund for Small and Medium Enterprises Development, tasked with the creation of technology hubs, incubation, acceleration and venture capital – and private efforts such as Sirdab Lab, also focused on incubation and venture capital, there is still a long way to go.

### *Access to smart capital*

Making it easier for entrepreneurs to access capital facilitates the process of starting a business. Providing pathways for start-ups to access funding creates a more inclusive entrepreneurial environment and is particularly helpful for starting micro projects. As SMEs obtain greater pathways for medium- and long-term growth financing, their chances of contributing to job creation and economic growth are directly improved.

<sup>16</sup> Hanadi Mubarak Al Mubarak and Michael Busler, "Business Incubators: Findings from a Worldwide Survey, and Guidance for the GCC States", *Global Business Review*, 2010.

However, the provision of capital is insufficient. Instead, access to "smart capital" is even more important. Smart capital represents the provision of financing combined with strategic and operational support, entrepreneur mentoring, corporate governance advice and assistance with the recruitment of human capital, all designed to help a start-up company successfully transition from an early-stage entity to a growth-stage business and, subsequently, a fully-fledged profitable organization in its own right. Companies that scale contribute to the largest proportion of the share of jobs in most economies and play an indispensable role in economic growth.

WAMDA Research Labs, a subsidiary of WAMDA Capital, a venture capital fund in the Middle East, published an extensive report reflecting sample opinions from entrepreneurs, experts and investors on approaches to alleviating growth challenges in MENA.<sup>17</sup> The report cites a survey in which 60% of entrepreneurship experts have indicated that scaling is the most challenging development phase for entrepreneurs in the region – more than starting a business, institutionalizing, launching and exiting. "Obtaining an investment" was identified as the second barrier to scaling (28% of expert respondents). Surveyed entrepreneurs cited the supply of venture funding in their countries as small (36%), while the next most selected challenge was "investor not offering enough value beyond cash (24%)".

The Kuwait government will need to rely on the private sector and local and regional venture capital firms to provide this form of non-financial, operational and strategic support and to provide access to other value-creation drivers.

## **We advocate the establishment of an entrepreneurial advisory entity, with representation from the public and private sectors, to address incubation, acceleration and smart capital initiatives.**

The advisory committee will provide guidance on the:

- Establishment and management of incubators and accelerators
- Development of ecosystems to support smart funding and venture capital programmes
- Establishment of specific training and development programmes for new businesses, including cash-flow management, intellectual property, corporate governance business plan creation, etc.

<sup>17</sup> Wyne, Jamil, "The next step – Breaking barriers to scale for MENA's entrepreneurs", *WAMDA Research Lab*, March 2014.

# Transparency and Good Governance: A Road Map for Job Creation and Inclusive Growth



By Mahmood Sariolghalam, Professor of International Relations, National University of Iran, Islamic Republic of Iran.

## A framework for transparency and good governance

Political and economic elites as well as governments need to have a firm determination to move their countries forward. This will be critical as a starting point. Ideologies, religious or otherwise, only divide. Statecraft is the art of solving problems through local traditions as well as global knowledge. When one studies the European experience in development, business, trading and labour groups gradually were empowered through their skills, organization and financial power. Consequently, they were able to demand justice and rule of law from their sovereigns. The Middle East has a history of weak societies and powerful states. If these countries aspire to develop, the initiative lies within the conceptual and organizational capacities of their elites. One should be mindful of the fact that the Republic of Korea, Indonesia, Turkey, Chile, Brazil and Argentina were originally motivated to develop by their military elites.

The fortitude to change and develop is far more significant than the nature of the social or political class of elites. An elite group's interest in national harmony and its wealth is the primary growth engine. As a universal trend and a prerequisite to sustained development, citizens' mental and real satisfaction is instrumental to national security and even to regime security. Many Middle Eastern countries are experiencing challenging processes for state building. Their focused attention on the economic and social needs and aspirations of their citizens is vital for their security. Political liberties surface only after economic and basic needs are fulfilled. Any nation that feels happiness is being achieved through the policies and programmes of its responsible politicians will uphold its identity and even the identity of the ruling elites. Democratic principles and institutions will only materialize in a process, a process where wealth is created and evenly distributed.

Political disturbance in the Middle East – and even radicalism – is the result of oligarchies, inattentive elites and poor distribution of resources. Most Asian countries are not democratic, yet many have responsible governments focused on sustained development that benefits most citizens. As wealth is created and the middle class expands, these Asian states will have to address political transparency,

independent media and party competition. National security and even regime security are therefore achieved when citizens are happy economically and feel their country is moving in the right inclusive and efficient direction. Transparency is a derivative of good governance. Transparency is a basic requirement initially and particularly in the economic realm, gradually maturing in the political arena.

## Transparency and good governance: Guidelines for implementation

There are three areas that need to be addressed in dealing with good governance and transparency:

1. Rules and regulations
2. Law enforcement
3. Media

A country that is ruled by regulations can proceed with development. A successful Asian country in this regard is Singapore followed by the Republic of Korea. Since the Middle East and North Africa (MENA) region is in the process of state building, its most immediate task is to move towards a system of rules and regulations. In all areas of finance, trade, taxation, customs and overall economic policies, the legal framework of a country should be understood with utmost clarity. Such rules and regulations cannot be based on an individual or founded on individual discretion. Given regional and international conditions, such regulations also need to be stable for the medium- and long-term attraction of foreign direct investment. The less politicized the process of a country's rule-making, the more reliable and predictable it will be both for internal and external investors. Even more important is the whole domain of rule enforcement. It must be in the subconscious of those in the political and economic contexts that law enforcement is a serious and unquestionable matter. In all successful economies, such a tradition is pervasive.

A law-abiding and law enforcement culture needs to be cultivated not only in the print media, but also in the television networks. Investigative reporting of corruption and

violations of regulations should be encouraged. Such a journalistic atmosphere must include both the private and the government sectors. These matters need not interfere with political or state security. Discipline in the economic and financial sectors should be taken seriously. Though government policies are relevant for promoting inclusive growth, the media can play a more significant role in raising awareness as well as highlighting the contradictions that impede such inclusiveness.

Companies and state institutions need to be sensitive to public opinion for their reputation and efficiency. In this regard, labour unions can, and should, be allowed to be more organized and demand – both peacefully and professionally – justice and equality. Political elites should be supportive of such qualitative expansion of civil society. A country develops when both its society and government are empowered and state-society relations are further regularized. Investors appreciate stability and rule of law. Once economic outcomes become predictable, companies are more inclined for greater involvement over the long term. These issues are applicable to all MENA countries regardless of size, regime type and economic structure.

## Country groupings

MENA countries can be grouped into four on the basis of size, population, human and/or natural resources, domestic consumer and capital markets, geopolitical significance, historical and cultural relevance:

1. Saudi Arabia, Iraq, Egypt, Iran, Algeria
2. UAE, Kuwait, Qatar, Bahrain, Oman
3. Jordan, Tunisia, Morocco, Lebanon, Palestinian Authority
4. Yemen, Libya, Syria

The first group of countries are sensitive to political and even economic reforms initiated from the outside. Therefore, cautionary measures need to be implemented to project cooperation, coordination and dialogue with these countries. At least in economic growth and development, it must be realized that some degree of sovereign rights must be given up. In other words, political sovereignty needs to be differentiated from economic sovereignty. Although there is still some diversity in this group, they all require foreign investment and particularly technology to develop industries that produce economic growth and jobs.

In all four groups, partnership with foreign investors and companies is essential for growth and development. Reform in smaller countries may be more promising because there is more willingness for cooperation and learning and also more awareness of vulnerabilities. Big and more powerful countries may hide behind their financial resources and postpone reforms. Opportunities and impediments to growth, job creation and inclusive growth differ from one country to another, and need to be recognized. The UAE is a successful story in terms of cooperation and partnerships.

No elite group can adopt a purely local and endogenous outlook when it comes to economic development. Regionalism, as seen in Asia and Latin America, is on the

rise, with economies locked to one another and the capital, labour and consumer markets in competitive mode. The reduction of barriers is both constructive for growth as well as competition. In this context, while every country needs to customize its particular model of development, it also needs to meticulously delineate the following:

*Wealth creation:* As Asian and Latin American countries have focused successfully on wealth creation as a general strategy for economic improvement and even political stability and legitimacy, this universal purpose has no substitute in the contemporary international system.

*Comparative advantage:* Joint ventures in areas where there is comparative advantage can create jobs and sustain an industry where there is a market at home and in the close neighbourhood. Being locked to interested economies can also be a useful strategy. Poland has locked itself to Germany, with widespread technical, financial and industrial benefits. The long-term view is instrumental, while domestic political stability and rule of law are guaranteed. Even generational commitments are crucial at least to develop horizons and to secure political stability. No country has been able to improve its economic conditions without paying close attention to changing its business environment.

*Time-sensitivity:* MENA countries take longer than in other regions of the world to implement reforms. The government, the private sector, banks, contractors, labour groups, engineering groups and all related planners need to be more time-conscious when it comes to completing projects. Efficiency and time-consciousness are critical for creating jobs and accelerating the economic cycle.

*Local partnerships:* The political elite of each country can bring about a long-term outlook as well as a partnership between the private sector, public enterprises, academia, NGOs and the media. Sometimes it may be necessary to include the security services and the military for confidence-building and inclusive growth. A consensus on the outlook is strategic for the success of the effort.

*Infrastructure and education:* While partnerships in industrial and consumer goods may be more profitable and bring about quick economic and tangible results, elites also need to pay close attention to infrastructure and the educational system to provide the necessary tools for sustained economic growth and development.

# Corporate Governance for Competitiveness in the Middle East and North Africa



*Badr Jafar, Chief Executive Officer, Crescent Enterprises, United Arab Emirates<sup>18</sup>*

Trust underpins all economic activity, and economies flourish and fail to the extent that they establish or undermine institutions to support and promote it. The corporation is one of the most powerful of these institutions, and its ability to generate trust is central to its commitment to, and influence over, all of the stakeholders it interacts with.<sup>19</sup> Ultimately, earning and generating trust is what good corporate governance should seek to achieve.

Recent events involving fraud, waste, nepotism, abuse of power, conflict of interest and corruption have shone a light into the darkest corners of the corporate landscape. They have brought corporate governance, previously considered by some to be an arcane and technical topic, to the fore as a business imperative. It has become increasingly clear that corporate governance is not about policing or uncovering scandals; it is about creating long-term value, and building the environment of trust, transparency and accountability that is necessary for fostering investment, financial stability and business integrity. As a result, better corporate governance practices support stronger and more sustainable economic growth and help build more inclusive societies.

In practice, corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders, and provides the core foundation and structure through which corporate objectives are defined, monitored and achieved. Even though certain pillars on which corporate governance rests are contained in laws and regulations, true corporate governance is about far more than just compliance and the adoption of generic standards. Rather, good corporate governance practices need to be fully integrated into the culture, strategy and operations of an organization. When

this occurs, corporate governance fundamentally improves the quality of decisions being made, enhances the substance and structures of internal controls, boosts competitiveness, encourages investment, and builds reputation and trust among stakeholders.

Corporate governance is crucial for the sustainability of privately-held, listed and state-owned companies across the Middle East and North Africa (MENA) region. It is critical for family businesses, many of which are undergoing generational change, for listed companies which are seeking to attract international investment, and for state-owned businesses backed by public funds and dependent on the trust of citizens.

## Privately-held firms

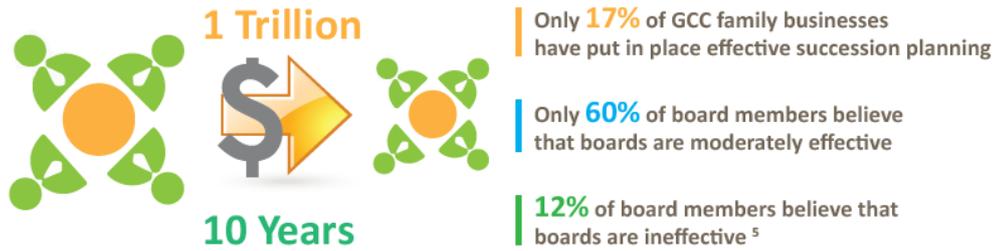
While significant progress has been achieved over the past decade in establishing governance frameworks for listed companies in particular, and especially in countries with large capital markets, progress in improving governance of privately-held family firms has been slower. As a result, the quality of governance practices displayed by privately-held firms in the region varies significantly. While some have embraced a culture of better governance, others are persisting with practices that are dangerously ill-suited to the region's increasingly complex and globally-integrated economic environment.

The recent reform of company legislation, especially in the Gulf Cooperation Council (GCC) countries, heralds an important step forward in advancing shareholder rights and promoting disclosure from privately-held firms. However, in light of a lacklustre initial public offering (IPO) pipeline in most countries of the region, it is clear that creative solutions are still required to improve the governance arrangements within privately-held firms. Importantly, these solutions must strike an appropriate balance between the flexibility required by family businesses and the need for large, systemically important firms – regardless of their ownership structure – to abide by internationally recognized governance standards.

<sup>18</sup> The following piece is an abridged version of "Corporate Governance for Competitiveness in the Middle East and North Africa" developed by Crescent Enterprises in collaboration with Alissa Amico and The Pearl Initiative as Knowledge Partner. Co-editors and contributors of the report include Badr Jafar, Tushar Singhvi, Kirsty Smallman, Ghada Abdelkader and Imelda Dunlop. The full report can be downloaded at: [http://www.crescententerprises.com/media/WEF\\_MENA\\_RBC-CE\\_Report\\_on\\_Corporate\\_Governance.pdf](http://www.crescententerprises.com/media/WEF_MENA_RBC-CE_Report_on_Corporate_Governance.pdf).

<sup>19</sup> Klein, Michael, "Firms Behaving Nicely: Incentives and Commitment", *FC Corporate Governance Knowledge Publication*, 2013.

**FAMILY-OWNED ENTERPRISES in the GCC are estimated to hand over  
1 trillion USD of assets to the next generation over the next 5-10 years**



Sources: The Economist, 2015; McKinsey; GCC Board Director's Institute, 2015.

The economic significance of family firms should not be underestimated. In the next 5-10 years, over \$1 trillion of assets in the hands of family firms is expected to pass from one generation to the next (The Economist, 2015), the majority of which are transitioning from the second to the third generation. This succession is where the greatest destruction of value has occurred in the past with, on average, only 30% of family businesses surviving beyond the third generation.

Stronger corporate governance policies could serve as a key preventative measure to mitigate this huge risk, which has the potential to have major ramifications on employment and economic activity in the region. Importantly, while most family firms recognize the importance of corporate governance, implementation remains an issue. That is why policy reforms are needed to create a more enabling environment for improving governance within the region's family businesses.

Policy recommendations for privately-held firms in MENA include:

- Tangibly improving the quality of governance arrangements in private firms will require enhancing standards embedded in company laws.
- Policy-makers should consider introducing specific requirements for private firms whose capital is open to multiple shareholders and/or large companies as measured by specific metrics.
- It is recommended to enhance the role of the companies' comptroller, the Ministry of Commerce or equivalent in the dissemination of corporate information.
- Further thought as to mechanisms which would allow founding shareholders to retain control while introducing stringent minority shareholder protections is merited.
- Attracting family businesses and SMEs to list remains a major challenge in the region, which needs to be addressed in order to deepen equity markets and to provide new sources of equity financing for growth companies.

**Listed firms**

The quality of governance practices of listed firms in the region has seen a significant improvement since Oman first introduced a dedicated corporate governance code in 2002. Since then, most countries in the region have adopted a code for listed companies based on the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance. Following the introduction of corporate governance codes and related securities regulations, the emphasis in the corporate governance debate has focused on the enforceability of these rules which currently lie, within the GCC countries, almost exclusively with the securities regulators.

A recent survey of enforcement activity of the region's securities regulators demonstrates that their capacity requires further development in most countries of the region, owing to their relatively recent establishment and lack of experience in prosecuting complex cases (OECD, 2014). While the governance practices of listed firms have certainly improved in a number of ways, some areas have come under the spotlight such as the effectiveness of boards of listed companies and the quality of disclosure practices which continue to be a key concern for foreign investors, hampering the ability of the region to attract the same levels of institutional investment as other emerging markets.

Policy recommendations for listed firms in MENA include:

- The implementation of corporate governance standards by listed companies has been driven by compliance requirements and has not had the desired impact on the corporate culture.
- Governments may wish to consider requiring institutional investors such as pension funds and insurance companies to formulate and disclose their voting policies and decisions pertaining to their local listed holdings.
- Securities and sectoral regulators responsible for the regulation and oversight of investors should examine how they and their investment committees are governed and how they exercise their voting rights.
- Effective enforcement of corporate governance rules requires more rigorous public enforcement by securities regulators as well as a more effective framework for the private enforcement of shareholder rights.

## State-owned enterprises

Despite the significant privatization momentum that emerged in the 1980s and 1990s, state-owned enterprises (SOEs) remain some of the largest employers and service providers in the region. Only few MENA countries have subjected their SOEs to comprehensive governance reform beyond privatization. This has resulted in governance structures in MENA SOEs, which are, on average, far less transparent as compared with listed companies and with their peers globally. Additionally, the quality of SOE governance varies significantly across the region, whereby countries such as Algeria and Tunisia still lag compared with the majority of GCC countries, which have made strides in professionalizing SOE boards and in ensuring more effective oversight. Areas of priority to address in the future include anti-corruption in SOEs and integrity in their relationship with the private sector as well as competition regulation.

Policy recommendations for state-owned enterprises in MENA include:

- The establishment of independent sectoral regulators is essential to create a more level playing field between SOEs and their private counterparts.
- Empowering competition authorities is crucial for creating a level-playing field with the private sector.

- The private sector in the region stands to benefit from the creation and better resourcing of anti-corruption authorities as well as state audit bodies.
- The introduction of corporate governance codes or regulations for SOEs would be useful to bridge the governance gap between SOEs and publically-listed firms.
- The practices of leading and successful SOEs in the region and globally should be shared in order to promote them across the region.

## Why corporate governance matters

Corporate governance is a critical aspect of business and organizational management. Well-governed companies are able to attract and retain the best talent, much better equipped to deal with a volatile economic environment, more sustainable in the long term, and attract greater foreign investments. Good governance is essential in emerging markets in order to create an environment of trust for outside investors, especially when most companies are controlled by a single or a few shareholders and where the risks of shareholder abuse are perceived to be high.

### INVESTORS ARE READY TO PAY A PREMIUM FOR GOOD GOVERNANCE, ESPECIALLY IN EMERGING MARKETS



**15%** of European institutional investors consider corporate governance to be more important than financial issues such as profit performance or growth potential.



It is estimated that **22%** of European institutional investors are willing to pay a premium of 19% on average for a well-governed company.

Source: McKinsey, 2002.

Corporate governance is an integral part of the solution to both the immediate and longer-term challenges facing most MENA enterprises, including corporate sustainability, investment attraction, internationalization and competitiveness. The obstacles to improving corporate governance for listed, private and state-owned companies in the region are often unique to each country and specific to the different types of enterprise. At the same time though, there are common themes identified that deserve to be explored at the regional level, recognizing that measures to improve governance need to be scalable and adaptable to the size and sophistication of equity markets, the prevalence of state-owned assets, and the unique characteristics of the SME sector that underpins all economies in the region.

Improving governance in family businesses must remain a priority considering that \$1 trillion of assets are expected to be passed on from one generation to the next in the GCC region alone within the next 5-10 years. Insufficient progress has been made on this front in the region to date. Further requirements should be considered for large, systemically-important enterprises or firms that, while privately held, have a particularly wide shareholder base. Further progress is also needed to ensure minority shareholder rights in privately held firms are respected.

While having evolved at a faster pace, governance within listed companies also requires improvement in order to attract more institutional capital to the region's markets, particularly following the opening of the Saudi stock exchange and the easing of investment limits for foreign investors in markets such as Qatar. Improvements in the

governance of listed companies have been notable, especially in markets where corporate governance codes apply on a “comply-or-explain” basis, but less so in other markets where recommendations remain voluntary. The enforcement of corporate governance rules remains a challenge, even for listed companies, and legal changes are likely to be required to adequately address this issue.

Today, institutional investors in MENA markets are generally passive. Institutional investors need to be more engaged in a stewardship capacity to create stronger demand for better corporate governance. They need to engage with the boards and executives of listed companies on issues they see as critical to the future success of these firms. It is recommended that governments require institutional investors such as pension funds and insurance companies to formulate and disclose their voting policies and decisions when they vote on specific issues at the AGMs of local listed companies.

While questions of privatization must rightfully remain with governments, creating a more level playing field between SOEs and private firms is needed to improve conditions for growth and employment in the private sector. The introduction of governance codes or regulations specifically aimed at state-owned companies based on internationally recognized principles could help to bridge the governance gap between state-owned and private firms in the region.

The World Economic Forum’s MENA Regional Business Council is well-positioned to develop suggestions on how good governance can contribute to greater sustainability, productivity and integrity at the micro level while addressing macro challenges such as the need to create jobs, stimulate

# Appendix

## World Economic Forum Press Release

### Making Complex Reforms Work in MENA – Seven Principles for Public-Private Cooperation

**Geneva, Switzerland, 1 June 2016** – A select group of over 70 leaders from business, government, academia and civil society met at World Economic Forum headquarters in Geneva to steward an action-oriented agenda on the Middle East and North Africa’s most pressing challenges. Convened under the theme “Redesigning Public-Private Cooperation for the Middle East and North Africa”, the meeting focused on two imperatives for the region: peace and prosperity.

Given the instability and geopolitical disruptions posing unprecedented challenges to prosperity in the region, participants explored the fragile security and humanitarian context. They agreed on the need for collaborative diplomatic action to help resolve conflicts in Syria, Iraq, Libya and Yemen, and for private-sector innovation in humanitarian aid delivery. “The World Economic Forum is committed to providing the international community a platform for greater public-private collaboration to respond to humanitarian and diplomatic imperatives,” said Klaus Schwab, Founder and Executive Chairman of the World Economic Forum.

The current reform momentum created by low oil prices is seen as a key enabler for prosperity in the region. The reform needs are well recognized but, due to their complex nature, how to successfully implement them is not. In addition, the broad range of social issues in the Middle East and North Africa makes it challenging to find political consensus for undertaking successful reforms, especially for unpopular but needed ones.

In a pledge to make complex reforms work, representatives of the World Economic Forum’s communities, including leaders from government, business and civil society, defined the following seven principles for public-private cooperation to promote an effective and inclusive reform process:

1. **Create a clear vision** – Leadership’s vision and political commitment are the most important prerequisites for successful reforms and provide the framework for planning and implementation
2. **Establish an environment for trust** – The decision-making process needs to be transparent and provide confidence that the reforms will genuinely benefit social and economic progress
3. **Foster inclusive collaboration** – Reform implementation needs to be a collaborative process among government, policy-makers, the private sector and civil society with the objective of generating balanced benefits for all citizens
4. **Consult public beforehand and maintain momentum through regular communication** – Along with effective communication, it is important to consult the public before planning reforms, continuously communicate during the process, and inform the public about the results achieved



5. **Enable an ecosystem for accountability** – Social and economic progress requires the government to establish an ecosystem that encourages and validates citizen demand for accountability
6. **Attract and promote talent** – Considering the national interest and complexity of reforms needed, their design and implementation call for consulting the best experts available
7. **Build foundations for stability** – Greater public-private collaboration is imperative to address the humanitarian crisis and build regional cohesion because peace is fundamental to prosperity

“The principles defined by our core communities take the agenda for public-private cooperation to a new level, consistent with the needs of the region today,” said Miroslav Dusek, Head of Middle East and North Africa and Member of the Executive Committee, World Economic Forum.

#### Notes to Editors

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