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THE ROLE OF CORPORATE GOVERNANCE IN ATTRACTING FOREIGN DIRECT INVESTMENT TO THE ARAB COUNTRIES

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ABSTRACT

After the nineties, the Arab counties witnessed a growing interest in corporate governance because of the escalation of corruption and the lack of strust by foreign investors. the aims of this paper is to address the crucial role of the corporate governance; as a prerequisite for attracting foreign direct investments to the Arab countries, because of their impact on efficiency and earnings management factors, as well as making the right investment decisions

KEYWORDS*: Corporate governance, foreign direct investment, Arab countries, international rapports.*

INTRODUCTION

Corporate governance gained an important position after the succession of the various financial crises that occurred in many countries; which witnessed the collapse of many substantial and "*heavy-weight*" institutions, due to the lack of their managements to good practices in monitoring and supervision, financial statements fraud and the false accounting information contained therein.

After the nineties, the Arab counties witnessed a growing interest in corporate governance because of the escalation of corruption, and the reluctance of many foreign investors from entering the Arab markets for the lack of trust, despite the urgent need to various funding resources to achieve the economic development, namely the foreign capitals in the framework of foreign direct investments.

Therefore, the purpose of this study is to address the crucial role of the application of the corporate governance principles; as a prerequisite for attracting foreign direct investments to the Arab countries, because of their impact on efficiency and earnings management factors, as well as making the right investment decisions.

1. DEFINING CORPORATE GOVERNANCE

The term "corporate governance" was first used in the early nineties of the last century. Its use increased widely in recent years by experts, especially officials of international, regional and local organizations.

When exploring the international experiences on corporate governance, we note that the US was the first in this field, when New York Stock Exchange (MYSE) proposed rules obliging companies to appoint independent managers, and to review potential risks periodically. As for Japan, Tokyo Stock Exchange announced putting a new applications guide for corporate governance to guide the Japanese institutions[1](Nicole Decoopman.)

For that reason, more attention was paid to the success and maintain of the organization, by preserving the rights of all parties concerned, which are the "stakeholders", and by increasing interest to and implementing the corporate governance principles, which were basically established by the OECD[2](Helbling. C. and J. Sullivan.2003)

Whoever observes the previous events that affected the money markets and the collapse of many American companies such as: the energy company ENRON in 2001, the global telecommunications company WorldCom in 2002, and some European companies AND in Eastern Asia, is aware that they are the main reasons lying behind the implementation of the corporate governance principles, as well as complying with the transparency and accountability standards; in order to maintain the credibility of information issued by institutions to all shareholders, investors and other parties to ensure the smooth operation of institutions, and activate the performance of the Boards of Directors and Committees related thereto; which reflect the actual financial situations of the economic units[3](Ahmad Mounir Najjar2007).

Many definitions were given to corporate governance for its versatility such as:

1.1 The British Cadbury Committee's report:-

which defined it as "a system by which shareholders are allowed to direct; manage and choose the external controller. It also includes the organization of the rights and responsibilities of the parties related to the company, and providing the mechanism that equilibrates between the company's economic and social objectives on the one hand, and between the individual goals and the company on the other hand[1](Eric le boucher)".

1.2. The Organization for Economic Cooperation and Development (OECD):-

"Corporate governance system as the structure that organizes the company's management and control; ensuring that this structure includes a system of incentives for managers, and that the Board of Directors is linked to the company's performance, which aims to maximize the shareholder profits and encourage management to the best investment of the company's resources"[1](OECD)".

1.3. The International Finance Corporation:-

It defined corporate governance as "structures and processes of control and management of companies centered on the relationship between the Board of Directors, shareholders, qualified shareholders and the rest of the stakeholders. It is also the system by which institutions are managed and business is controlled"[1](FIDA)".

In addition to the definitions of international organizations aforementioned, there are others which were given by some prominent researchers and intellectuals such as Farid Kourtel who defined it "a set of rules, regulations and decisions aimed at achieving quality and excellence in performance by choosing appropriate and effective methods to achieve the objectives and plans of the institutions"[1]([2] Farid Kourtel2008)".

The previous definitions show that the concept of corporate governance seeks to determine how to regulate the relationship between all parties to the organization, and preserve the rights of shareholders and stakeholders while organizing the market values resulting from good performance and the company's functioning activity and increasing its competitiveness.

Transparency, responsibility and accountability concepts are considered as the basic principles of the good corporate government. Literature identified several channels through which corporate governance affects growth and development such as:

- Increasing opportunities to obtain external financing by companies, which may lead to increased rates of investment, achieve higher growth rates and increase the generation of employment opportunities.

- Reducing the capital cost and the high level of the company's evaluation, making it more attractive to investors and thus achieve more investments.
- Building better relationships with all stakeholders and reducing the risk of crises in general and financial in particular; and which may have a significant impact on the economic and social costs.

2. DETERMINANTS OF CORPORATE GOVERNANCE

They refer to the rules and principles that define how decisions are made, and the way powers are distributed within the organization between the General Assembly and the Board of Directors and executives[1](Iskandar Mand Chamlou2002).

Corporate Governance enhances confidence in the national economy and deepens the role of the capital market, increasing its capacity to mobilize savings, raise investment rates and preserve the regional rights and small investors. A good implementation of corporate governance depends on the quality of two sets of determinants:

2.1. External determinants:-

They refer to the regulatory elements that ensure the general investment climate in the country, including all laws regulating the market, efficiency of the financial sector, providing the necessary funding for the projects and efficiency of the regulatory bodies and companies operating in the capital market[1]([2] Michel Garrabe2007),.

2.2. Internal Determinants:-

They refer to foundations and rules that determine the way decisions are made, and the division of authorities between the Boards of Directors, the Directorate and the General Assembly in order to reduce conflicts between interests of all parties.

In addition to internal and external determinants, there are general principles which are indispensable for the good corporate governance including:

3. THE ORGANIZATION OF ECONOMIC COOPERATION AND DEVELOPMENT PRINCIPLES OF GOOD GOVERNANCE

In 1999 the Organization for Economic Cooperation and Development (OECD) issued five basic principles of Corporate Government, and amended them in 2004 by focusing on the following points:

3.1. Preserve the rights of all shareholders:-

It facilitates the exercise shareholders' and property rights owner's rights in main or major functions, as well as their right to participate effectively in the meetings of the General Assembly.

3.2. The equitable treatment of shareholders:-

Ensure the equitable treatment of all shareholders, including minority and foreign shareholders, and be informed on all the transactions with the members of the Board or Executives[1](OECD2008).

3.3.Protect stakeholders and related parties:-

Encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises, and the mandatory respect of the stakeholders' legal rights. Stakeholders should have the opportunity to obtain effective redress for violation of their rights.

3.4.Disclosure and transparency:-

Ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. Disclosure must be made in a fair and timely manner without costs burdens, or in the least costly way possible[2] (OECD.)

3.5. The responsibilities of the Board:-

Ensure the effective monitoring of management by the Board and strategic guidance of the company. They were amended in 2004 and became six criteria.

3.6. Ensuring the Basis for an Effective Corporate Governance Framework:-

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

4. ROLE OF THE CORPORATE GOVERNANCE IN ATTRACTING DIRECT FOREIGN INVESTMENTS TO THE ARAB COUNTRIES

Corporate governance has a large role in enhancing the economy's competiveness in terms of attracting investments, and supporting the economic performance over the long term through several ways and methods namely:

- Emphasizing on transparency of the company's transactions, accounting procedures and financial audit; where corporate governance confronts the corruption that leads to the depletion of the company's resources, and consumes its competitiveness and consequently, the departure of the investors.
- Corporate governance improves the company's management, which helps attract investments under good conditions, and improve the efficiency of the company's performance.
- Adopt standards of transparency with investors and lenders may help to avoid banking crisis.
- The application of corporate governance strengthens the public confidence in the privatization process, and helps the country to achieve better returns from investments which in turn enhances competitiveness.

There are some Arab countries which are very strict in implementing corporate governance standards like the United Arab Emirates, which implements clear rules concerning the responsibility of the members of the company's Boards of Direction; nevertheless, the legal protection of minority stakeholders is still weak in the Arab countries.

The table below demonstrates the Arab countries where powerful ways to protect investors and minority stakeholders exist.

Table 1: Index of the extent of disclosure in the Arab countries

Extent of disclosure index (0-10)			
Most		**Less**	
Saudi Arabia	9	**Mauritania**	5
Lebanon	9	**Djibouti**	5
Bahrain	8	**Iraq**	4
Egypt	8	**Emirates**	4
Oman	8	**Saudi Arabia**	0

Source: The Center for International Private Enterprise guide of the establishment of corporate governance in emerging markets

Qatar also was very careful to implement corporate governance principles by obliging companies to put them into practice, especially after the establishment of the corporate governance system adopted in the financial markets. This system was issued by the Board of Directors at its meeting in 2009 and clarified all matters relating to the responsibilities of the management accountant, the internal control and all the other bodies concerned.

Corporate governance is very important to curb the administrative and financial corruption which impedes the flow of foreign funds foreign to the Arab countries, where principles and values of ethics and integrity that establishes the culture of how companies will realize them is the prerogative of the stakeholders in the private sector, investors, shareholders and participants; beginning with the rule of law and personal commitment, and perseverance to put an end to corrupt practices that allow individuals to use their powers to serve personal purposes.

4.1 Position of the Arab countries in the Corruption Perceptions Index:-

This index is issued by Transparency International since 1995 on a scale from 100 (very clean) to 0 (highly corrupt). The corruption report of 2013 showed that all the countries are still facing the threat of corruption at all government levels, from the issuance of local licenses to law enforcement and regulations.

As for the Arab region, the United Arab Emirates ranked 1st in the Arabic world and 26th globally at a rate of 69 to 2013, improving one place than 2012, and this reflects exactly the levels of corporate governance and volume of foreign capital flows. The table below presents the ranking of the Arab countries.

Countries	World ranking
Somalia	175
Sudan	174
Libya	172
Iraq	171
Syria	168
Yemen	167
Mauritania	119
Egypt	114
Algeria	94
Djibouti	94
Morocco	91
Tunisia	77
Kuwait	69
Jordan	66
Arabia	63
Oman	61
Bahrain	57
Qatar Saudi	28
U.A.E.	26

Source: The Center for International Private Enterprise corruption becomes a way to realize corporate governance in the Middle East and North Africa by Jawad Rachhi May 2012.

Qatar ranked 2^{nd} in the Arab world and 28^{th} globally. Yemen, Iraq, Syria, Sudan, Libya and Somalia are ranked at the bottom of the list both in the Arab world and internationally. Bahrain maintained the 3^{rd} rank in the Arab world and 57 globally, as for Jordan it declined to the 166^{th} rank among 177 countries and Kuwait ranked 7^{th} and 66 globally[1](Http: www.transparency.org/research).

Arab countries rank last in the Corruption Perception Index for many reasons such as:

- ✧ The unclear reform plans aimed at combating corruption effectively and definitely within the government's lack of transparency in decision-making.
- ✧ The problem of obtaining information and their unavailability for law enforcement accountability and punishment of corrupt officials[2](Corruption international, www.act-international.com/ corruption).

However, despite the latest standings observed above, efforts are made actually to curb corruption by applying corporate governance, and widespread it in all the private and public institutions; in order to arrange the financial products and activate the human resources of institutions in the Arab countries, to make transparency and disclosure as a key determinant for attracting foreign direct investments and increase their performance and gains.

The results obtained above relating to the amount of foreign expenditures in the Arab countries confirm the advantages of the strict enforcement of governance and elimination of corruption. This development is due to serious reforms carried out mainly for developing the region and raising the credibility of the investment climate.

CONCLUSION

Corporate governance provides the structure through which objectives are set and attained, and the means of attaining those objectives and monitoring performance are determined. However, it does not concern the internal structures of the company only, but it also requires the participation of supportive external institutions to encourage transparent and efficient markets, and ensure an encouraging environment for foreign direct. Actually, Arab countries have made advanced and encouraging strides in this field, and considered them as a key tool in the fight against corruption as well as complementary to reforms efforts made regarding investment, enforcing strict policies in this respect.

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