

# **Alfaisal University College of Business**

**Saudi Corporate Governance Index 2018**

**Description, Methodology, and Ranking**

**April 22, 2018**

**Corporate Governance Center  
Alfaisal University, College of Business**

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## **Message from President of Alfaisal University**

It is my great pleasure to introduce to you one of Alfaisal University projects done by the College of Business (CoB) with a support from Saudi Arabian General Investment Authority (SAGIA).

Alfaisal University continues to be innovative in establishing programs and projects that serve the Kingdom of Saudi Arabia and its citizens. The initiative of establishing the first Corporate Governance Center (CGC) in the Kingdom is an example. It is used to institutionalize the Corporate Governance (CG) education and practices, and aim to increase the society awareness of good CG and its value for the economy. It received the endorsement of Saudi government agencies that deal with financial regulations, commerce and investment. It is coming at an opportune time for the country as the Kingdom is embarking on fundamental changes in its economy.

The Corporate Governance Team at CGC has been hard at work on this project for the last two years and they are continue putting a good effort to improve and sustain the center.

	<b>HE Dr. Mohammed Bin Ali Alhayaza</b> <b>President of Alfaisal University</b>
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## **Message from Dean of College of Business, the Principal Investigator of CGC**

It is with great pleasure that I introduce to you the Second Annual Report of Corporate Governance Index (CGI) 2018". The CGI is developed by our dedicated team at the Corporate Governance Center (CGC). The CGC team with support from SAGIA, and the cooperation of Capital Market Authority (CMA), Saudi Arabian Monetary Authority (SAMA) and the Ministry of Commerce and Investment (MCI) and strong support from Alfaisal University (AU) administration has been working for the last seven months on the calculations of the CG Indices for all companies traded on the Saudi Financial market; totaling 171 companies. This is a big increase over the 92 companies that were evaluated last year. Furthermore, while the process applied the CG principles developed by CMA and OECD it was augmented by the CG principles developed by SAMA for the banking and insurance industries. It also benefitted from the observations of many colleagues in the public and private sectors, and from the experiences of international experts on CG. Our main objective for CGI and the annual mini-conference that held on 22<sup>nd</sup> of April 2018 is to spread the culture of good CG and to help improve the CG practices in the Saudi businesses.

In the conference, we first presented the CG process and how it was implemented; and then presented the CG indices for the fiscal year 2016 and hear from a world-renowned expert on **"Rising Importance of CG Indices Worldwide"** then shared with the participants the results of a research paper produced by a member of the CG Center titled, **"Impact of Good CG on Company Profitability and Sustainability"**. These are followed by two panel discussions: The first deals with the role of related government agencies in developing policy and CG principles that suit the Saudi and GCC environment and help the realization of Vision 2030; where the second panel focusses on the impact of practicing good CG in the private sector.

The conference is being held at an opportune time as the Kingdom of Saudi Arabia is embarking on huge change in its economy. We hope it will continue to be held on an annual basis and attract the attention and participation of those interested in good CG in the public and private sectors. It will be the focal point for the presentation and dissemination of CG research and development.

I wish to thank the support of Alfaisal University Administration and its President Dr. Mohammed Alhayaza, and the support of SAGIA, and the cooperation of SAMA and MCI. I also wish to thank the CGC Team of CoB and its international consultants Dr. Stephen Davis of Harvard University and Kobirate of Turkey.

<b>Dr Bajis Dodin</b> <b>Dean of College of Business, Principal Investigator of CGRC</b> <b>Alfaisal University</b>
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## **Part I. Corporate Governance: Definition, Importance & Measurement**

### **Introduction**

Good governance is the key for Saudi companies in the increasingly global competitive market; particularly, when family-run businesses are in the transition to be integrated into the global market and the country is moving toward attracting international investors for big projects within 2030 Vision. For instance, it was recently announced that the Saudi Arabian stock market will join FTSE Russell's emerging market index. This is expected to draw billions of dollars of fresh foreign portfolios investment to the Kingdom. It is may not be possible to attract global investors without good corporate governance practices. That is because good governance provides assurance for long-term profitability and sustainability. It gives a positive signal to outside investors to earn their trust. Therefore, it is absolutely essential to develop sound corporate governance (CG) assessment tool to monitor and promote good governance among Saudi corporations and businesses.

We believe a reliable CG index will raise Saudi Arabia's overall corporate governance standards and will provide possible financial and investment benefits as a result of making governance improvements. Because of these benefits, many countries around the world have set up CGIs over the past decade. We benefited from their experiences to develop an efficient CGI process for Saudi companies. The index is expected to provide great help in monitoring and promoting good governance among Saudi corporations.

Corporate Governance Research Center (CGRC) has released the first Saudi Corporate Governance Index (CGI) last year evaluating 92 companies based on 117 good CG principles and practices. This is our second Saudi CGI report covering 171 companies fall in 19 sectors listed in the Saudi Stock Exchange Market (Tadawul).

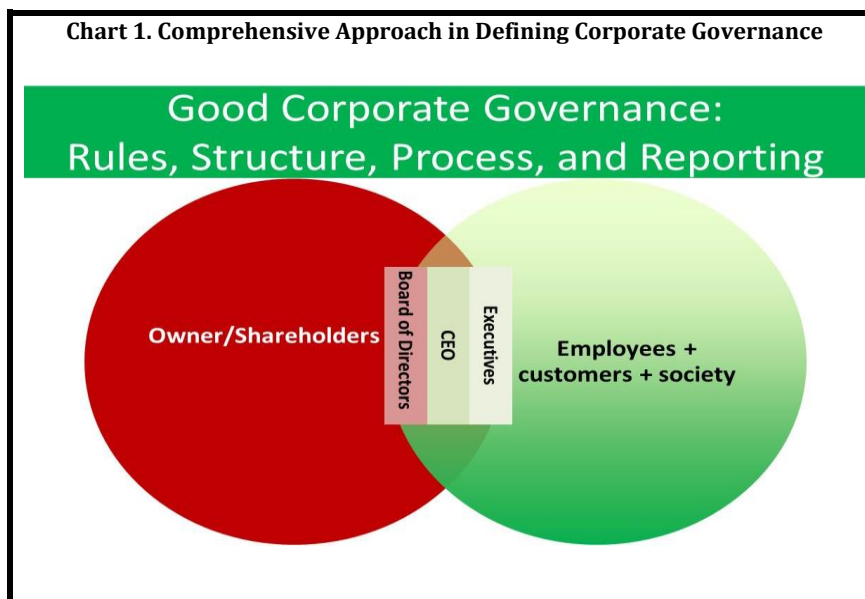
In this report, we provide WHAT, WHY, and HOW of corporate governance before introducing the findings of 2018 Saudi CGI, for the fiscal year 2016.

### **WHAT is Saudi CGI?**

Saudi CGI is a scientific index developed by a team from CGC at the College of Business of Alfaisal University in collaboration with consultants from Harvard University and Kobirate Co.<sup>1</sup> with a partial funding from Saudi Arabian General Investment Authority (SAGIA). The objective of the index is to monitor and promote good governance practices among corporations doing business in Saudi Arabia. The index captures the governance of corporations in terms of rules, structure, process, practices, and reporting in regard to board of directors, shareholders' rights, public disclosure & transparency, and stakeholders' rights. The CGI is based solely on good CG principles set by the Saudi Capital Market Authority (CMA), Saudi Arabian Monetary Authority (SAMA), and the Organization for Economic Co-operation and Development (OECD). As shown in the graph below, we perceive corporate governance in comprehensive manner covering rules, rights, structure, process, and accountability for shareholders, board of directors, management, employees, customers, and society at large.

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<sup>1</sup> Kobirate International Credit Rating and Corporate Governance Service Inc.



### WHY to have CGI?

CGI is a way to assess companies in terms of their compliance to the good governance principles for better decision making, risk management, and higher performance. Those principles are expected to promote equal treatment of shareholders; ensure transparency through constant flow of relevant information related shareholders and stakeholders; and provide effective structure to hold decision makers accountability for their business decisions. The ultimate benefit of good governance is to develop efficient and effective corporate culture based on good rules and institutions for higher productivity and sustainable growth in increasingly competitive global market.

### HOW to measure CGI?

The CGI is a composite index based on the weighted score of corporate governance within the four categories (shown in the table below). Each category is evaluated over 100 points using evidence based CG practices. The final CG score is the weighted average of four categories over 100 points. The base model for all companies includes 117 variables while the banking and insurance sectors have additional variables as shown below:

**Table 1. Number of CG Attributes in CGI Subcategories for Three Models**

	<b>Board of Directors</b>	<b>Shareholders Rights</b>	<b>Public Disc. &amp; Transparency</b>	<b>Stakeholders rights</b>	<b>Total Variables</b>
<b>Base Model</b>	39	30	35	13	117
<b>Banking Model</b>	69	36	42	18	165
<b>Insurance Model</b>	78	30	39	13	160

We evaluate good corporate governance by creating an index which assesses companies in terms of their compliance to the related governance rules in the country and best governance

practice around the world. A major 2013 World Bank report<sup>2</sup> on developing CG index recommends the following eight steps to come up with an efficient CG index:

- 1) Use a wide initial consultation
- 2) Define objective of the index
- 3) Select the index approach
- 4) Customize the governance criteria for the country when adopting international standards
- 5) Build a transparent and credible evaluation process
- 6) Achieve maximum possible disclosure
- 7) Effectively monitor the index criteria
- 8) Develop the index.

We have followed the recommendation above in developing CGI for Saudi companies. We used wide range of consultation to make sure that we come up with best measurable criteria to evaluate corporate governance policy and practices. We collaborated with international consultants and worked with local partners to establish index with proper categories and variables. With this index, we aim to provide data-based independent guidance to Saudi companies helping them to adopt good governance principles. We believe that the adoption of those principles would help companies to make better decisions and resolve challenges that could emerge between corporate executives, shareholders, and stakeholders in the course of doing business.

The CGI project aims to accomplish the following objectives:

- Provide data-based, objective, and independent evaluation of Saudi companies in terms of their adherence to CG principles set by CMA and OECD, and SAMA in case of banks and Insurance sectors.
- Promote good corporate governance practices and culture by studying and sharing best practices
- Monitor the status of corporate governance on annual basis
- Provide guidance/consultancy to companies to improve corporate governance

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<sup>2</sup> Raising the Bar on Corporate Governance: A study of eight stock exchange indices, World Bank, June 2013.

## Part II. Corporate Governance Project Overview

### 1. Corporate Governance Research Center at Alfaisal University

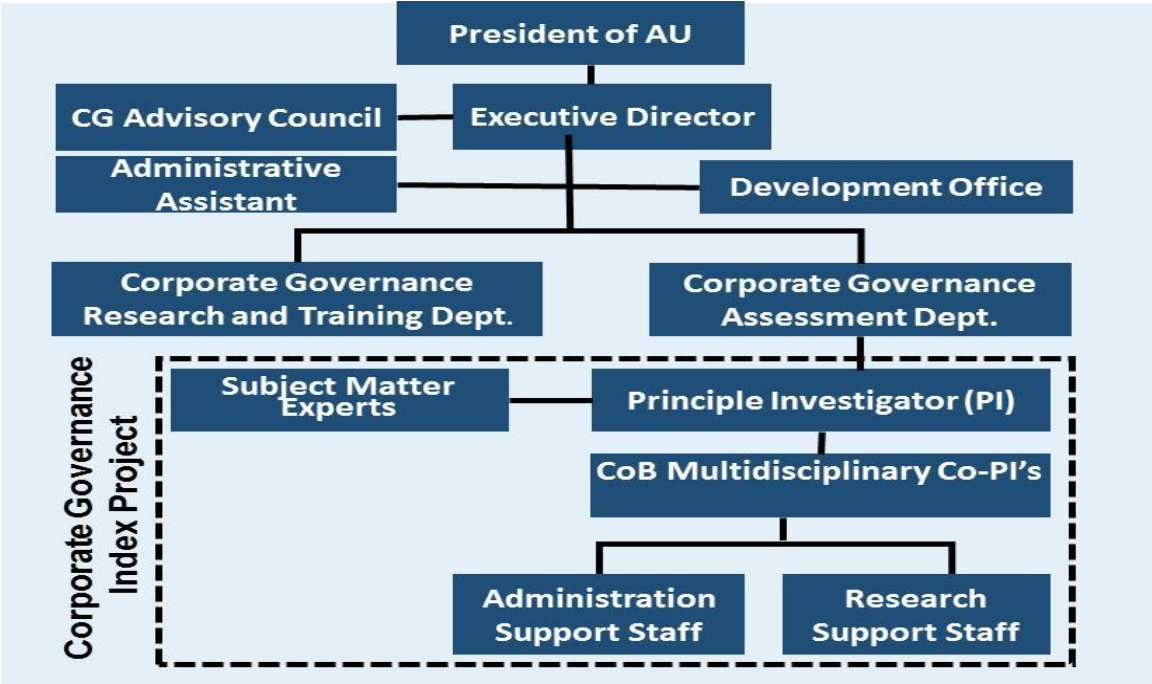
**Vision:**

We aspire for the Corporate Governance Center (CGC) to be the leading center in the Gulf Cooperation Council (GCC) region for impactful research on CG and for promoting best CG policies and practices.

**Mission:**

The mission of the center is to provide reliable and independent CG policies and practices through quality research and education that serves the GCC region and its economies.

The CGRC has been established in June 2017. It was approved by the College of Business; Council of Deans at Alfaisal University (AU), by AU Council, by AU Board of Trustees and by Ministry of Education. It is expected to be fully operational by January 2019. The chart below shows the structure of the center once it is fully functional:



### 2. CGI Project Overview

It is the second year that CGC is undertaking a major study to develop a Corporate Governance Index for companies trading on the Saudi Stock Exchange (Tadawul). The index is based on the CG practices for the fiscal year of 2016. The project is partially funded by the Saudi Arabian General Investment Authority (SAGIA) and encouraged by Capital Market Authority (CMA), Saudi Arabia Monetary Authority (SAMA) and Ministry of Commerce and Investment (MCI).

A dedicated team from College of Business at Alfaisal University is working at CGC with support from well-experienced consultants to develop this index. The CGI is based solely on good CG principles set by CMA and OECD augmented by the banking and insurance

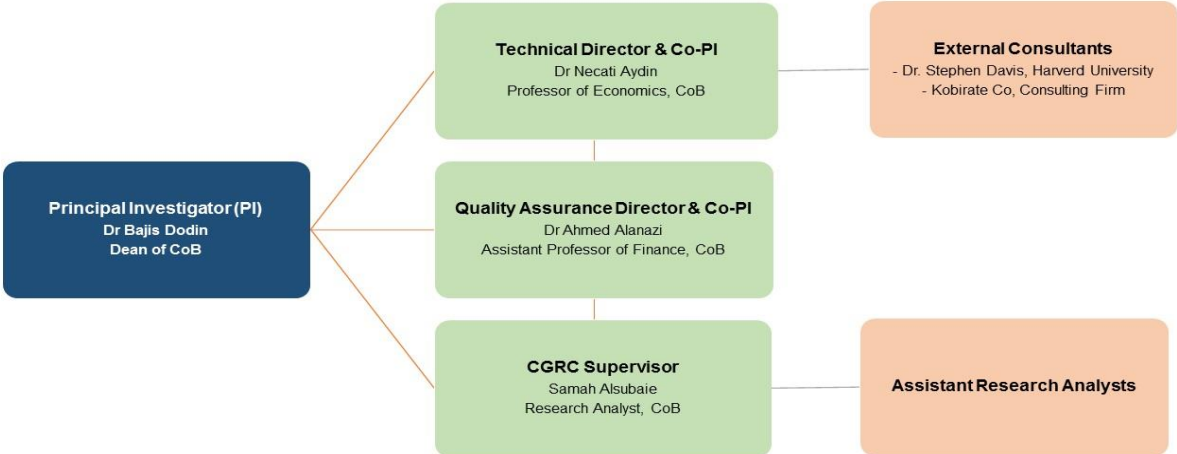


principles developed by SAMA. The goal is to rank the publicly traded companies in the Saudi market according to their compliance with those principles and performance.

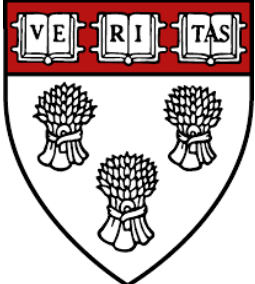

The CGI project is of three years duration. The first year, which ended in May 2017, dealt with the calculations of CGI for the fiscal year of 2015 for the top 92 companies traded on the Saudi Financial market. The second year which ended in April 2018 dealt with the calculations of the CGI for all companies traded in Tadawul using the data for the fiscal year of 2016. Then the third year that is expected to end in April 2019 as it releases the CGI for all companies traded in the Tadawul based on new CG principles from CMA, extend the CG principles to some family owned businesses, and completes the formation of the Corporate Governance Center.

**3. Project Team**

**a. Alfaisal University CGI Team**

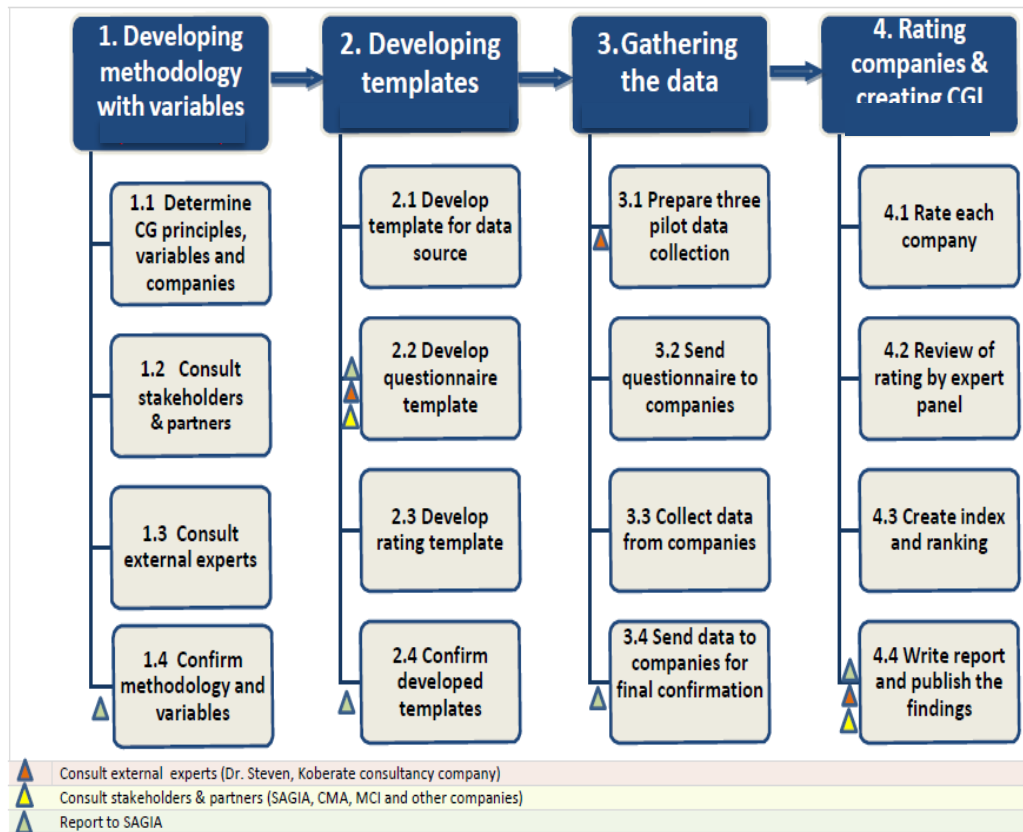


**b. External Consultants**

<p><b>1) Dr. Stephen Davis</b></p> <ul style="list-style-type: none"> <li>• Associate Director and Senior Fellow, Programs on Corporate Governance and Institutional Investors at Harvard Law School</li> <li>• One of the architects of today’s global corporate governance framework, based at Harvard Law School.</li> </ul>	 <p><b>Harvard University Program on CG</b></p>
<p><b>2) Kobirate Consulting Firm</b></p> <ul style="list-style-type: none"> <li>• Has been doing CG rating since 2008</li> <li>• Has developed a unique software for CG index</li> <li>• Has rated nearly 30% of Borsa Istanbul (BIST) Corporate Governance Index Companies, more than 50 Corporate Issuers and made more than 1000 Companies’ scoring processes.</li> </ul>	 <p><b>Kobirate Consulting Firm, Istanbul, Turkey</b></p>

#### 4. Project Flowchart and Timeline

## Project Flowchart and Timeline



#### 5. CGI Methodology

##### a. Process of Developing CGI Categories and Variables

1. Explored world-wide CGI practices
2. Collaborated with world-wide renowned Consultants
3. Engaged with local partners (SAGIA, CMA, SAMA, MCI)
4. Determined CG principles for the index based on CMA, SAMA & OECD CG principles
5. Established four CGI categories with up to 165 variables through consultation
6. Developed CGI questions based on selected CG principles through consultation

## b. CGI Categories and Variables for the Base Model

As shown below, the base model consists of four categories with 117 variables. We used the base model to evaluate all sectors except banking and insurance sectors.

### **1) The Board of Directors (39 variables)**

Variables by Category	Number of Variables
Main Functions of the Board of Directors	13
Responsibilities of the Board	4
Formation of the Board	7
Qualifications of Independent Board Members	9
Committees Formed within the Structure of the Board of Directors	2
Nomination and Remuneration Committee	2
Meetings of the Board	1
Remuneration and Indemnification of Board Members	1

### **2) Shareholders (30 variables)**

Variables by Category	Number of Variables
Facilitation of Shareholders' Exercise of Rights and Access to Information	6
Investor Relations	3
Shareholders' Rights Related to the General Assembly	13
Voting and Minority Rights	3
Dividend Rights of Shareholders	4
Transfer of Shares	1

### **3) Public Disclosure and Transparency (35 variables)**

Variables by Category	Number of Variables
Policy and procedure	15
Board of Directors' Report	20

### **4) Stakeholders (13 variables)**

Variables by Category	Number of Variables
Stakeholders	13

### c. CGI Categories and Variables for the Banking Sector Model

For the banking sector, we added to the base model 48 additional variables to make sure that banks follow corporate governance principles set by CMA and SAMA and OECD, as well. Most of additional variables are related to board of directors and public disclosure as seen in the table below:

## CATEGORIES & VARIABLES (165) CG Index for Banking Sector

### 1) The Board of Directors (69 variables; 31 from SAMA principles)

Variables by Category	Number of Variables
Main Functions of the Board of Directors	13
Responsibilities of the Board	4
Formation of the Board	6
Qualifications of Independent Board Members	19
Committees Formed within the Structure of the Board of Directors	25
Meetings of the Board	1
Remuneration and Indemnification of Board Members	1

### 2) Shareholders (36 variables; 7 from SAMA principles)

Variables by Category	Number of Variables
Rights of Shareholders	4
Facilitation of Shareholders' Exercise of Rights and Access to Information	6
Shareholders' Rights Related to the General Assembly	17
Voting and Minority Rights	4
Shareholders' Dividend Right and Transfer of Shares	5

### 3) Public Disclosure and Transparency (42 variables; 15 from SAMA principles)

Variables by Category	Number of Variables
Policy and procedure	22
Board of Directors' Report	20

### 4) Stakeholders (18 variables; 5 from SAMA principles)

Variables by Category	Number of Variables
Stakeholders	18

#### d. CGI Categories and Variables for the Insurance Sector Model

Similar to the banking sector, SAMA sets additional sets of principles for the insurance sector. Therefore, we added 43 variables to the base model in assessing the insurance sector. The added variables are related to the board of directors and public disclosure as seen in the table below:

## CATEGORIES & VARIABLES (160) CG Index for Insurance Sector

### 1) The Board of Directors (78 variables; 41 from SAMA principles)

Variables by Category	Number of Variables
Main Functions of the Board of Directors	14
Responsibilities of the Board	12
Formation of the Board	19
Committees Formed within the Structure of the Board of Directors	26
Meetings of the Board	6
Remuneration and Indemnification of Board Members	1

### 2) Shareholders (30 variables)

Variables by Category	Number of Variables
Rights of shareholders	3
Facilitation of Shareholders' Exercise of Rights and Access to Information	6
Shareholders' Rights Related to the General Assembly	13
Voting and Minority Rights	3
Dividend Rights of Shareholders	5

### 3) Public Disclosure & Transparency (39 variables; 12 from SAMA principles)

Variables by Category	Number of Variables
Policy and procedure	14
Board of Directors' Report	25

### 4) Stakeholders (13 variables)

Variables by Category	Number of Variables
Stakeholders	13

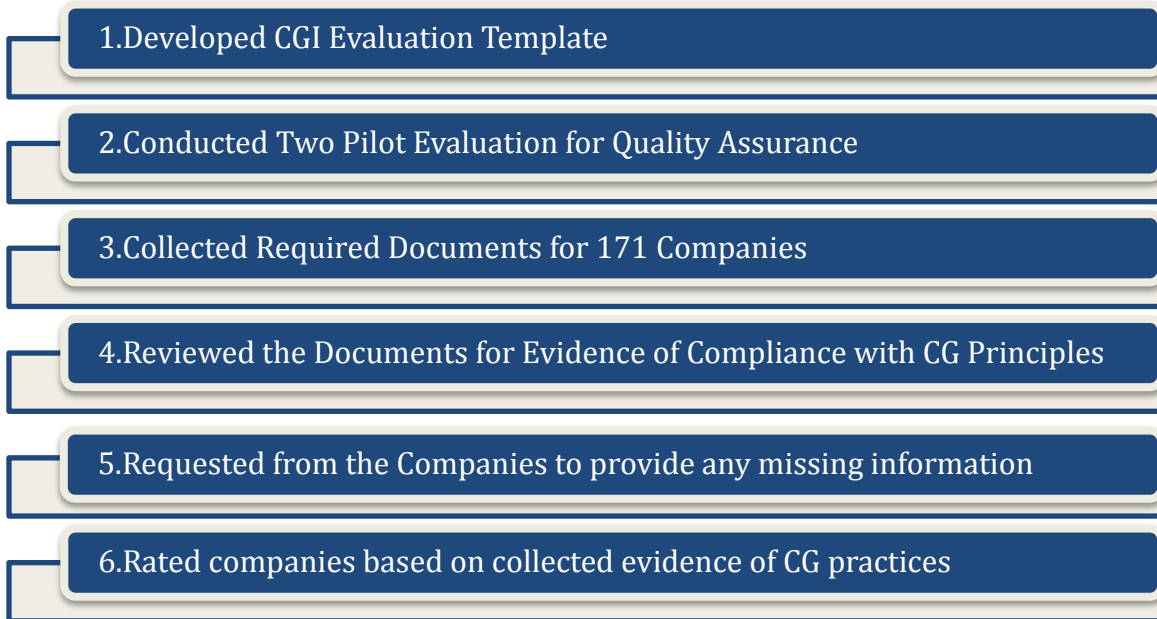
### e. Company Selection for CGI and Company List

Last year, we used the market capitalization as the key determining criteria to select 92 companies for the CG index. The median market value was set as the threshold. The companies that had median market of value of 2 billion riyals were included. The second criterion was that the company has to be listed in the market for a minimum of three years. This was to ensure enough time for the transition of the company from private ownership into public ownership. For this year, we evaluated all actively listed companies in Tadawul. The table below provides sectoral breakdown of the companies which were assessed for the CG index:

**Table 2. List of Companies by Sector**

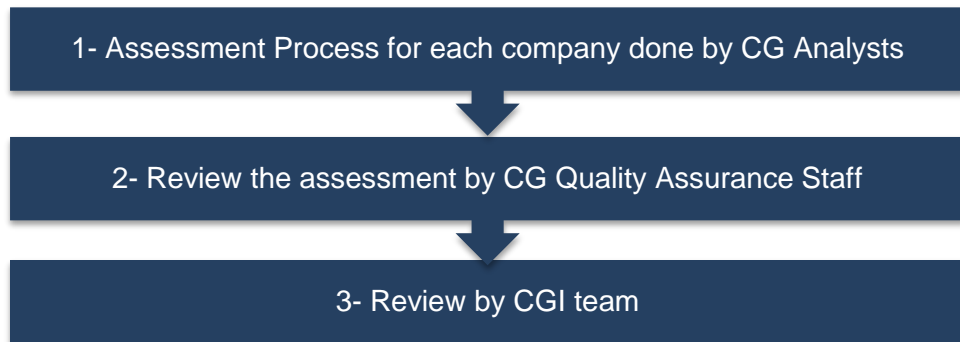
<b>Sectors</b>			
	<b>Frequency</b>	<b>Percent</b>	<b>Cumulative Percent</b>
<b>Energy and Utilities</b>	6	3.5	3.5
<b>Material</b>	40	23.4	26.9
<b>Capital Goods</b>	13	7.6	34.5
<b>Commercial Serv. and Retailing</b>	8	4.7	39.2
<b>Transportation</b>	5	2.9	42.1
<b>Consumer Durables and Consumer Services</b>	11	6.4	48.5
<b>Telecom and Media</b>	6	3.5	52.0
<b>Food &amp; Staples and Food &amp; Beverages</b>	16	9.4	61.4
<b>Healthcare and Pharma</b>	7	4.1	65.5
<b>Bank and Diversified Financials</b>	16	9.4	74.9
<b>Insurance</b>	33	19.3	94.2
<b>Real Estate</b>	10	5.8	100.0
<b>Total</b>	171	100.0	

## 6. Company Evaluation and Rating Process



## 7. CGI Quality Assurance Process

### a. Internal Quality Assurance



### b. External Quality Assurance

Review Items	Consultants	Feedback Requested
CGI Variables and Categories CGI Rating Methodology CGI Company Selection Criteria CGI Pilot Evaluation	Dr. Stephen Davis & Kobirate Consultant Team	SAGIA, CMA, SAMA, and MCI

## 8. Rating Methodology and Scale

We used the three different models in rating companies. The base model with 117 variables within four categories was used for all sectors except the banking and insurance sectors. The banking sector model had 165 variables within four categories while the insurance sector model had 160 variables within four categories. Each category is evaluated over 100 points. The final CG index is the weighted average of four categories over 100 points. The CG score reveals the compliance of companies to good corporate governance principles which are determined by CMA, SAMA, and OECD. The four categories and their weight on the final CG score are as follows<sup>3</sup>:

- Board of Directors and Executive Management (35%)
- Shareholders' Rights and General Assembly (25%)
- Public Disclosure and Transparency (30%)
- Stakeholders (10%)

The lowest cumulative CG score is zero which means no compliance to good corporate governance principles measured through the variables. The highest cumulative CG score is 100 which means 100% compliance with the assessed principles. The first table below provides rating methodology for all categories based on the compliance to CG principles while the second table shows CG rating scale:

**Table 3. Rating Methodology for CGI Categories**

Categories	Variables	Earned Points			Cat. Total	Weight	C. Total
		Yes	Partial	No			
	#						
BoD (m.) <sup>4</sup>	14	0.5	0.25	0	100	.35	100
BoD (v.)	25	1	0.5	0			
SHR (m.)	0	NA	NA	NA	100	.25	
SHR (v.)	30	1	0.5	0			
PD&T (m.)	13	0.5	0.25	0	100	.30	
PD&T (v.)	22	1	0.5	0			
STR(m.)	0	NA	NA	NA	100	.10	
STR(v.)	13	1	0.5	0			

BoD: Board of Directors; SHR: Shareholder rights; PD&T: Public disclosure and Transparency; STR: Stakeholder rights; m: mandatory compliance; v: voluntary compliance; Cat: categorical; C: cumulative (normalized)

**Table 4. CGI Rating Scale**

Score	Letter Grade	Description
90-100	A	Excellent
80-89	B	Very good
70-79	C	Good
60-69	D	Fair
Below 60	F	Very weak

<sup>3</sup> The weight of sub-categories is determined based on their relative importance, number of criteria, empirical evidence, and international practices.

<sup>4</sup> Following CMA recommendation, we give more weight to voluntary CG principles. A company gains half point if a CG principle is mandatory while full point if it is voluntary.



### Part III: Executive Summary of CG Ranking

#### A) Overall Findings

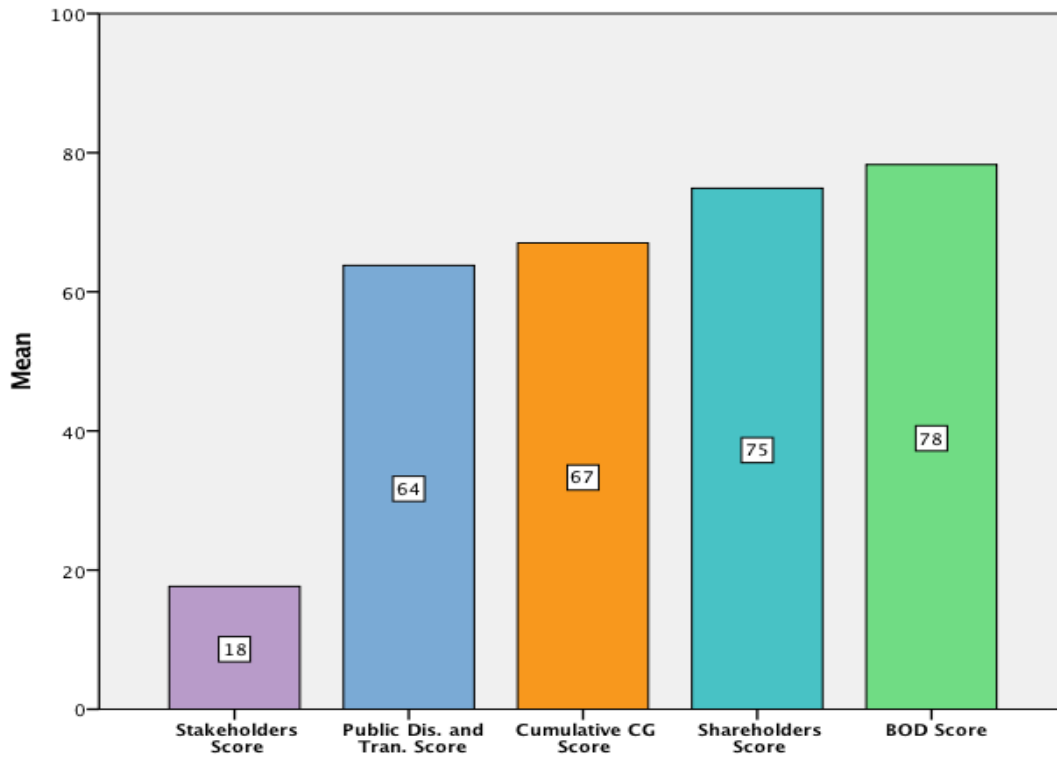
The overall CG score is a composite score of four categories based on the weight stated before. The table below shows the mean, median, standard deviation, minimum score, maximum score, and percentiles statistics for the assessed companies. The cumulative CG scores range from 45 points to 91 points with a mean of 67 and standard deviation of 8. This shows that companies vary significantly in terms of their CG practices. Based on the median value, the half of companies scored 67 or above the other half scored less than 67. This means that overall companies are doing fine in terms of corporate governance even though they have significant room for the improvement.

**Table 5. Summary Statistics of 2018 Saudi CG Index**

	Cumulative CG Score	BOD Score	Shareholders Score	Public Dis. and Tran. Score	Stakeholders Score
<b>N</b>	<b>171</b>	<b>171</b>	<b>171</b>	<b>171</b>	<b>171</b>
<b>Mean</b>	<b>67.02</b>	<b>78.29</b>	<b>74.89</b>	<b>63.78</b>	<b>17.66</b>
<b>Median</b>	<b>66.90</b>	<b>79.71</b>	<b>75.00</b>	<b>64.10</b>	<b>15.38</b>
<b>Std. Deviation</b>	<b>7.75</b>	<b>8.04</b>	<b>9.52</b>	<b>11.43</b>	<b>17.51</b>
<b>Minimum</b>	<b>44.60</b>	<b>49.28</b>	<b>45.00</b>	<b>16.18</b>	<b>0.00</b>
<b>Maximum</b>	<b>90.60</b>	<b>95.00</b>	<b>95.00</b>	<b>91.03</b>	<b>88.46</b>

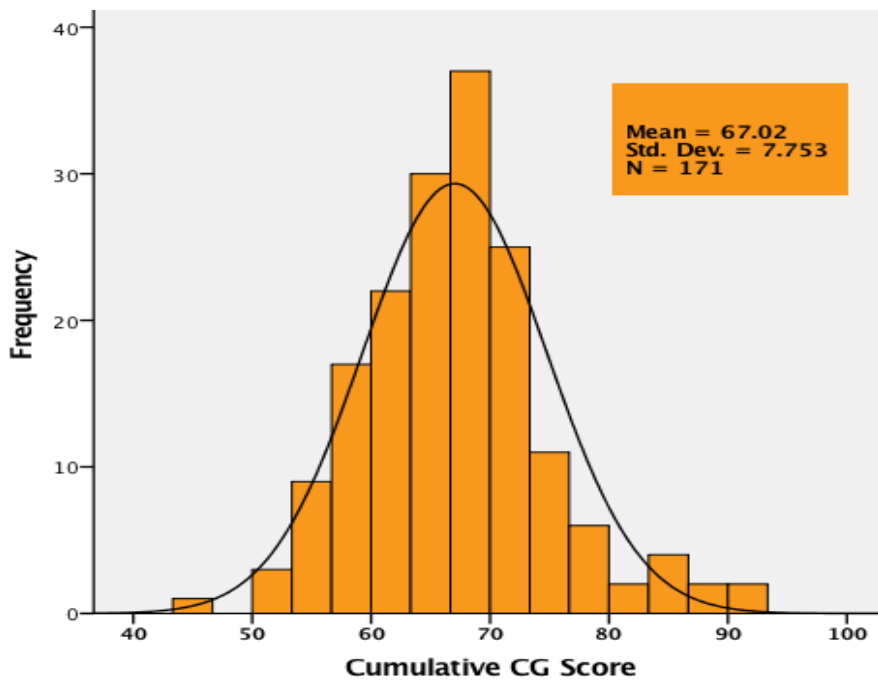
As seen in the chart below, the companies are scored “good” in terms of board of directors and shareholders rights while doing “fair” in terms of public disclosure and transparency. The score for stakeholder rights is considered “very weak”. In general, companies are doing fine when a principle is mandatory because they get penalized in case of incompliance. Since most of corporate governance principles are not mandatory, companies would follow the relevant principles if they are convinced in their added value. The relatively low score for public disclosure and transparency indicates that companies are doing well in terms of meeting the minimum requirements for public disclosure. However, they tend to keep important policy information confidential unless it is pushed by the regulators. In reality, public disclosure and transparency are essential elements of good corporate governance as they provide necessary information for informed decision by shareholders, stakeholders, and potential investors. Therefore, it is important to ensure timely and reliable disclosure of financial information by publicly tradeable companies. Finally, stakeholders’ rights are important traits of good corporate governance as well. However, since they are largely driven from OECD principles, companies have little interest to follow those good practices.

**Chart 2. Average CGI Scores for 171 Companies**

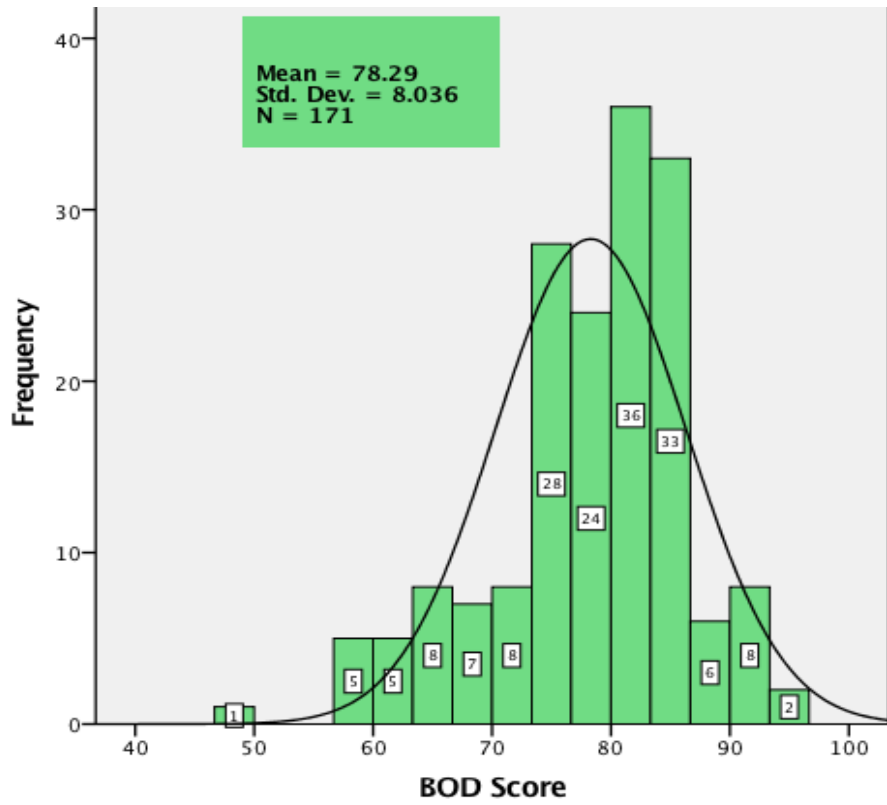


As shown in the frequency distribution graphs below, the scores for subcategories reveal that companies are particularly doing well in terms of the CG principles related to board of directors and shareholders' rights. However, they need great improvement in the areas of public disclosure and transparency, and stakeholders.

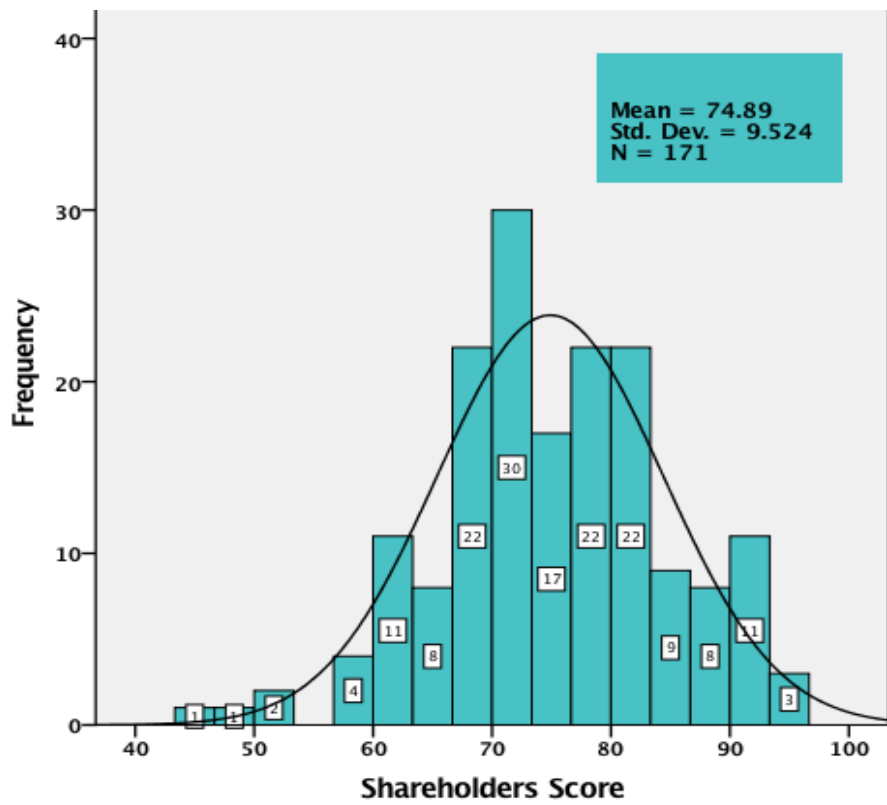
**Chart 3. Cumulative CG Score of 171 Companies 2018)**



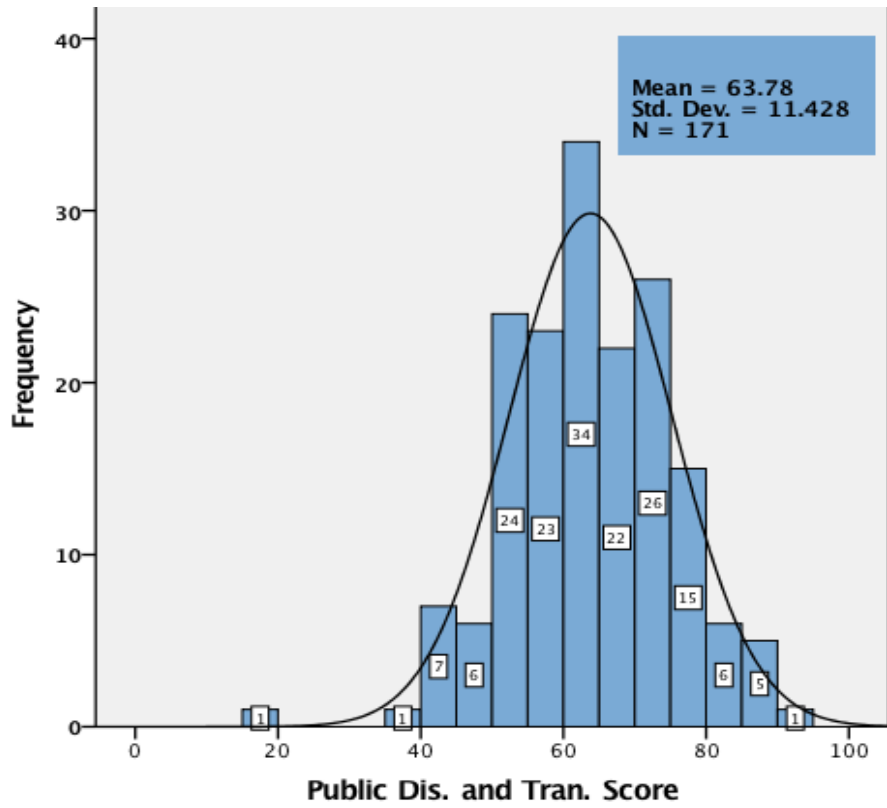
**Chart 4. Board of Directors Score of 171 Companies 2018)**



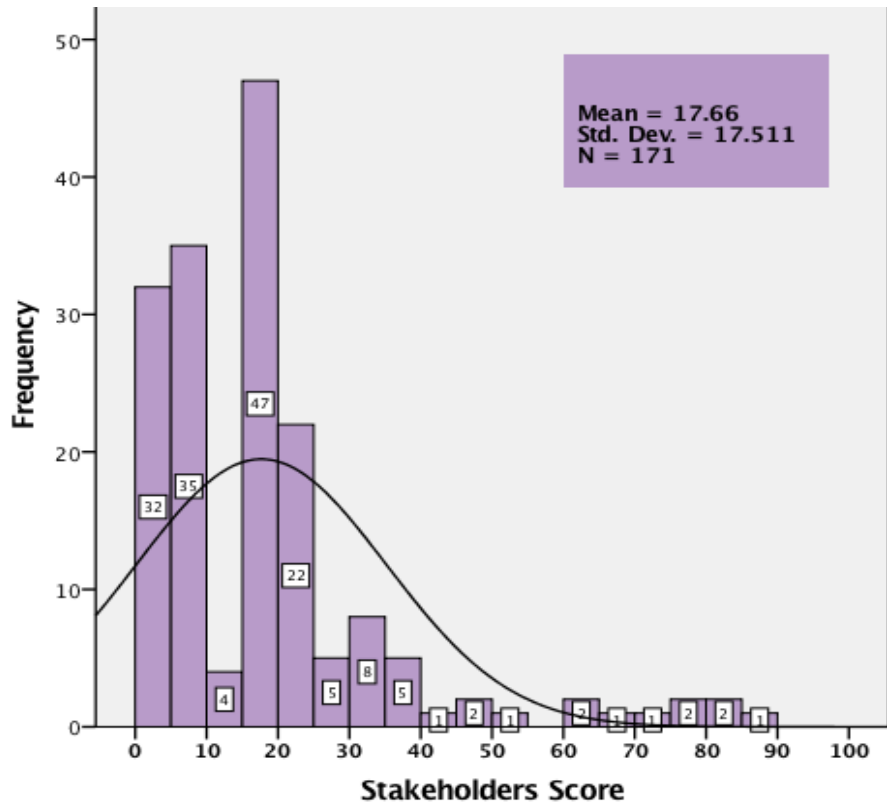
**Chart 5. Shareholders Score of 171 Companies 2018)**



**Chart 6. Public Disclosure and Transparency Score of 171 Companies 2018)**



**Chart 7. Stakeholders Score of 171 Companies 2018)**



## B) Top Ranking Companies with Highest CGI Score

At the CG conference, we released top ten for cumulative CGI score based on weighted average of four CG categories. We also made public the names of top ten companies for each subcategories of CGI as seen below. We expect positive competition among companies in regard to good CG practices.

### Top Ten Companies based on Cumulative CGI Score

Ranking	Company Names
1st.	Saudi Basic Industries Corp.
2nd.	Saudi Airlines Catering Co.
3rd.	Saudi International Petrochemical Co.
4th.	Saudi Investment Bank
5th.	Saudi Telecom Co. (STC)
6th.	Saudi Arabian Mining Co.
7th.	Savola Group
8th.	Saudi Electricity Co.
9th.	Bupa Arabia for Cooperative Insurance Co.
10th.	Almarai Co.

### Top Ten Companies based on CGI Board of Directors Score

Ranking	Company Names
1st.	Saudi International Petrochemical Co.
2nd.	Filing and Packing Materials Manufacturing Co.
3rd.	Saudi Airlines Catering Co.
4th.	Saudi Basic Industries Corp.
5th.	Saudi Telecom Co. (STC)
6th.	Saudi Ground Services Co.
7th.	Saudi Chemical Co.
8th.	Saudi Electricity Co.
9th.	Jazan Energy and Development Co.
10th.	Al Sorayai Trading and Industrial Group

### Top Ten Companies based on CGI Shareholders Rights Score

Ranking	Company Names
1st.	Saudi Airlines Catering Co.
2nd.	Saudi Basic Industries Corp.
3rd.	Almarai Co.
4th.	Sahara Petrochemical Co.
5th.	United Wire Factories Co.
6th.	Saudi Telecom Co. (STC)
7th.	Saudi Arabian Mining Co.
8th.	Savola Group
9th.	Riyad Bank
10th.	Saudi Electricity Co.

**Top Ten Companies based on CGI Pub. Disc. & Trans. Score**

<b>Ranking</b>	<b>Company Names</b>
<b>1st.</b>	Bupa Arabia for Cooperative Insurance Co.
<b>2nd.</b>	Savola Group
<b>3rd.</b>	Saudi Investment Bank
<b>4th.</b>	Saudi Airlines Catering Co.
<b>5th.</b>	Saudi Basic Industries Corp.
<b>6th.</b>	Almarai Co
<b>7th.</b>	Saudi Arabian Mining Co.
<b>8th.</b>	Arabian Shield Cooperative Insurance Co.
<b>9th.</b>	MetLife AIG ANB Cooperative Insurance Co.
<b>10th.</b>	National Commercial Bank

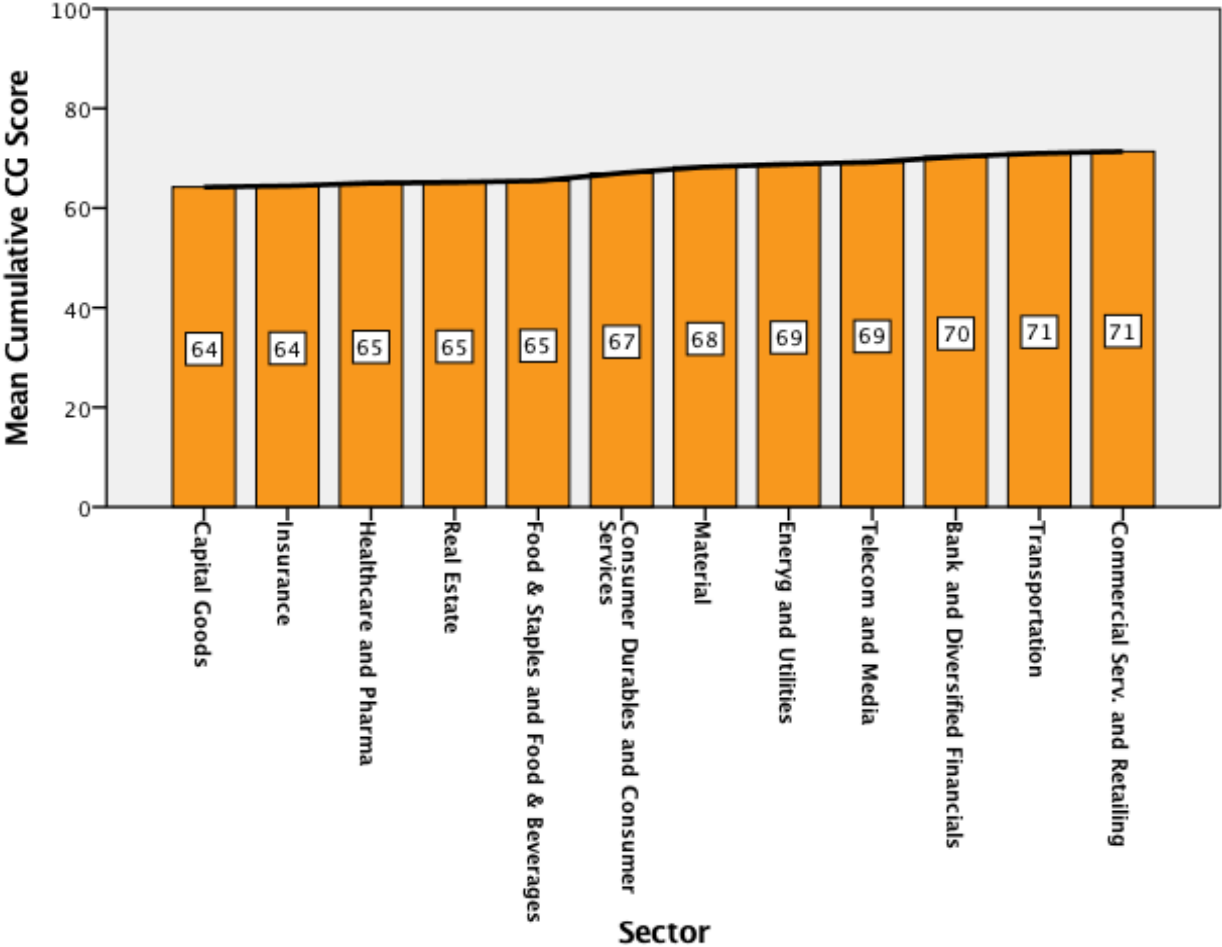
**Top Ten Companies based on CGI Stakeholders Rights Score**

<b>Ranking</b>	<b>Company Names</b>
<b>1st.</b>	Saudi Telecom Co. (STC)
<b>2nd.</b>	Saudi Basic Industries Corp.
<b>3rd.</b>	Saudi International Petrochemical Co.
<b>4th.</b>	Saudi Airlines Catering Co.
<b>5th.</b>	Al Rajhi Bank
<b>6th.</b>	Saudi Investment Bank
<b>7th.</b>	Saudi Arabian Mining Co.
<b>8th.</b>	Saudi Electricity Co.
<b>9th.</b>	Riyad Bank
<b>10th.</b>	National Commercial Bank

### C) Sectoral Analysis of CGI

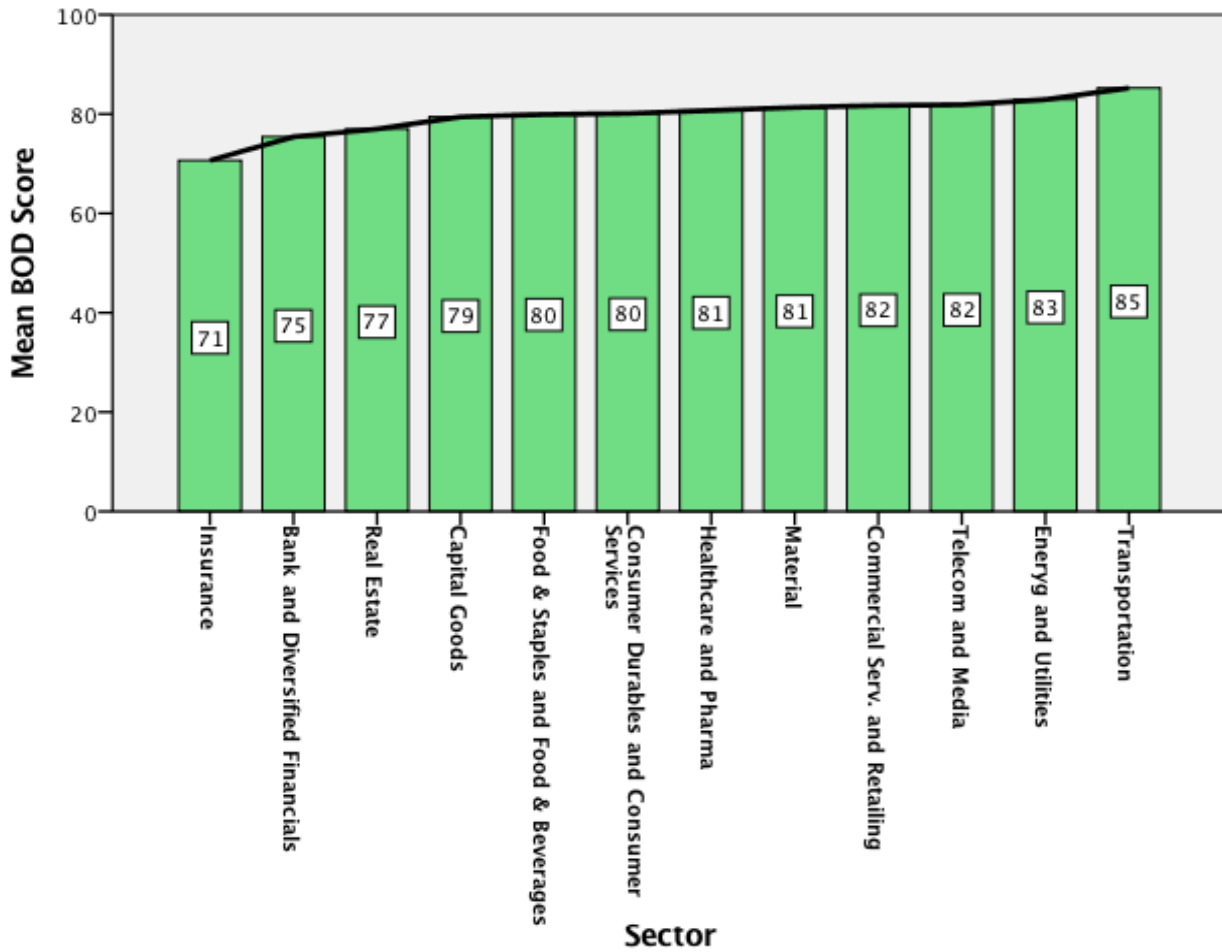
We did sectoral analysis to see whether companies differ in terms of their CG practices by sectors. The chart below shows that the cumulative score ranges from the lowest mean score of 64 out of 100 for Capital Goods sector to the highest means score of 71 out of 100 for the Commercial Services and Retailing sectors. Insurance, healthcare and real estate sectors score relatively low while transportation, banking, and telecom sectors score relatively high.

Chart 8. Mean Cumulative CGI Score by Sectors



The chart below shows the board of directors' score by sectors. The variation is relatively high compared to the cumulative CGI score with the lowest score of 71 and highest score of 85. Due to more rigorous model for the banking and insurance sectors, it is not surprising to see those sectors score low. Transportation, energy & utilities, and telecom sectors have relatively high score.

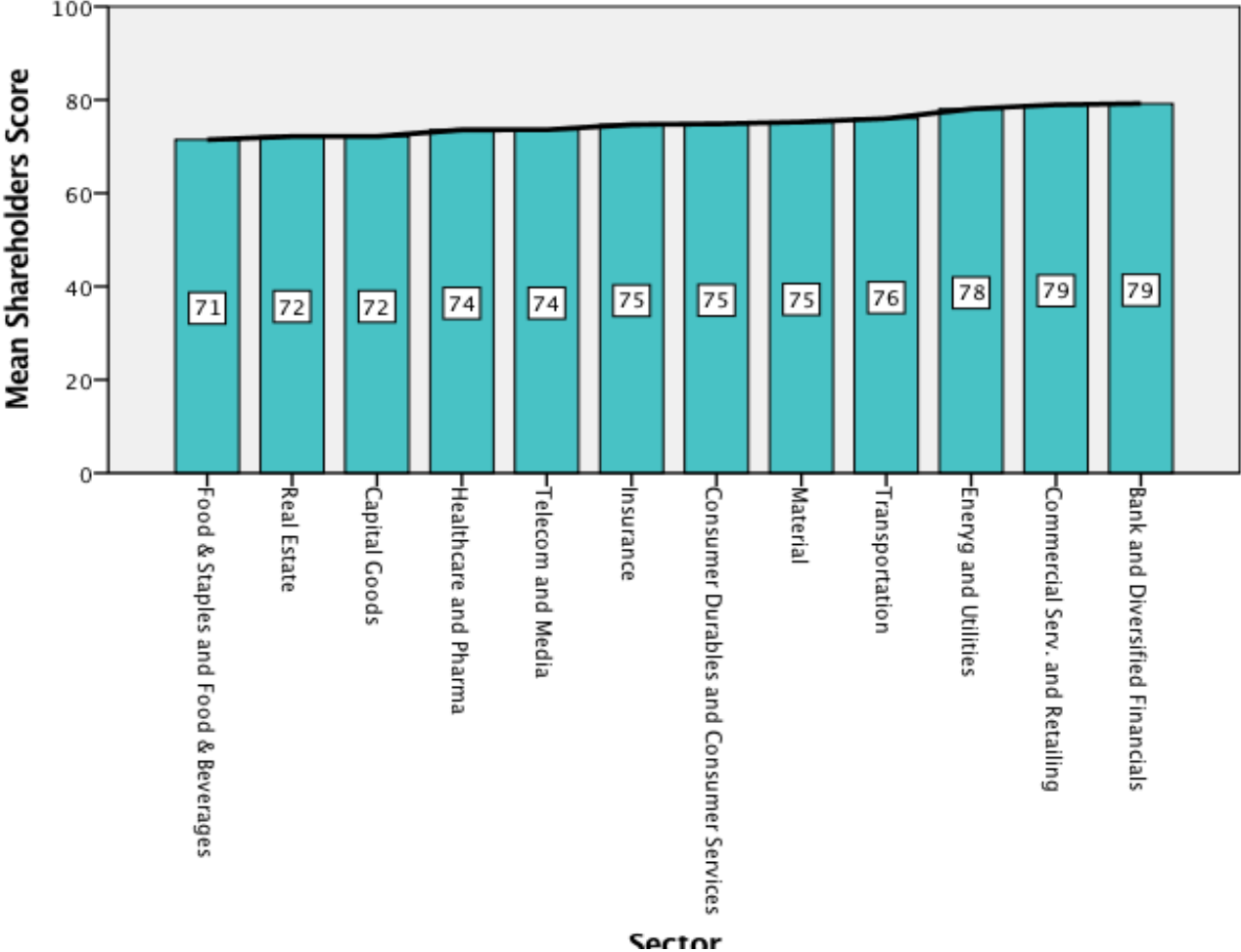
**Chart 9. Mean Board of Directors Score by Sectors**





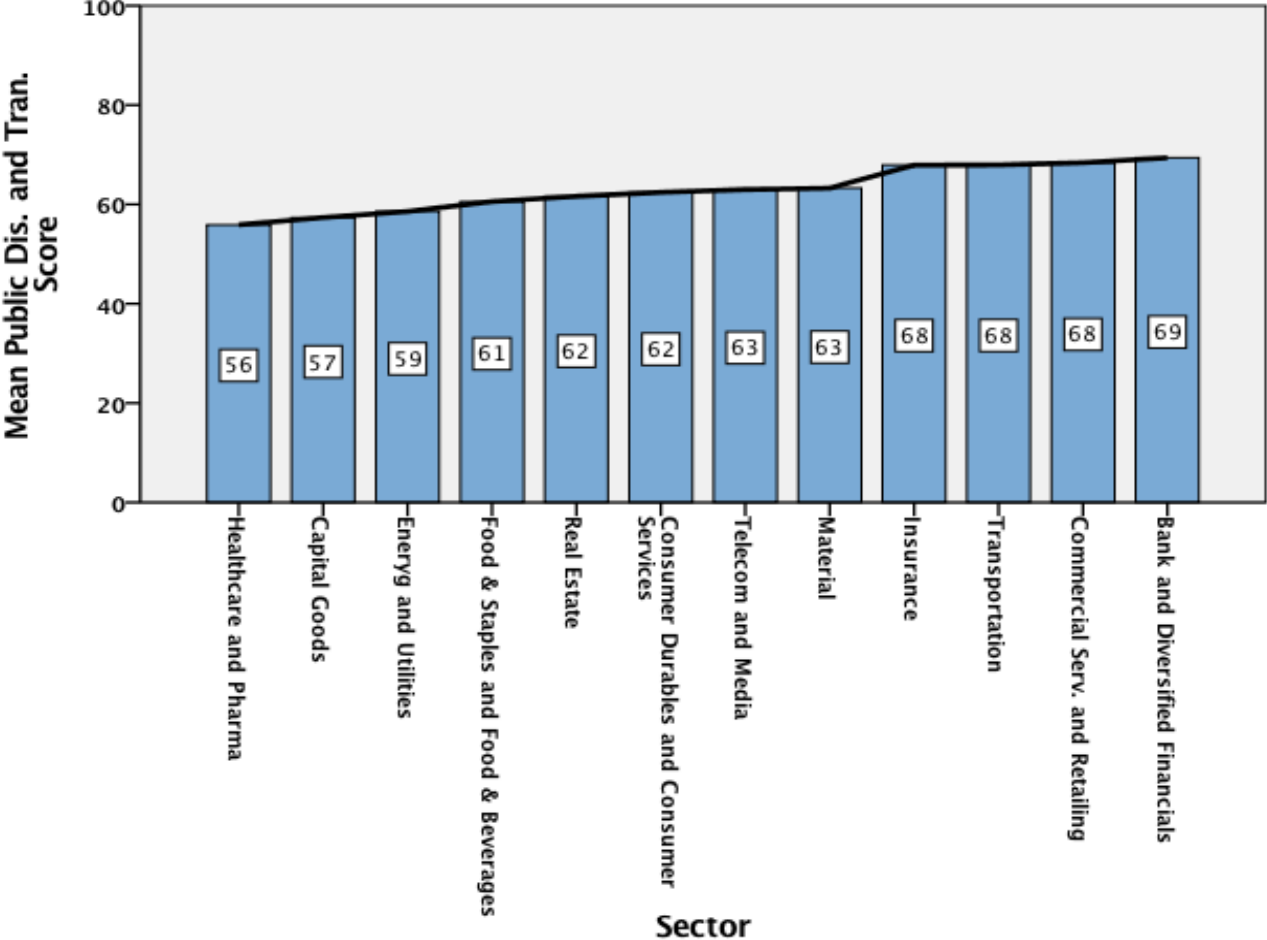
The chart below shows the mean shareholders rights score by sectors. Overall, all sectors score between 70 and 79 out of 100. Banking and commercial services sectors score highest with the mean score of 79 while capital goods, real estate, and food sectors score lowest with the mean score of 71 to 72. The variation by sectors is not quite high compared to the board of directors score. As explained in the Part 2, the banking model, we added 65 new variables based on SAMA regulations. While 31 of those variables are related to board of directors, only 7 of them are concerned with shareholder’s rights. Thus, relatively more rigorous standards in the area of board of directors explain why banking sector is doing poor in BOD score compared to shareholder rights score.

**Chart 10. Mean Shareholders Score by Sectors**



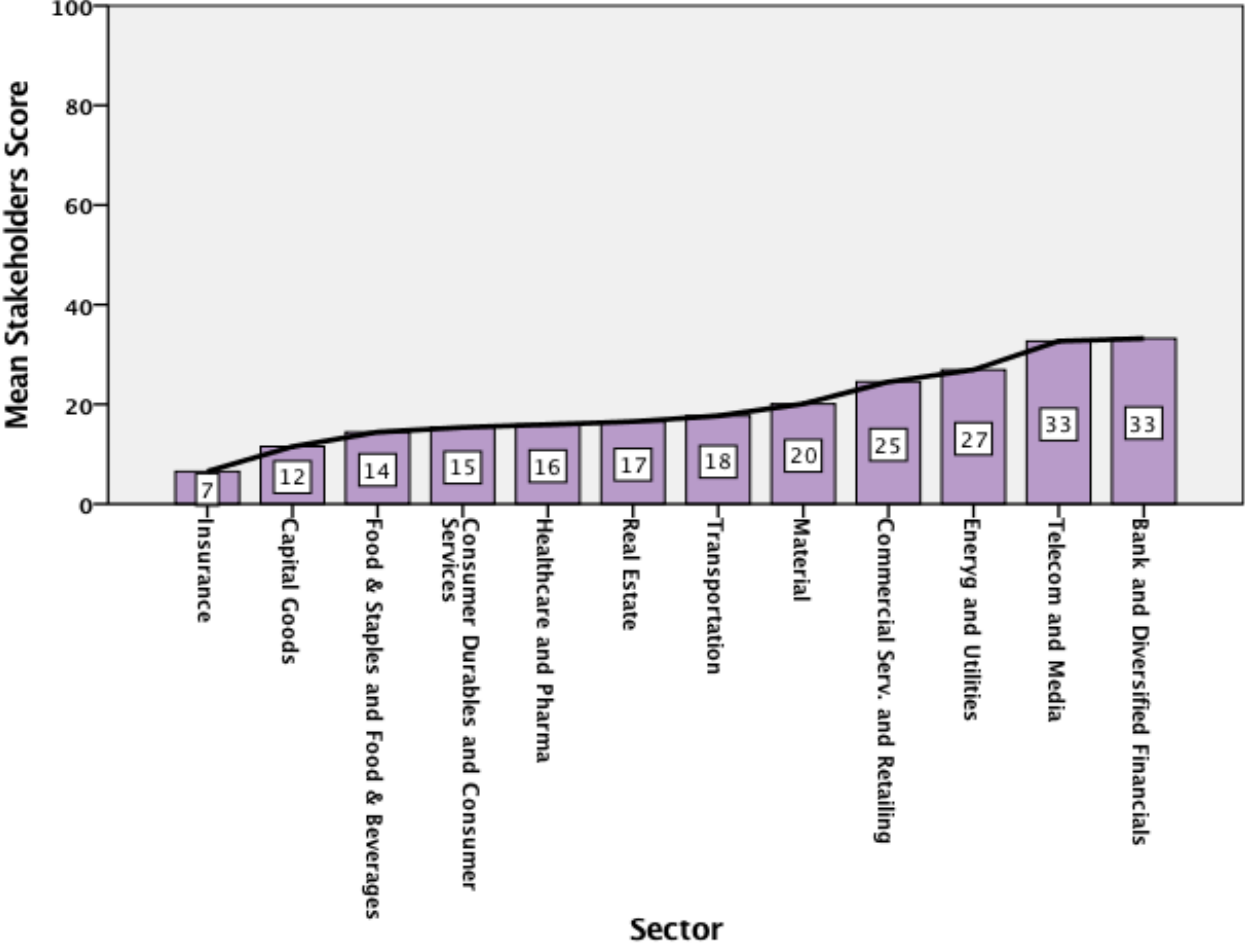
The chart below shows the mean public disclosure and transparency score by sectors. Overall, all sectors score between 56 and 69 out of 100. Both the overall scores and the high variations reveal some serious issues in regard to CG practices related to public disclosure and transparency. Banking and commercial services sectors score highest with the mean score of 69 while capital goods, health care, and energy & utilities sectors score lowest with the mean score of 56 to 59.

**Chart 11. Mean Public Disclosure and Transparency Score by Sectors**



The chart below shows the mean stakeholder rights score by sectors. Overall, all sectors score very poorly with highest score of 33 out of 100 and lowest score 7 out of 100. The result is striking, but not surprising because the underlying variables are mostly from OECD CG principles, not CMA principles. The poor score is a clear sign that most companies perceive corporate governance principles as compliance issue. Banking and telecom sectors do relatively better while insurance and capital goods sectors score really low.

**Chart 12. Mean Stakeholder Rights Score by Sectors**



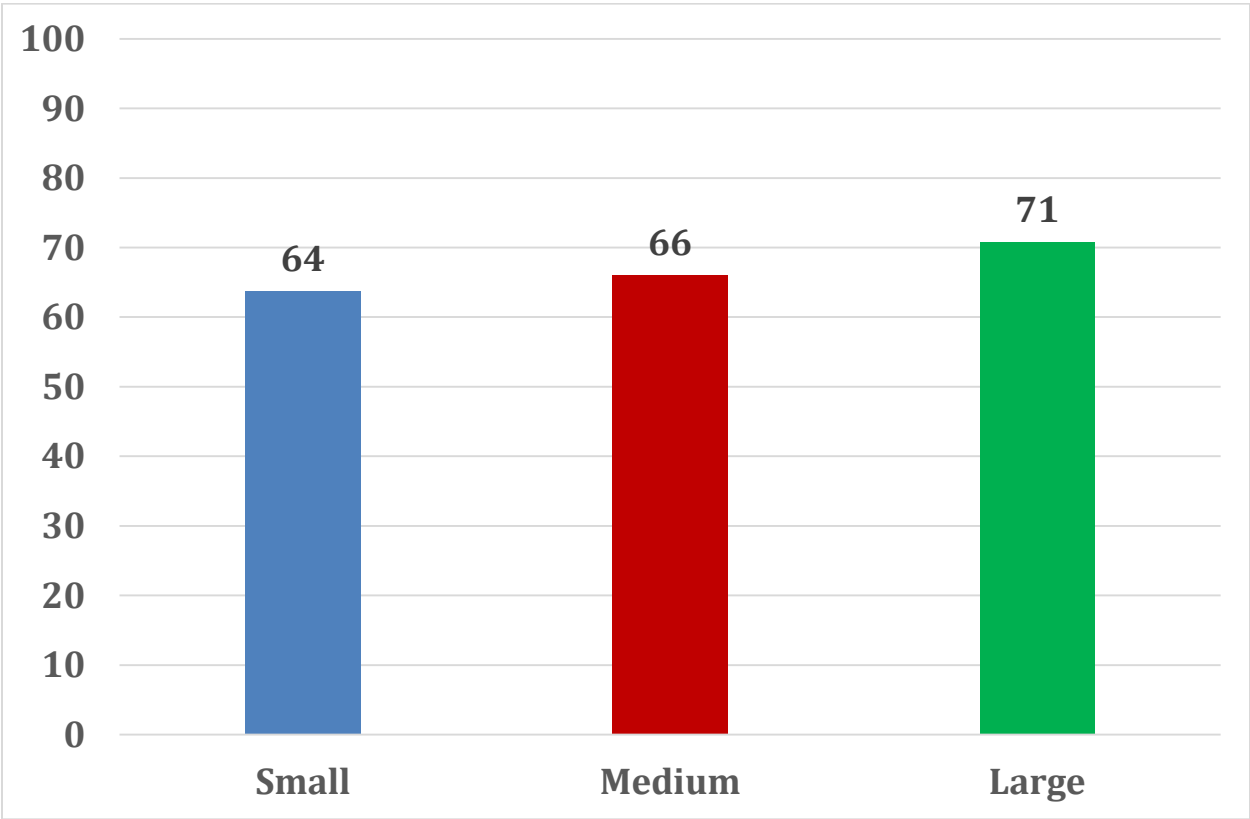
**D) Corporate Governance Indices as a function of the Company Size**

We also did comparison by as seen in Table 3 and Figures 11-15. We divided companies into three categories by size using total assets for all firms as of 2016. The total asset for all companies was almost 4 trillion SAR with average of 23 billion SAR and median of 2 billion SAR. Due to the skewed distribution, we used the 60th and 40th percentile to divide them into three groups. The 69 companies which were above the 60th percentile (SAR 2.6 Billion) are considered as large. Those in the 60th and

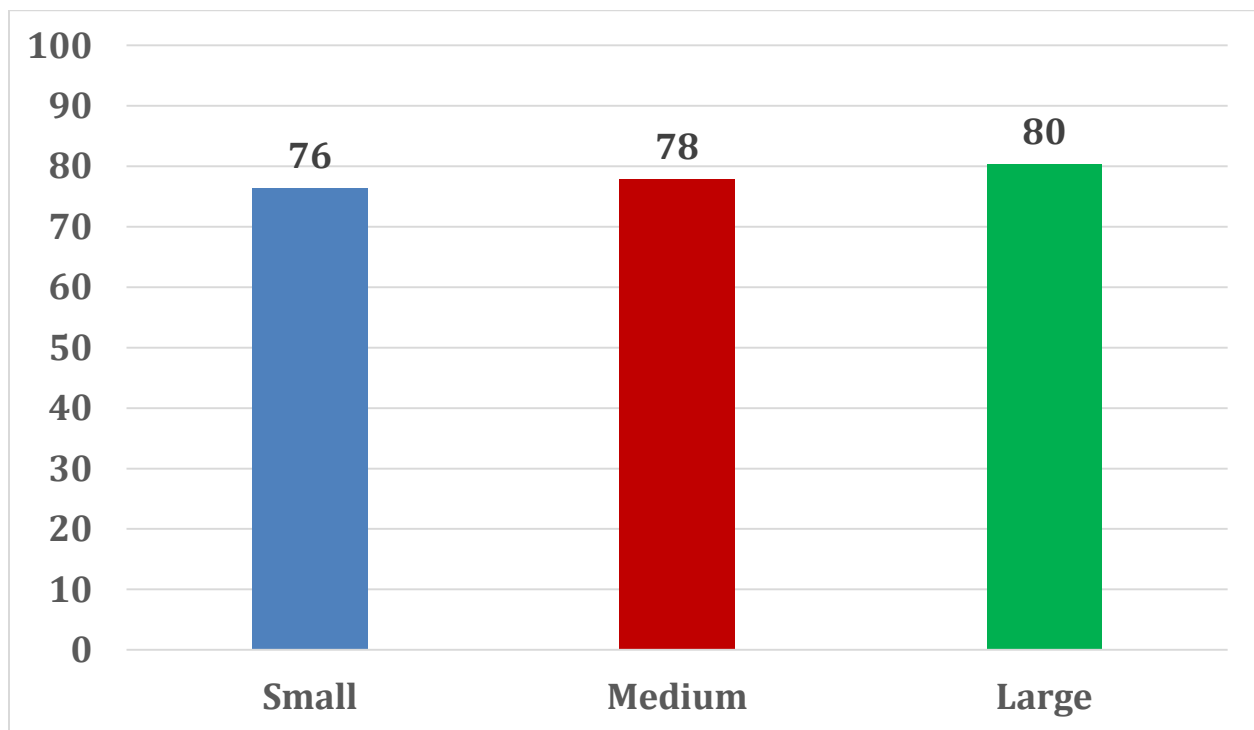
40th percentile is considered as medium in size. We have 34 companies classified as medium with the total asset above 1.5 billion but below 2.6 billion SAR. Those under the 40th percentile (SAR 1.5 Billion) are considered as small. We have 68 companies considered as small.

Similar to the first-year study, it is clear that large and medium size companies have better corporate governance than small size companies. The cumulative CG score goes up with seven points difference between the large and small companies. The sub-categorical comparison reveals similar pattern in terms of company size and sub-categorical scores. The gap between small and big companies is getting quite large in terms of public disclosure and transparency. Similarly, large companies do much better in terms of stakeholders' rights when compared to the small companies. In short, it is clear that the size does matter.

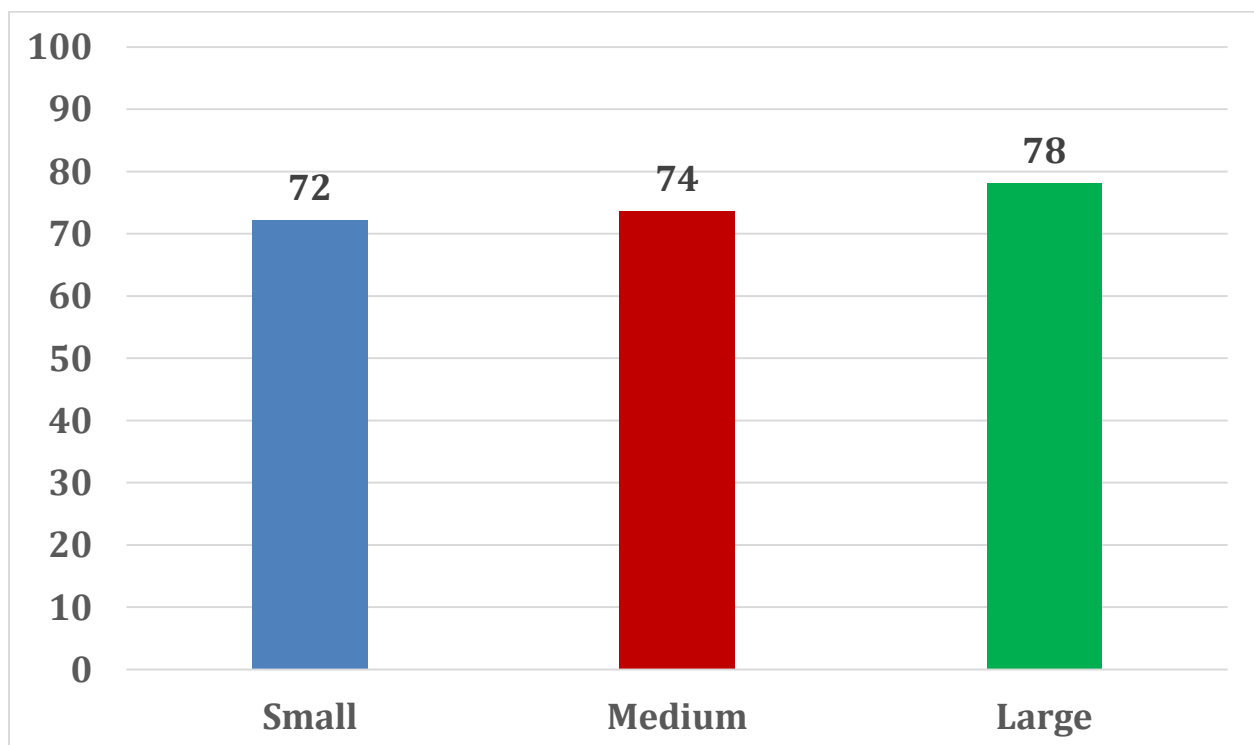
**Chart 13. Cumulative CGI Score by Company Size**



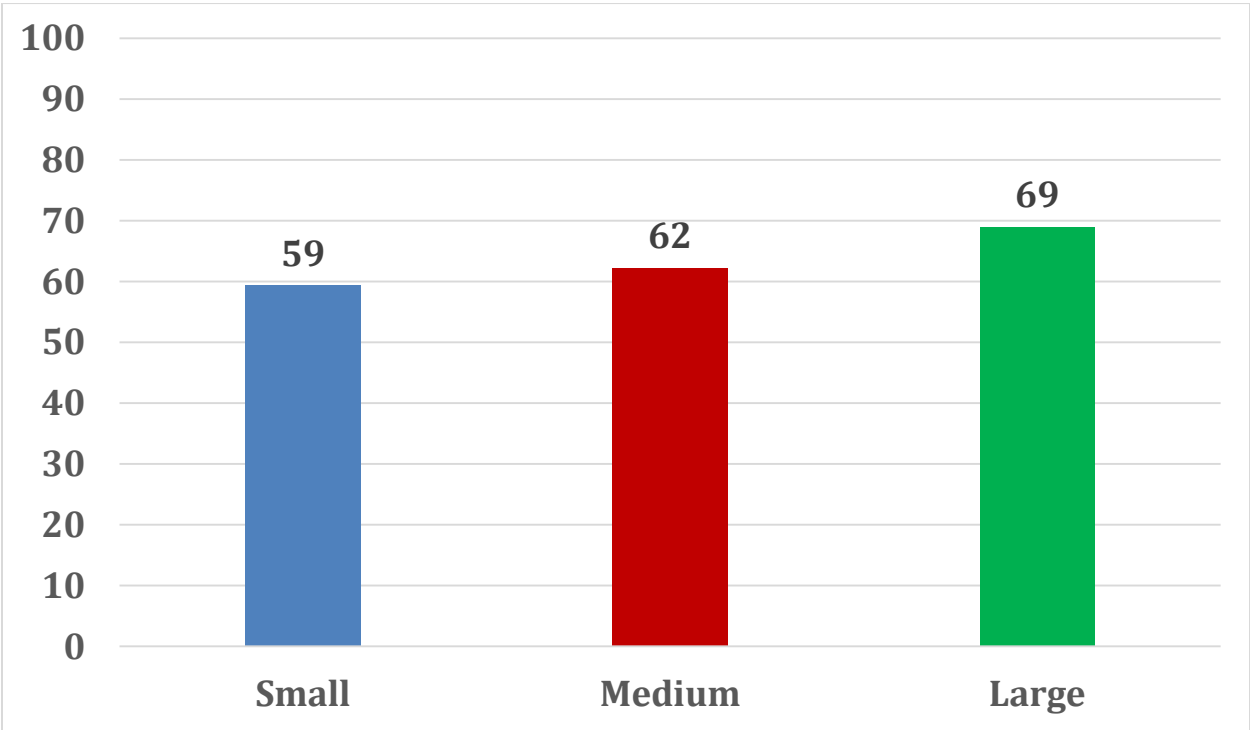
**Chart 14. Board of Directors' Score by Company Size**



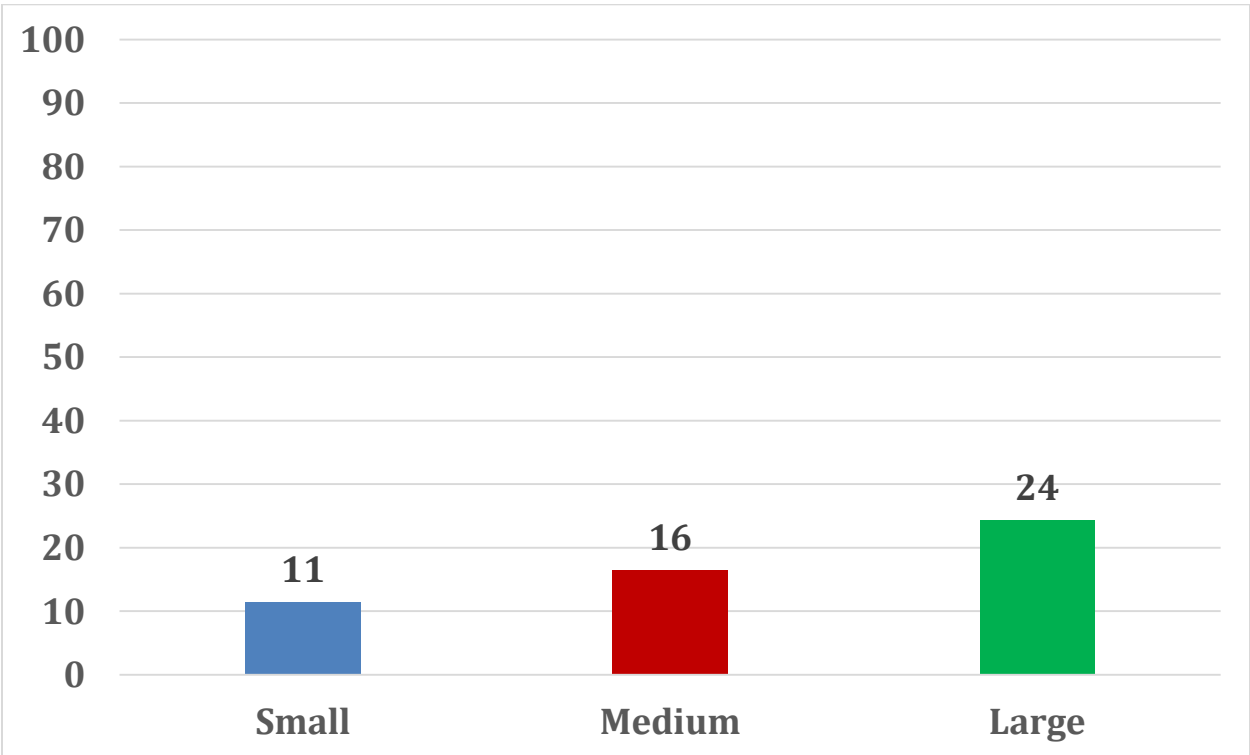
**Chart 15. Shareholders Rights' Score by Company Size**



**Chart 16. Public Disclosure and Transparency Score by Company Size**

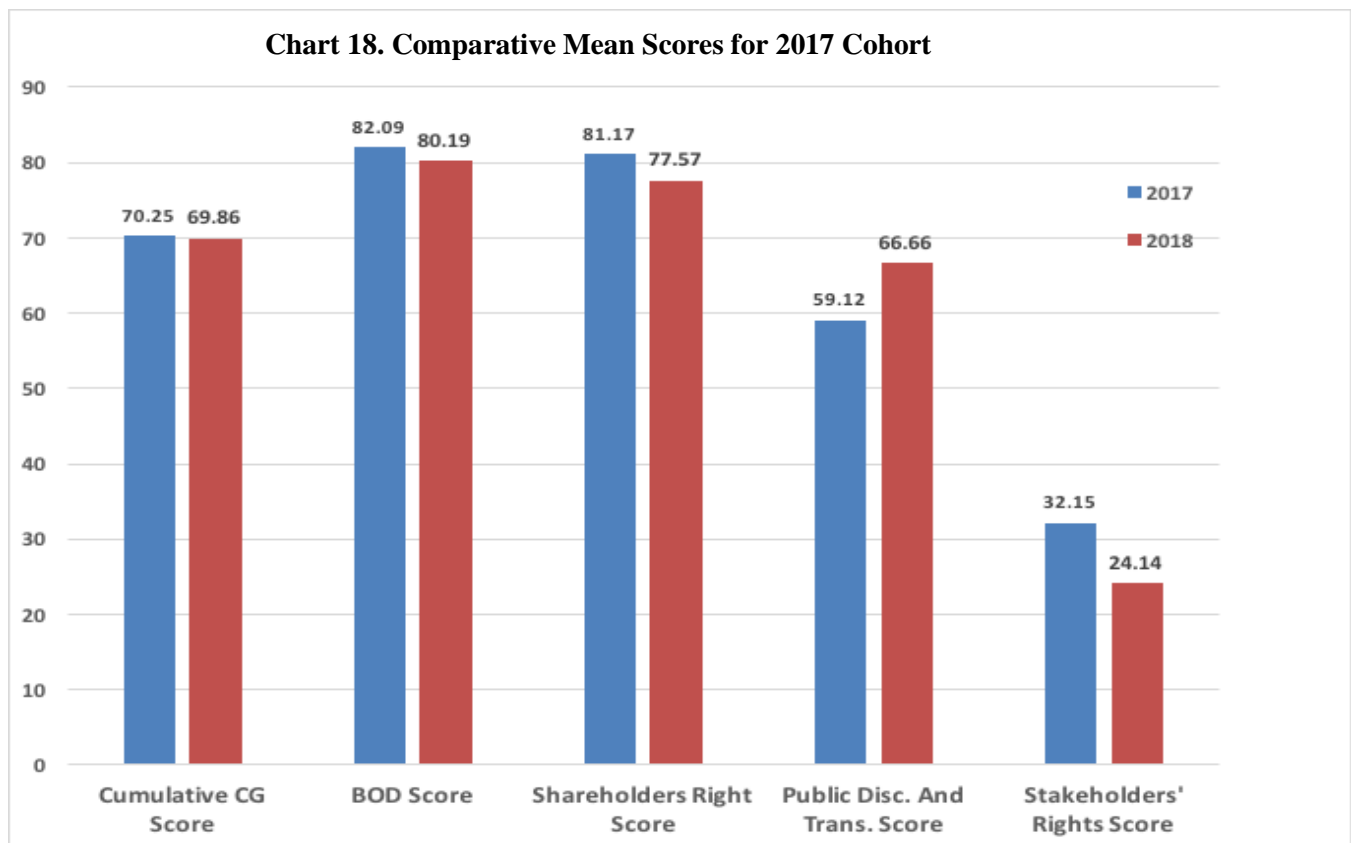


**Chart 17. Stakeholders Rights' Score by Company Size**

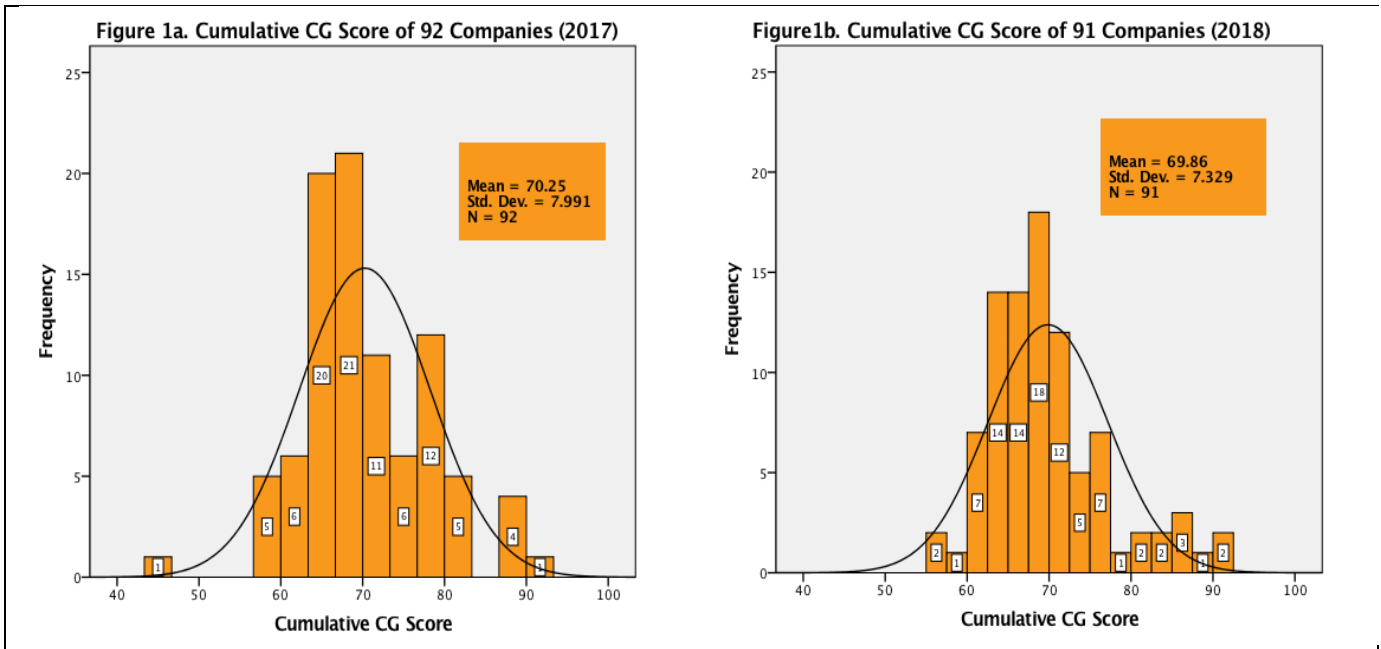


### E) Trend Analysis using 2017 CGI Cohort

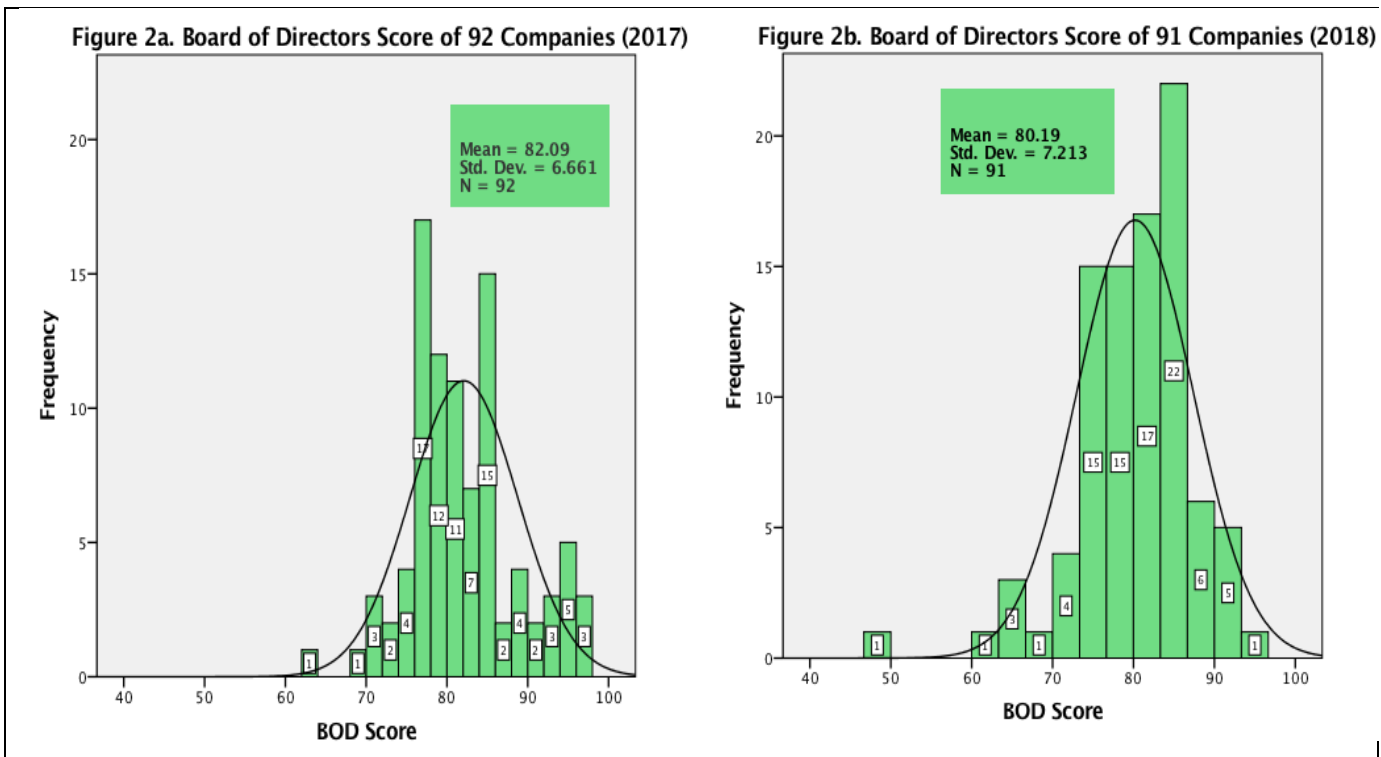
We conducted a trend analysis to see any change in CGI score for the 92 companies we evaluated last year. Since then, one company has been delisted from Tadawul. Therefore, 2018 CGI score includes 91 companies. As seen in the chart below, the mean cumulative score is same. This means that the companies we included this year have lower CGI score on average. Since for the banking and insurance sectors, we added nearly 50 more variables (hence, more constraints), it was expected that the mean score shall be lower this year. On average, the 2018 CGI score is same with the last year. This means a small improvement in the CGI score compared to the last year if we ignore the additional variables. The mean score for board of directors was 82 out of 100 last year while it is 80 out of 100 this year due to additional variables. Similarly, the score for shareholder rights is down from 81 to 78 due to the added variables. The score for public disclosure and transparency is up from 59 to 66 out of 100. It means that some companies are changing their practices; may be this is due to knowing to be evaluated by an independent entity! We expect bigger impact in 2019 CGI score since most of our assessment for 2018 CGI was based on the same CG principles in 2016. Finally, the stakeholders rights score got a real hit dropping from 32 to 24 points out of 100 because in the second year we explored for evidence-based practices rather than a compliance statement.



The chart below compares the cumulative CGI score for the 2017 cohort. The mean and standard deviation scores are almost identical which means no significant difference between CG practices in 2016 versus 2017.

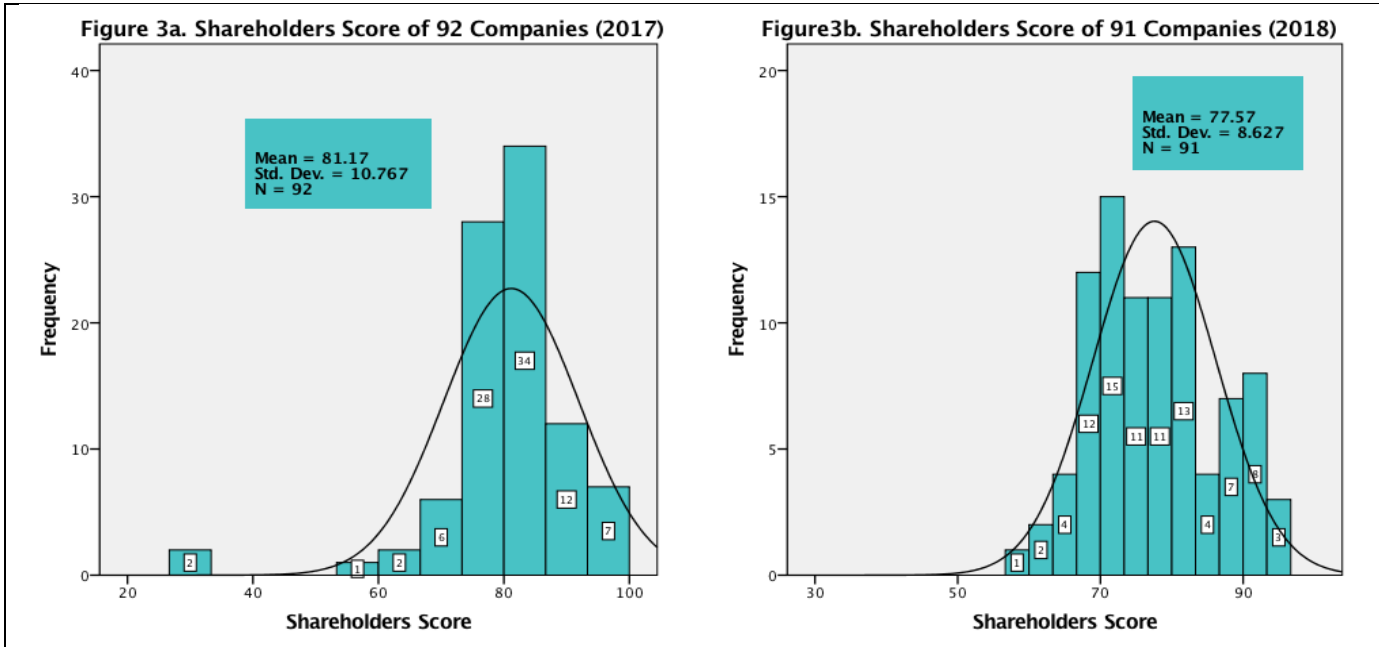


The chart below compares the board of directors' score for the 2017 cohort. The mean score is down very little due to the added new variables. The standard deviation is also little bit up.

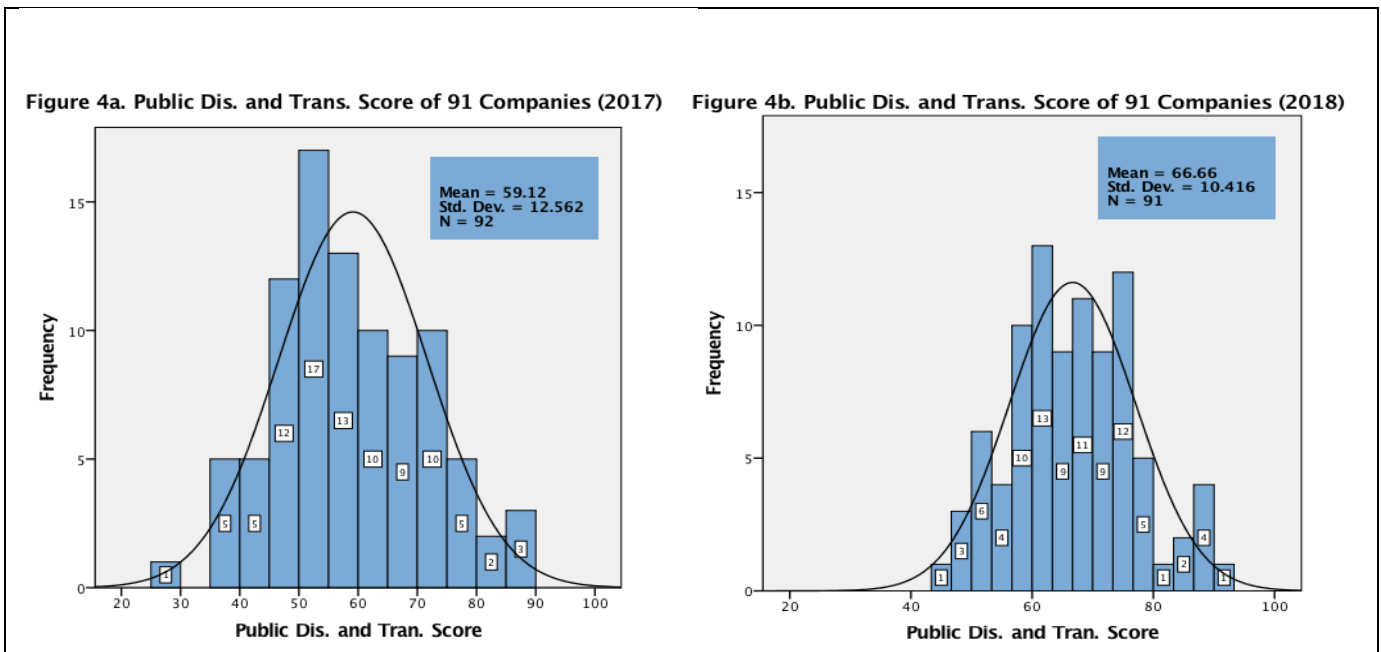




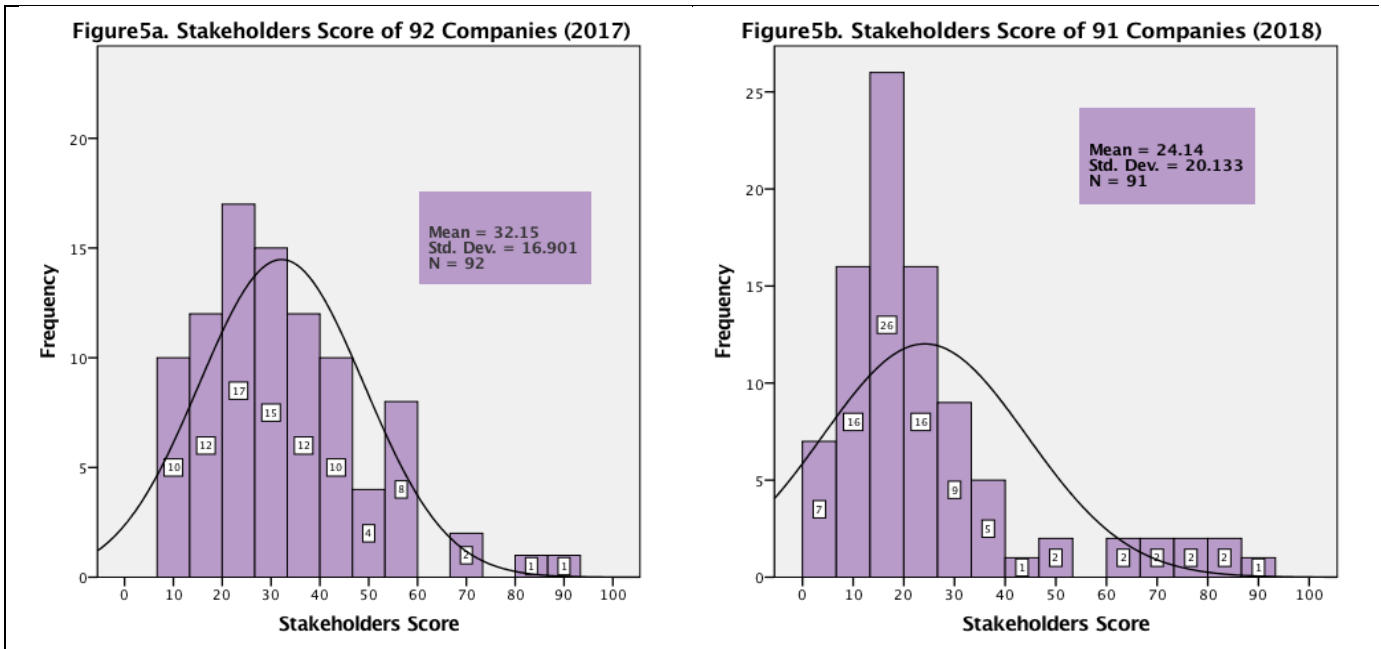
The chart below compares the shareholder rights score for the 2017 cohort. The mean score is down from 81 to 78 due to the added new variables. The standard deviation is actually better for this year.



The chart below compares the public disclosure and transparency score for the 2017 cohort. The mean score is 67 in 2018 up from 59 in 2017. The standard deviation value is also improved.



The chart below compares the stakeholder rights score for the 2017 cohort. The mean score is down to 24 from 32 out of 100.



**F) Overall Strengths and Weaknesses of CG within Four Categories**

The CG score reflects how well companies follow the CMA corporate governance principles as well as relevant international principles related to board of directors, shareholders rights, public disclosure and transparency, and stakeholder rights. The second-year assessment indicates the corporate governance systems work well overall although they need improvements. Our assessment based on publicly available documents related to the shareholders rights revealed both strengths and weaknesses of the companies in regard to the corporate governance practices.

The detail learned lessons regarding both strengths and weaknesses of the companies are discussed below within the four categories of corporate governance principles.

**Table 6. Summary Statistics for Cumulative and Sub-categorical CGI Scores**

	Cumulative CG Score	BOD Score	Shareholders Score	Public Dis. and Tran. Score	Stakeholders Score
<b>N</b>	171	171	171	171	171
<b>Mean</b>	67.02	78.29	74.89	63.78	17.66
<b>Median</b>	66.90	79.71	75.00	64.10	15.38
<b>Std. Deviation</b>	7.75	8.04	9.52	11.43	17.51
<b>Minimum</b>	44.60	49.28	45.00	16.18	0.00
<b>Maximum</b>	90.60	95.00	95.00	91.03	88.46

**1) Board of Directors (BOD)**

We used up to 65 variables to assess companies in terms of their compliance to the principles related to the Board of Directors. For the scoring of each variable, we collected evidence from publicly available documents to assess practices in respect to relevant corporate governance principles. The strengths and weaknesses of the companies in the area of board of directors are discussed below.

The mean score for BOD part is 78 (out of 100) with standard deviation of 8. This means that the companies did score C+ on average in terms of their compliance to the principles related to BOD. The BOD score is the highest among the four areas of the assessment. The review of publicly available documents shows that **most of the companies** in the study accomplished the followings in the fiscal year of 2016:

- Board of Directors has prepared a comprehensive strategy and business plan for the company; it has the explicit responsibility to guide, review and approve corporate strategy.
- Board of Directors undertakes regular assessments of its own performance.
- Board of Directors has established internal control systems and determined supervision rules for them.
- Board of Directors has adopted a “Conflict of Interest” policy covering board members and related party transactions.
- Board of Directors has prepared a Corporate Governance Code for the company.
- There are specific and explicit policies, standards and procedures in the Articles of Association about formation of the Board of Directors, election of its members and its working principles.
- The policies, standards and procedures about formation of the Board of Directors, election of its members and its working principles have been presented for the approval of General Assembly.
- Powers, duties and responsibilities of Board of Directors are described by the Articles of Association in a clearly separated fashion from powers belonging to General Assembly.

- Board of Directors has prepared an orientation procedure for all members, starting with non-executive members, in order to help them learn about company's business, particularly financial and legal aspects of it.
- Board of Directors complies with the rule which states that, unless authorized to do so by the Articles of Association, it can't borrow for a term of more than 3 years, it can't sell or mortgage company's estates or cancel its debts.
- Board of Directors has a membership structure, which is in compliance with corporate governance principles.
- The Articles of Association specifies number of Board members; it states that a single term of service on the Board of Directors is 3 years maximum.
- Chair of the Board of Directors is a different individual from the CEO or General Manager.
- Article of Association specifies situations, which would lead to termination of board membership
- There is a provision in the Articles of Association stating that a corporate entity with the right to appoint a representative to the board cannot vote for other board members.
- Committees along its working principles for Audit, Nomination and Remuneration have been established in order for the board of directors to fulfill its duties efficiently.
- Remuneration Committee is composed entirely of non-executives; Articles of Association include criteria for remuneration of members of Board of Directors.
- Board of Directors holds its ordinary meetings upon request of chairperson.

## 2) Shareholders

We used up to 36 variables to assess companies in terms of their compliance to the principles related to the shareholders rights. Again, the assessment based on publicly available documents related to the shareholders rights revealed both strengths and weaknesses of the companies as discussed below.

The mean score for the shareholders rights part is 75 with the standard deviation of 9.5. Even though the score is quite close to that of BOD, it has relatively high standard deviation which indicates bigger variation among companies. Hence, some companies need improvements in the shareholders' rights. The score means that the companies are graded C+ on average in terms of their compliance to the principles related to the shareholders' rights. The review of publicly available documents shows that **most of the companies** in the study accomplished the followings in the fiscal year of 2016:

- The companies specify the procedures and measures to ensure shareholders' exercise of their legal rights in its articles of association
- All shares that make the company's capital are allowed to use all rights of being shareholder in an equal and fair manner; shareholders who own all shares are entitled to ask questions and to have access to information without having any prejudices against Company's interests.
- The companies maintain and regularly update a comprehensive website along a separate section on corporate governance on their website and in their annual report to shareholders.
- The companies produce their annual report in English as well as Arabic.

- The companies have an investor relations department. The name and contact information of the director of this department is disclosed to public.
- There is a separate section for investor relations in the corporate website.
- The companies hold a General Assembly meeting at least once a year or within 6 months after completion of its financial year
- The auditor has the right to summon General Assembly to meeting.
- Shareholders who represent at least 5 % of company capital have the right to summon General Assembly to meeting.
- The companies inform shareholders about the date, place and agenda of General Assembly at least 10 days before the meeting.
- The companies publish its General Assembly meeting invitation on the corporate website and on the Tadawul website.
- Shareholders are provided with the opportunity to vote by proxy at the General Assembly
- Shareholders are informed about meeting rules before the General Assembly.
- There are provisions in the Articles of Association and internal procedures to ensure choosing the most convenient place and time in order to facilitate participation of maximum number of shareholders to the General Assembly
- Shareholders are given the right to pose questions related to agenda items to Board members and representatives of external auditor at the General Assembly?
- Sufficient information is given to shareholders before the meeting about the items of agenda in order to make them informed enough to make a decision.
- All owners of shares comprising the company's capital have the right to attend General Assembly meetings and vote on resolutions there.
- The company applies no restrictions on the voting right.
- Cumulative voting is used at the General Assembly for voting on board member candidates.
- Board of Directors has prepared a dividend policy that protects the interests of the shareholders and company; Board of Directors' annual report includes dividend policy.
- The amount of dividend to be distributed has been approved by the General Assembly; the companies put its dividend policy to a vote by shareholders in the General Assembly
- The companies give shareholders the right to transfer their shares whenever they want.

### **3) Public Disclosure and Transparency**

We used 42 variables to assess companies in terms of their compliance to the principles related to the public disclosure and transparency. The mean score for the public disclosure and transparency is 64 with the standard deviation of 11. The average score clearly revealed that companies need major improvement this area of corporate governance. The score shows that most of the companies are failing to follow the recommended principles. Around 30 percent of companies scored B while 40 percent scored C and the rest scored D and below. The small percentage of companies which scored high accomplished the followings in the fiscal year of 2016:

- They have prepared disclosure policy for public disclosures.
- They disclose shareholders structure on its website, including a list of largest equity owners.
- They publish Company's Articles of Association on their corporate website
- Material event disclosures are disclosed to shareholders and the public on the corporate website.
- Company's annual reports and financial statements are published on the corporate website.
- Corporate website has agendas, attendants and minutes of general assembly meetings.
- Dividend policy is published on the corporate website.
- Remuneration policy is published on the corporate website.
- The annual report includes Board Members' CV's and CEO succession plan.
- The Big Four accounting firms are hired to audit financial statements and accounting systems.

#### 4) **Stakeholders**

We used 18 variables to assess companies in terms of their compliance to the principles related to the stakeholders. The mean score for this category of corporate governance is 18 with the standard deviation of 18. It is the lowest score within all categories. The result is striking, but not surprising because the underlying variables are mostly from OECD CG principles, not CMA principles. Limited number of companies in our study scored B which shows that those exemplary companies accomplished the followings in the fiscal year of 2016 and can be used as examples for the other companies:

- They have prepared training and development policies for their employees.
- They have a policy of conducting periodic surveys of employees to test for morale, attitude, and confidence in management
- They have established mechanisms to solve conflicts between it and stakeholders or to solve complaints.
- They have corporate social responsibility policies and active projects.
- They ensure independent verification of its product / service quality.
- They have performance evaluation and rewarding criteria for its employees.

## Recommendations for the Improvement

Similar to the findings in 2017 CGI report, even though the average cumulative corporate governance score is good, our study revealed that companies are relatively doing good in terms of corporate governance practices related to the **board of directors**, and **shareholders rights**. However, they did score quite poorly in terms of practices related to **public disclosure and transparency**, and **stakeholders**. The relatively higher standard deviation for these two categories also indicates that the good practices are not equally divided among the companies. We recommend the followings to further improve corporate governance practices:

- Companies shall go beyond the minimum requirements. They shall internalize CG principles and aspire to follow at maximum level. For instance, for public disclosure and transparency, companies could do the followings to get better score:
  - Post CVs for Board members and executives
  - Reveal the individual bonus and/or compensation package for each of the BoD members
  - Upload meeting minutes-
  - make the CG code of the company available on corporate website
  - Post other announcements and information concerns shareholders on their website
  - Keep the archive of last three years' news and reports for potential investors. Some companies update their website and ignore the previous information were shared on their website!
- Increase oversight by CMA in terms of compliance to the relevant principles. In our assessment, we came across some discrepancies between what companies had as principles and did as practices. Good oversight might increase the compliance to the corporate governance principles
- Given the fact that most of corporate governance principles are voluntary based, it is important the government organizes workshops and conferences to increase awareness and facilitate sharing of best practices.
- Pay greater attention the small and medium size companies given the fact they score lower perhaps due to the allocation of insufficient resources to corporate governance practices and training.
- Develop a certificate program for the training of company executives in regard to corporate governance principles and practices.
- Provide research grant to researchers to study the importance and economic impact of good corporate governance. This will generate empirical evidence to encourage companies to comply with voluntary corporate governance principles.
- Pay greater attention to the compliance to the corporate governance principles related to public disclosure, transparency, and stakeholders. The CMA might make some of those principles mandatory for companies to assure that companies are taking them seriously.
- Benefit from the practices of some of the companies that are scoring well on the four CG categories.

- Companies that are not scoring well on any combination of the four CG categories are encouraged to obtain a copy of its score card (report) from the CoB Corporate Governance Center. The report shows where such a company is not scoring well and where improvements are required.

## **Part IV: Customized CG Report**

### **1. Do you want a customized CG report for your company?**

One of the services provided by the Corporate Governance Center is an individual report, which is a report of governance customized for your company. The report will include full assessment of the company's corporate governance practices within four categories (Board of Directors, Shareholders' Rights, Public Disclosure and Transparency, and Stakeholders' Rights) using up to 165 variables. The cumulative CG score along with CG score by four categories will be provided. The report will provide detail graphical analysis of the company's corporate governance performance. It will include comparative analysis to reveal how the company performs compared to other companies. It will highlight both strengths and weaknesses of the company related to the four categories. It also reveals the ranking of the company within all companies traded on the Saudi market and within its sectoral group. Finally, the report will include key recommendations on how to improve corporate governance

### **2. How can you order a customized report?**

To order the customized CG report for your company, please contact CG Center at College of Business by phone: +966 -11 - 215 - 7682 or by email: [cgi@alfaisal.edu](mailto:cgi@alfaisal.edu).