ON THE SPECIFICS OF CORPORATE GOVERNANCE IN IRAN AND THE MIDDLE EAST

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Abstract

Corporate Governance (CG) is not a new concept for the transition economies of the Middle East, but corporate governance is especially important since these economies do not have the long-established institutional infrastructure to deal with corporate governance issues. This article is presenting the results of our survey analyzing the status quo of Corporate Governance in Iranian companies. The survey questions cover aspects of Corporate Governance awareness, board of directors, control environment, transparency and shareholder- as well as stakeholder rights. We find several specifics that apply to other countries in the MENA region too. Empowering shareholders and stakeholder, offering Corporate Governance trainings and case studies in the region as well as establishing a culture of independent directors is the way forward.

Keywords: Corporate Governance, Middle East, Iran, Shareholder, Stakeholders

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1 Introduction

Corporate governance is not a new phenomenon in the transition economies of the Middle East. Corporate governance issues are especially important in these economies since these countries do not have the long-established (financial) institutional infrastructure to deal with corporate governance issues (Braendle and Noll, 2006 and compare Black et al., 2010 on Brazil).

Corporate Governance issues were not discussed before a series of emerging market crisis in 1997 (Sourial, 2004). All this has changed and corporate governance codes as a measure of dealing with each country's specific governance problems have been adopted by most of the MENA (Middle East North Africa) counties. In the framework of various public and private initiatives where the codes were discussed, this has resulted in improvements of formal legal rules as well as in the drafting of soft-law recommendations.

Especially the financial scandals at the beginning of the 21st century led to a huge number of corporate governance codes all over the world. As a common denominator they want to shape comprehensive standards of good governance. These are the avoidance of conflicts of interests and the request for disclosure and transparency (Braendle and Noll, 2005), the constitution of the board of directors of independent directors, managerial compensation, as well as the claim for shareholder rights (Becht et al., 2002).

In this contribution we want to discuss the specifics of Corporate Governance in the Middle East based on our survey of Iranian companies. Section 2 compares Corporate Governance in the Middle East (and Iran in special) with global CG standards. Section 3 discusses the key obstacles to corporate governance in Iran. Section 4 presents the highlights of the survey. Based on the results of the survey we discuss the implications and conclude with what should be done to improve corporate governance in the region (section 5).

2 Corporate Governance in the Middle East

2.1 The MENA Region

The MENA region consists of countries with significant distinctions in levels of per capita income and and are in different stages in economic development (McLellan, 2011). This is a fundamental fact regarding the aims and their implementation of Corporate Governance Codes in such countries.

The countries of the Gulf Cooperation Council (GCC) are economically forming one group. Because of their crude oil resources and the steady increase in oil prices these countries are generally in surplus and are net capital exporters (Piesse et al., 2011). The GCC is a trading bloc covering the six Arabian Gulf states of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

A second group includes countries such as Egypt, Jordan and Morocco. These are net capital importers who have been engaged in economic reform programs since the mid-80s, largely with the help of the World Bank and the IMF and as well as major developed countries. For this group, securities markets are an integral part of widespread privatization programs and are relatively well developed in terms of infrastructure (Piesse et al., 2011).

The third group consists of eight countries that are either economically vulnerable due to political instability, or in the very early stages of economic development, or both. This includes Iran, Iraq, Lebanon, Syria, Algeria, Sudan, Libya and Yemen, as well as the West Bank and Gaza.

The focus of this paper is on the corporate governance system in Iran. Clearly Iran is not representative for the other countries in the region. But the choice reflects the fact many of the issues discussed for Iran can be applied to other countries in the region as well (Braendle, 2006).

2.2 Corporate Governance in Iran

Corporate Governance and its importance is a relatively new subject in Iran, having come to public attention with the first attempt by the Tehran Stock Exchange to develop the first draft of a code of Corporate Governance in 2004, which was based on OECD guidelines and was mainly benchmarked with Code of Corporate Governance in Malaysian Stock Market. In 2010, the Securities and Exchange Organization (SEO) completed and formally adopted the Code of Corporate Governance but implementation in the companies is not compulsory yet. In this period, there has also been a number of seminars, conferences and awareness raising activities on Corporate Governance. Meanwhile, SEO tries to improve the governance system of the listed companies and the market through separate bylaws such as Disclosure and Transparency bylaw. The OECD Principles of Corporate Governance was translated into Farsi in 2008 but discussion of Corporate Governance has mainly remained in the academic circles while major players have started to notice this concept.

Iranian companies have a one-tier board structure with Board of Directors, but some of the Iranian semi-government companies have a two-tier board structure: a Trustee Board and a Management Board. There are no independent directors in Iran yet. Board members are appointed not on the basis of their expertise and merits but because of their political connections and influence (Mashaveki and Bazzaz 2008). The board system is influenced by the ownership structure of the companies, which is characterized by a majority of small to medium-sized family-owned companies in the Middle East. “Within this structure, the roles and relationship between the family, board, shareholders, and management tend to be overlapping and unclear.” (IFC, 2011).

In its Doing Business report the World Bank (2011) provides a snapshot of the business climate in Iran by identifying specific regulations and policies that encourage or discourage investment, productivity, and growth. Key indicators and benchmarks are used to help measure the ease or difficulty of operating a business. Doing Business sheds light on how easy or difficult it is for a local entrepreneur to open and run a small to medium-size business when complying with relevant regulations. It assesses regulations affecting domestic firms in 185 economies and ranks the economies in 10 areas of business regulation:

Table 1. Doing business in Iran

Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Registering Property	Getting Credit
129	42	143	156	89
Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
167	115	131	49	111

Source: World Bank (2011)

Investor/shareholder protection, including transparency issues is among other things one of the major drawbacks of Iran’s corporate governance system. The Table below shows general information on the structure of Iranian companies and their board of directors.

Table 2. Structure of Iranian companies

Percentage of ownership required to invite the General Assembly	Only holders of shares above 20 percent can call an extraordinary shareholder meeting
Board's system	one-tier Board
Independent board members	Uncommon in Iran
Board Committee	Uncommon in Iran
Disclosure of information about board and managers	In listed firms, records and qualifications of board and CEO should be reported.
Compensation of the board services	Board's fees and remuneration will be exposed cumulative.
Ownership Disclosure	Yes - but understanding the ownership structure and identifying ultimate owner is very difficult

2.3 The MENA Region compared to global corporate governance standards

Ever since the OECD published its Principles of Corporate Governance in 1998, most codes developed over the years follow these principles, which are mainly based on

- Ensuring the protection of shareholder rights, including the rights of minority and foreign shareholders, and ensuring the enforceability of contracts with resource providers (Fairness);
- Requiring timely disclosure of adequate, clear, and comparable information concerning corporate financial performance, corporate governance, and corporate ownership (Transparency);
- Clarifying governance roles and responsibilities and supporting voluntary efforts to ensure the alignment of managerial and shareholder interests, as monitored by boards of directors (Accountability) and last but not least
- Ensuring corporate compliance with the other laws and regulations that reflect the respective society's values (Responsibility).

These principles are non-binding and do not aim at detailed prescriptions for national legislation. Rather, they seek to identify objectives and suggest various means for achieving them. Their purpose is to serve as a reference point (OECD, 2004).

In 2005 the MENA-OECD Working Group on Corporate Governance comprised of MENA and OECD officials as well as other public and private sector actors was established. It represents a network of exchange for corporate governance priorities, a sharing of best practices and enables to evaluate the implementation of the principles in the region. The intention of the working group is to raise awareness of government structures and processes in this region, to improve the policies and environment for investments in this region.

3 Key obstacles to corporate governance in Iran

Out of what we have seen in section 2, the key obstacles of Corporate Governance in Iran – and this might be true for most Middle Eastern countries - can be divided into four separate categories:

- Capital market structure and situation
- Low awareness on Corporate Governance functions and benefits in various stakeholders
- Non-conducive business environment in Iran:
- Lack of institutional laws to fully support responsible business, property right and stakeholder rights.

Even though the infrastructural prerequisites for a functional capital market are in place in Iran, trading and liquidity are minimal and only a few Iranian companies have turned to the stock market as a source for their financial needs (CGIran, 2011). The authorities have put substantial efforts in later years to transform the capital market into a place to provide finance for the companies, though these efforts was fairly not conclusive while only 15% of the total market is being traded in the market in free float shares. Although the legal framework for Corporate Governance and investor protection has been strengthened, the majority of market and public players are lacking a thorough understanding of the concept. As a result, compliance with the new rules is low.

Another issue of concern again regards the lack of a proper Corporate Governance understanding and knowledge and therefore causes shaky and unreliable practices among the most important and influential parties.

But challenges are not limited just to the low awareness of the concept in the society and further resulting weaknesses and deficiencies are also challenging. More specific and concerning challenges may include: limited protection for small shareholders (Braendle, 2006), poorly defined roles and responsibilities for boards and related bodies, a dearth of independent members in boards, and poor compliance with disclosure requirements. Many companies do not publish financial statements on a regular basis; ownership is often not disclosed; and audit quality is mixed and tends to further complicate matters; there is no functional supervisory system for internal control mechanisms, just to name of few of the problems (McLellan and Moustafa, 2011).

Independent directors have not been permitted in law and such concept has not been popular or even known in Iran. The Commercial Law of Iran does not accept such director on the board as every board member has to be a representative to shareholders. Moreover, there is lack of legal support and flexibility to assure the independence of such directors (Chung et al., 2011).

Ownership structure is the next problem regarding Corporate Governance in Iran (OECD, 2005). Institutional investors and large stock owners have been pushing others' rights towards the benefit of themselves. Stocks have been focused in hand of special groups while the increased costs of representation have provided an atmosphere of opportunism for the majority shareholders. One can confidently state that the ownership structure -which is mainly based on concentrated ownership, has been pushing towards the interests of major shareholders. The problems related to this are widely discussed (Shleifer and Vishny, 1986).

Finally cultural issues might also act as barriers when moving towards a more sound market environment (Braendle, 2005 and Schein, 1992), therefore a more gradual approach towards implementing Corporate Governance practices is highly advisable. Concepts like transparency, responsible business, shareholder rights and accountability are not widely appreciated and the business environment in Iran does not directly reward practicing these concepts.

4 Survey on corporate governance in Iran

4.1 Survey setup

4.1.1 Methodology

The intent of this study is to cover the how's and why's of Corporate Governance practices in Iran. Hence this study not only highlights recent improvements in Corporate Governance regulations but also tries to address measures on different aspects of Corporate Governance and dig into important reasons behind Iranian Corporate Governance situation.

CGRDC in Iran has started research project with the objective of analyzing situation of Corporate Governance in the Iranian companies.

The design of the study is simple. It comprises of 91 questions aimed at probing the effectiveness of Corporate Boards in Iran. We selected 24 well-known companies from all sectors namely, listed companies, multinational companies (MNCs), private sector and family-owned companies.

These companies are regarding their ownership structure family firms, semi-governmental companies, listed on a public stock exchange, banks, insurance and joint venture companies from different sectors as can be seen in table 3.

Table 3. Participants in the survey

Name	Ownership/ Sector	Field of Activities
Mahan Investment Group	Family Owned Business (FOB)/ Service	Airline
Atieh Group	FOB/ Service	Business Consulting
AryaMachine	FOB/ Service	Heavy Machinery
Pasargad Bank	Listed/ Financial Services	Finance and Banking
Rail Niru	Private/ Service	Transportation
Behpakhsh	Private/Service	Distributer
Mashad Carpet	FOB/ Manufacturing	Textile industry / Carpet
Ezam Holding	FOB/ Manufacturing	Spare part
Tak Makaron	FOB/ Manufacturing	Food Producer
Fouman Chimi	FOB/ Manufacturing	Chemical producer
Pasargad trading	Private/ Service	Trade and investment
Parak software	FOB/ Service	Software Developer
SEMEGA	Semi Government/ Tourism	Tourism investment
Khazar Shipping Line	Listed/ Service	Transportation
Rahshahr	FOB/ Construction	Construction / Contractor
Sanat Madan Investment	Listed/ Financial Services	Trade and investment
SITCO/Espandar	Private/ Manufacturing	Cement
Hamkaran System	Listed/ IT	IT
Dadeh Pardazi Iran	Listed/ IT	IT
Torbo Compresor Naft	Semi Government/ Manufacturing	Turbine
Aria Pishro Gharn	FOB/ Oil	Oil Engineering
Dana Energy	FOB/ Oil	Oil exploration
Saderat Bank	Semi Government/ Financial Services	Bank
Samexon	FOB/ Construction	Construction / EPC Contractor

4.1.2 Objectives

The scope of this project entails developing measures to assess situation of CG in the country, including identification of knowledge and awareness of the responding managers and board members on concepts related to CG, as well as their opinion on benefits and challenges of implementing CG in Iran. Conducting this survey provides the opportunity to:

- Identify challenges and needs of several business sectors of the country
- Develop and implement concepts of CG in selected companies.
- Develop tools and guidelines for promotion and facilitating implementation of CG in different business sectors of the Iranian Economy.
- Facilitate development of related regulations on Corporate Governance in Iran.
- Identify practices that are fundamental to improving level of Corporate Governance in Iranian companies.

4.1.3 Questionnaire

The questionnaire is divided into the following 6 sections:

- Awareness and Commitment to Good Corporate Governance Practices
- The Board Responsibilities
- Control Environment and Processes
- Disclosure and Transparency
- Shareholders' Rights and the Key Duties of Owners
- The Role of Stakeholders in Governance of the Firm

The questionnaires were completed by the researchers in in-depth interview sessions with the study subjects.

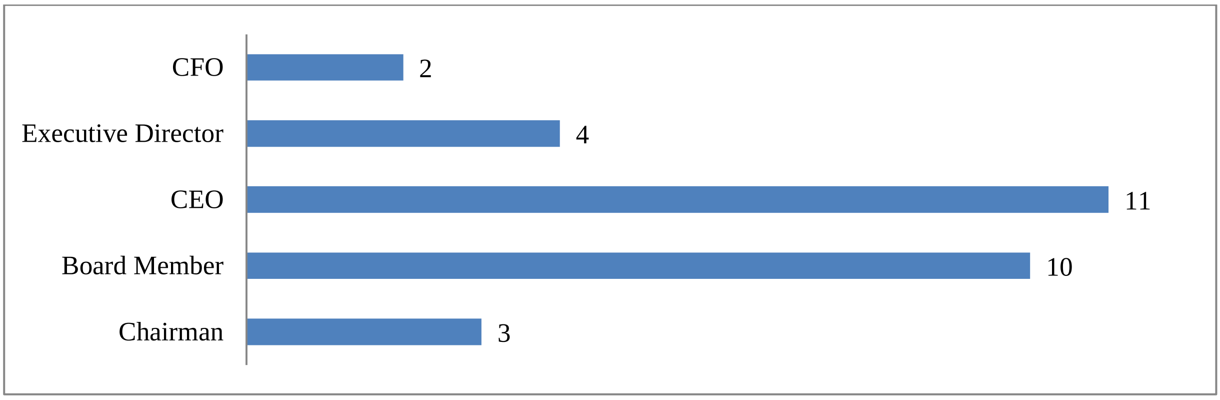
The main research questions were as follows:

- What aspects of Corporate Governance leads to improved business environment in Iran?
- Which aspects of Corporate Governance help enterprise managers to better run their company in the Iranian context?
- What are the stakeholder's expectations from mechanisms of Corporate Governance?
- What dare the challenges of the market regulatory bodies to develop proper regulations in regards to Corporate Governance?
- What are the main challenges and difficulties in implementing Corporate Governance mechanisms in different business sectors of the Iranian Economy (FOB, Listed, Government Owned, Quasi-Governmental)?

4.1.4 Respondents

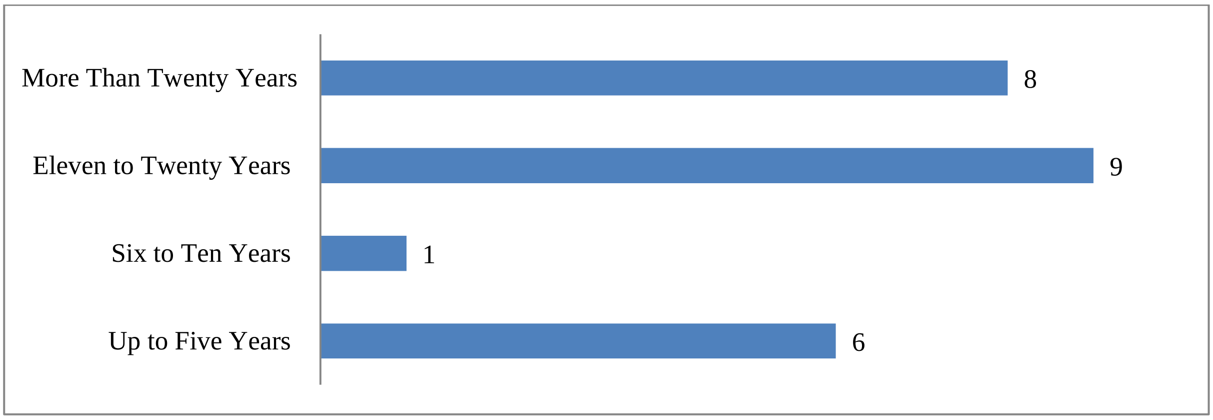
For the purpose of this study, convenient sampling method was used from 30 directors and C-level managers in 26 Iranian corporations. The rationale for deploying this method is that this research was an exploratory study and convenient sampling is most often used in such investigations. No specific industry had the focus of this research so that the results of this study would be generalized easier and would portray a better picture of the corporate governance situation in diverse industry sectors. Breakdown of the respondents by their positions are illustrated below:

Figure 1. Respondent's Position



Also the breakdown of the companies by their respective year of establishment is shown in the following graph.

Figure 2. Surveyed companies by year established



The design of the study comprised of 91 questions aimed at probing the effectiveness of corporate governance in Iran. We selected 26 well-known companies from all sectors: listed companies in the public sector, Multinational Companies (MNCs) and Private Local/Family Owned companies. These companies are combination of family firms, quasi-governmental, public stock exchange, banks, insurance and joint venture companies from different sectors. The survey conducted in 2011 included 30 managers (CEOs, CFOs, board members, chairmen)

The issues in questions are

• What aspects of Corporate Governance leads to improved business environment in Iran?

• Which aspects of Corporate Governance help enterprise managers to better run their company in the Iranian context?

• What are the stakeholder's expectations from mechanisms of Corporate Governance?

• What dare the challenges of the market regulatory bodies to develop proper regulations in regards to Corporate Governance?

A questionnaire divided into six sections was sent out to the above mentioned 26 companies, addressing the following issues which will be discussed in the following subsections:

• Awareness and Commitment to Good Corporate Governance Practices

• The Board Responsibilities

• Control Environment and Processes

• Disclosure and Transparency

• Shareholders' Rights and the Key Duties of Owners

• The Role of Stakeholders in Governance of the Firm.

4.2 Awareness and commitment to good corporate governance practices

In many countries, ratification and enacting codes of Corporate Governance in the capital markets are the main drivers for implementation of the concept of Corporate Governance practices in the business arena (see OECD, 2011); However, in Iran the code has not been implemented yet.

Our survey reveals that:

• 18 % of the respondents are familiar or knowledgeable with the concept of Corporate Governance and its principles, this number is 52% in Turkey, 59% in Pakistan (CG Iran, 2011), and 60% in the MENA region (IFC, 2008).

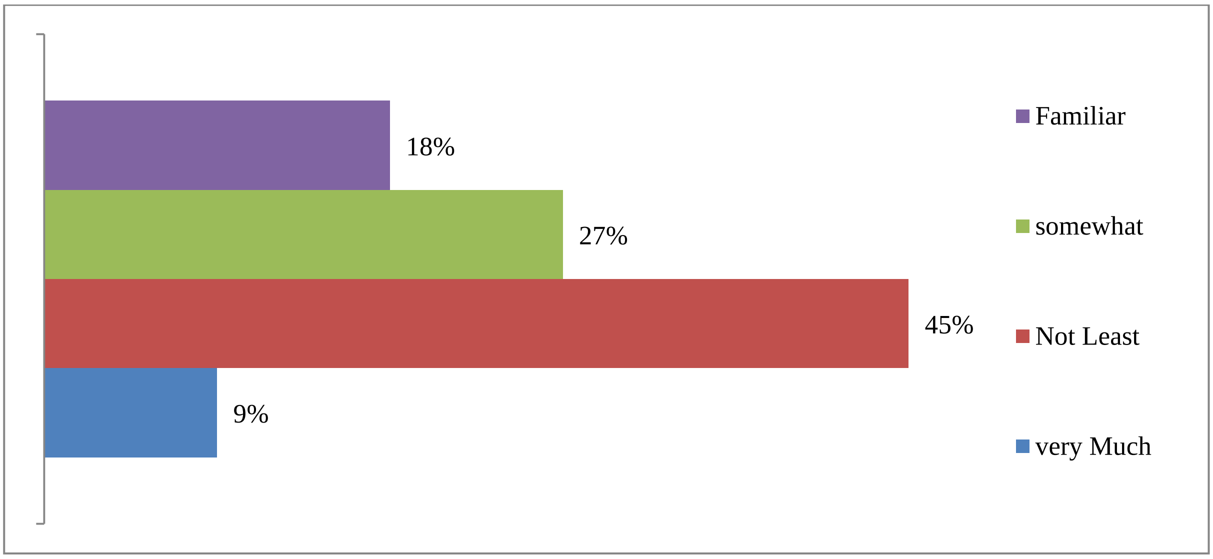
• 82% of the respondents accept that the main benefit of implementing Corporate Governance practices is compliance with the legal and regulatory requirements.

• None of the respondents have developed their own code or guideline for Corporate Governance, while 63% of their counterparts in Turkey and Pakistan have formalized codes of conduct and ethics (CGIran, 2011)

• A significant barrier in implementing good Corporate Governance was the unavailability of qualified staff and a lack of information/know-how as well as Lack of effective rules and regulations about Corporate Governance principles and practices, similarly, respondents in the MENA region have asserted that main barriers for effective implementation of CG are lack of qualified specialists and lack of information and knowledge of the subject (IFC, 2008).

As we see in the below graph, only 9% of respondents indicated that they knew Corporate Governance principles, specifically the OECD Principles of Corporate Governance. This was followed by 45% of the respondents not knowing much on the concept.

Figure 3. How familiar are you with Corporate Governance?



In addition to gauging awareness of good Corporate Governance practices, the survey sought respondents' views on the level of compliance with Corporate Governance best practices in their own companies.

Although still the principles/codes of Corporate Governance in the country have not been enforced, some companies- relying on managers' personal experiences, are taking advantage of management consultants in organizational longevity of organization and have implemented some of the aspects or principles of Corporate Governance in their companies. These activities are mainly in:

- Separation of CEO and managing director;
- Formation of audit and risk committees;
- Reporting of the financial director to the board.

Companies had adopted such Corporate Governance improvements as required by best practices; for example, while 9% had established board committees, 68% of the respondents have Separation of chairman and CEO , 73% of the respondents have not introduced independent non-executive directors to the board of directors, 86% have not established Board Evaluation Instructions, 60% have not established conflict of interest and related-party transactions administration procedures and 69% have not Implemented a formal remuneration system for executives.

Table 4. To what degree are international corporate governance standards followed?

Mechanisms on board selection criteria	13%
Nomination procedure	22%
Board committees (Internal Audit Committee, risk management, nomination and selection committee and ...)	9%
Developing compensation and remuneration mechanisms for board of directors and executives	31%
Board Evaluation Instructions	13%
Separation of chairman from CEO	68%
Independent and non-executive board members	27%
Developing procedures governing deals with related parties and preventing conflicts of interest	40%
Instructions for protecting shareholder and stakeholder rights	4%

Regarding barriers to improve Corporate Governance, 4% of the respondents did not identify any barrier to improvement as they believed every barrier has to be overcome and resistance is futile. Of the 96% of respondents who identified barriers, 77% mentioned unavailability of qualified staff to help with implementation of Corporate Governance practices and 68% stated lack of countrywide effective rules and regulations relating to Corporate Governance principles and practices as the barrier to improving Corporate Governance practices in the company. The other main obstacle identified by 18% of the respondents was that Corporate Governance identifies or discloses commercially sensitive information that cannot be shared with competitors. 9% asserted that the main obstacle to improvement of Corporate Governance practices was that they did not see any benefit in adopting such practices.

Table 5. Barriers to improve CG practices

Lack of effective rules and regulations	68%
Due to information disclosure and transparency as a part of Corporate Governance, we prefer to keep our financial information away from competitors and rival stakeholders	18%
We don’t find any use in it regarding the Iranian legal and business structure / We simply don’t see any value engaging with it.	9%
Lack of professional experts and consultants	54%
Lack of knowledge and expertise available to the company	77%
I do not see obstacle	4%

For an overwhelming majority (77%) of the respondents, the most important benefit of adoption of Corporate Governance practices was improved strategic decision-making process. Meanwhile, we can see that the perceived benefits of Corporate Governance are closely followed by improved risk management system and improved brand and credibility, each 72% and 68% respectively. It should be noted that the bottom three perceived benefits are also indicative. Defending shareholder’s rights and information disclosure and transparency as important goals of Corporate Governance are fully underestimated and a major benefit pertaining to better access to capital is unrealized the most.

Table 6. Benefits of adaption of CG practices

Increasing information disclosure	50%
Improved brand and credibility	68%
Improved risk management system	72%
Compliance with legal and judicial requirements	59%
Defending Shareholders Rights	50%
Improved strategic decision-making process	77%
Better access to capital and foreign partners	40%

4.3 Board Responsibility

Traditionally and also based on the Iranian commercial law, the board is responsible for executive and strategic duties (but in practice mainly administrative/executive tasks). However, the power structure in Iranian companies is very centralized, with little delegation of authority to lower management levels. Both in private and government-owned companies, the managing director's approval is needed for nearly all decisions with legal or financial liability on the company.

Iranian companies have a one-tier board structure with Board of Directors, but some of the Iranian semi-government companies have a two-tier board structure: a Trustee Board and a Management Board. In the one tier board companies, election of board members is made by the General Assembly and in semi-governmental companies; selection of the management board members is done by the Trustee Board. In semi government companies, the Trustee board is supposed to oversee the work of the management board, while the management board carries out the day-to-day operations of the company. Practice however varies greatly across companies, with Trustee boards playing little role in operation of some companies, while working full time in others and engaging in day to day management.

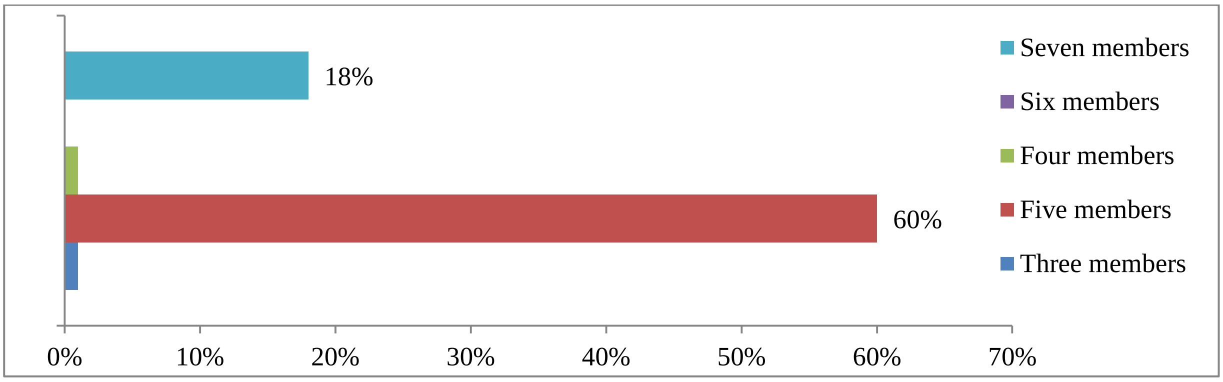
Regarding the number of board members, good Corporate Governance practices require that boards be large enough to encompass individuals with a range of specific skills on finance, legal and commercial affairs. On the other hand, smaller boards are more efficient (Becht et al., 2002). Meanwhile, the corporate law in Iran requires a minimum of two board members.

In our survey board of 3 and 4 members had 6% of the total each. The highest number of members recorded was five, found in thirteen of the surveyed companies and 18% had a board of 7 people.

Even though the definition of independent director was given in the questionnaire and explained during the process of interview, a majority of respondents did not understand the definition. For them, a non-executive director who did not work full time for a company was an independent director. A majority of the respondents expressed that it is difficult to find any non-executive directors and impossible to find independent non-executive directors.

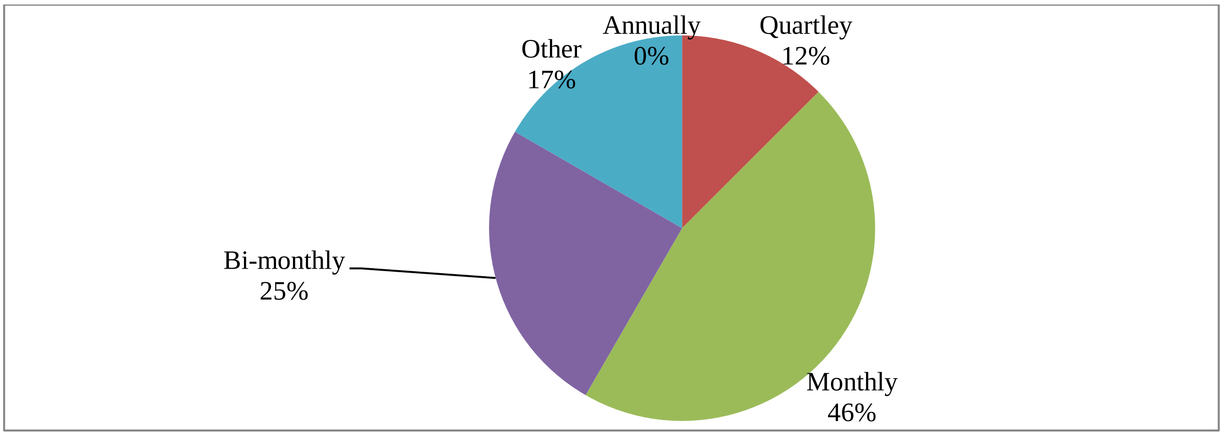
The Companies Ordinance requires that the directors of a public company meet at least once every year, and 100% of the responding sample stated that they complied with this. On the other hand, the Code of Corporate Governance recommends having a meeting every month.

Figure 4. Number of board members



The board of directors met on average 10 to 14 times a year, in 46% of the surveyed sample, and followed by around 6 times a year (25%). Meanwhile 91% stated that the directors are furnished with background material one week before the meeting, as required by law. In a considerable part of companies, 17%, it is not clear whether board meetings are not held or they do not document the meetings.

Figure 5. Frequency of board meetings

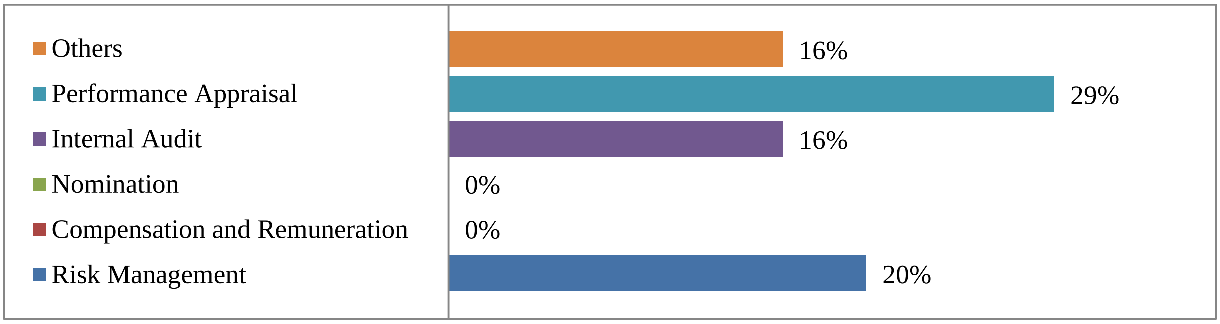


100% of the surveyed sample stated that the board was responsible for electing, appointing and dismissing the chief executive. The board of directors is responsible for setting the remuneration of the CEO. A majority 88% of the sample thus expressed that the board was responsible for approving the remuneration of the CEO. 33% of the respondents did not reply to the question relating to approval of the succession plan, while 33% stated that the board was responsible for the succession plan. By-laws or statements in which the board functions were described in details were not identified in the companies in this study. Board's duties and responsibilities are mainly confined to what is described in the commercial law and company's statutes. Only in one of the quasi-governmental companies (4%), there existed board duties booklet, which was handed in to them upon selection. This is while about 60% of the companies in the MENA region have developed their own board charter (IFC, 2008). An overwhelming majority (83% of the companies) stated that the board was responsible for setting the corporate strategy.

SEO has obliged all listed companies through a by-law that the CEO and chairman of the board have to be separated. Perhaps, that is why separation of CEO and chairman position with 66% is the most common phenomenon of CG practices in our sample of Iranian companies. The same practice is also dominant in the MENA region with more than 80% of companies have different CEOs than their chairs (IFC, 2008). Board committees play an important role in Corporate Governance best practices, and respondents were asked whether they had established or planned to establish the committees, generally considered necessary for adequate Corporate Governance. Although the Commercial law does not require specific supervisory board committees, a number of companies reported that they had established some committees.

The most prevalent existing committee was the performance appraisal committee (29.0%), followed by the risk management committee (20%), Internal- and Audit committee (16.0% each). However, an important point is that these committees were mainly established by CEO and usually board members are not members of this committee. This is while in the MENA region about 80% of the companies have audit committees (IFC, 2008).

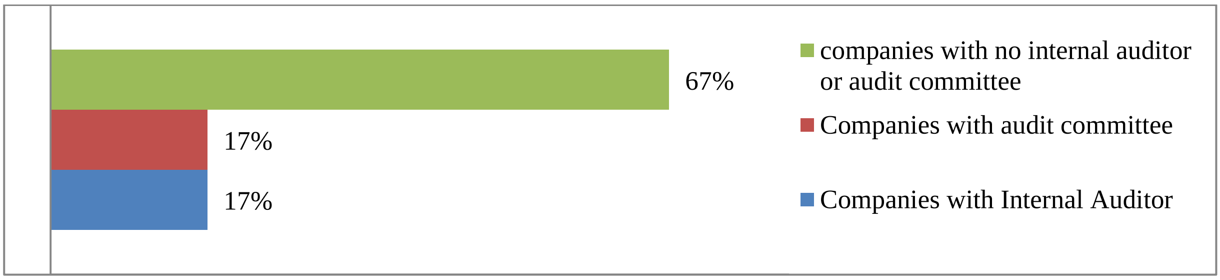
Figure 6. Prevalence of Board Committees



4.4 Control environment and processes

In our survey we found that 17% of the companies used internal auditors inside their organizations while 17% of them have formed an audit committee. The majority of the companies have neither an internal auditor nor an audit committee.

Figure 7. Prevalence of Audit Committees resp. Internal Auditors



We can see from the figure below that the internal auditor of the responding companies performs a number of functions where the most common are to perform regular and extraordinary inspections of the company's operations, to ensure compliance of the board of directors and executive bodies with legal requirements, charters and by-laws, and to develop policies and procedures for internal control and risk management.

4.5 Information disclosure and transparency

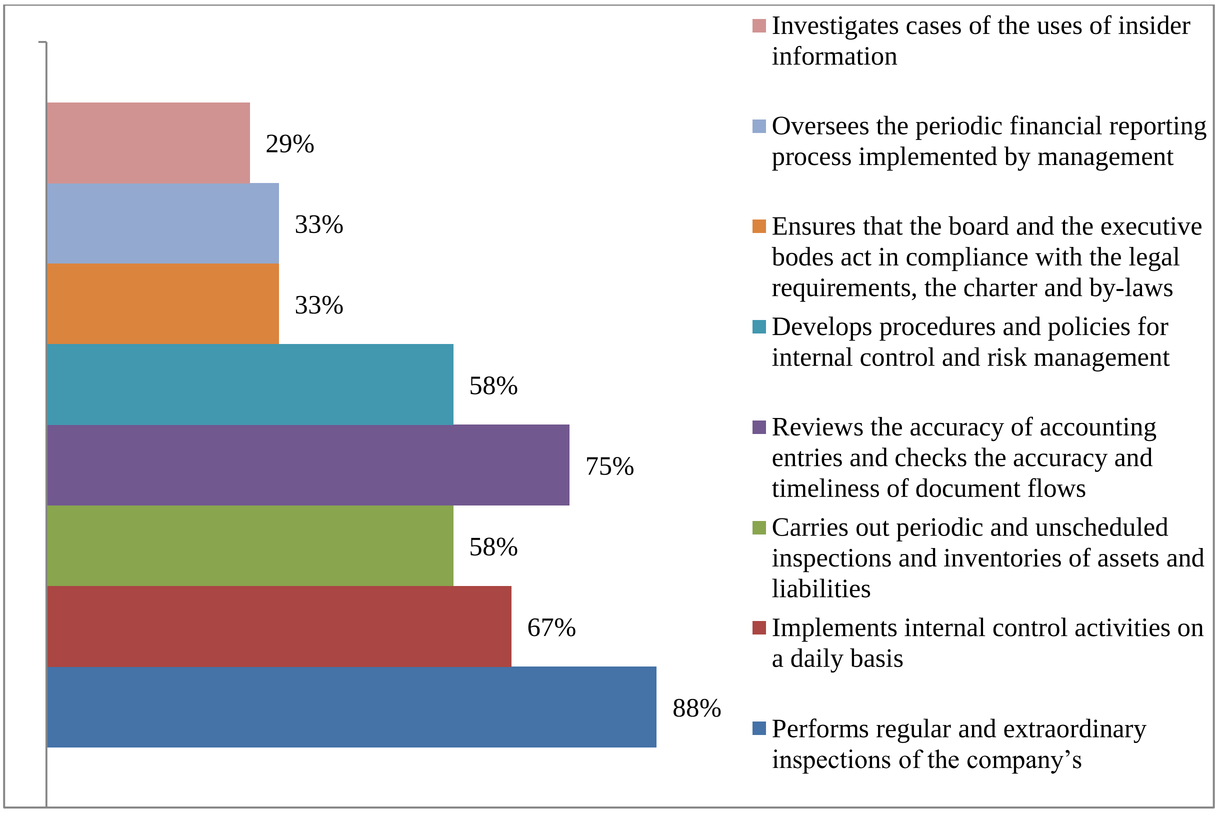
Effective disclosure, which includes financial disclosure and transparency, is fundamental to good Corporate Governance and essential for building investor confidence. Information transparency is also necessary for capital market efficiency. Since business entities only assume information disclosure costs, disclosed information is usually less than satisfactory. More disclosure results in less uncertainty but for this purpose, a cost-benefit limit should also be considered.

Banks and companies which are considered Public Interest Entities use National Accounting Standards (NAS[5]). Larger banks and some other companies, usually with foreign investment or control,

[5] The National Accounting Standards (NASs) issued by the Islamic Republic of Iran Audit Organization (IRIAO) are based on International Financial Reporting Standards (IFRSs), formerly known as International Accounting Standards (IASs), issued by the International Accounting Standards Board. IFRSs are being constantly reviewed and revised to keep up with changes in global financial practices and trends. Consequently, to remain in compliance, the IRIAO has been introducing new projects for incorporating revisions into NASs. According to IRIAO website, as of February 2009, amendments of NASs aimed at harmonization with international standards were in process. On its website, the IRIAO accounted for 9 NASs which made "minor departures" from the revised IASs, and 10 IFRSs that had not been adopted as of February 2009. In a May 2007 self-assessment report prepared for the International Federation of Accountants, the Iranian Institute of Certified Accountants noted that the IRIAO had established convergence of national auditing standards with International Auditing and Assurance Board pronouncements as a formal objective. To keep up with the revisions in ISAs, the IRIAO, according to the Iran Daily 2005 article, prepared seven new standards and was in the process of revising existing standards.

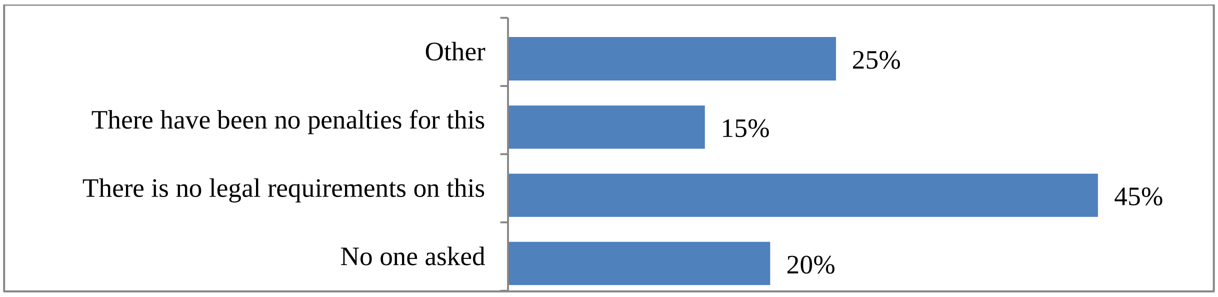
have made progress in implementing IFRS, but other companies have not. Many companies still do not comply with NAS and use tax accounting for their reports. All listed companies are required to publish audited financial statements that include a balance sheet and income statement.

Figure 8. Functions of internal auditors



In our survey we saw that only listed companies published their financial statements and annual performance reports and none of the other surveyed companies tended to publish their annual or financial reports. The main reason for non-disclosure of the voluntary information outlined above, provided by 83% of the respondents was the absence of any legal requirement to do so.

Figure 9. Reasons for non-inclusion of information in annual reports (SCALE IS MISSING)



4.6 Shareholder and stakeholder rights

- 46% of the respondents stated that more than 50% of all shareholders attended the last AGM.
- Electronic voting mechanisms are not used by any of the respondents;
- With respect to treatment of shareholders when changes of control occur, 91% did not have clear policies and none had block-voting mechanisms. Only in one company use of Silent Voting mechanism have been noticed.
- Evidence was found of an increasing number of related-party transactions among responding

companies, with 80% of the respondents stating that under a governing document or law it was mandatory to disclose related-party transactions. In addition, 67% stated that the related-party transactions should be verified by the external auditors

- According to by law of behavior in TSE accepted upon entering the market, companies are to treat all shareholders' rights equally. This by law also requires the companies to ensure availability and presence of all shareholders in the General Assembly, to ensure presence of CEO, board members and auditor in the General Assembly meeting, to allocate enough time for shareholders' questions and to disclose the dividend in the meeting.
- Regarding the dividend, listed companies on the average divided and distributed 80% of their annual profit between shareholders, but generally there are no way for a minority shareholder to affect the amount and distribution method of the profit to be divided.
- In order to help foster shareholder activism, shareholder institutions are beginning to play a crucial role in providing a platform to initiate collective shareholder activism. Re-activation of Individual Shareholder Association is one of the key initiatives recently
- The response showed that just one company has a Board-approved CSR policy whereas many public sector entities do not

Regarding stakeholders, there is no provision in the law requiring that board members treat all stakeholders fairly. However, some companies started some initiatives on the protection of stakeholders' interest. Examples could be defining code of conduct or code of ethics, preparing consumer-rights guideline, putting helpdesks where necessary, considering anti-bribery or anti-corruption guidelines, etc. Meanwhile, there is no requirement for labor to be represented on the board or in management.

Table below summarizes the availability and prevalence of different codes and guidelines:

Table 7. Availability of codes and guidelines

Code of Conduct	8%
Code of Ethics	13%
Consumer-rights Guideline	13%
Anti-Bribery	0%
Employees Representative on Board	4%

5 Implications and conclusion

Iran's capital market works with fairly low liquidity and Corporate Governance principals are often interpreted, illustrated, applied and implemented by the dominant shareholders.

Meanwhile, there is no clear division or difference of roles and responsibilities between shareholders and board of directors as board members directly represent shareholders. Minor shareholders do not have an effective or prominent role in Corporate Governance system or decision-making in General Assemblies.

The above survey gives an idea of what needs to be done in terms of Corporate Governance in Iran – but not limited to Iran, as the other MENA countries face similar challenges:

- Shareholders should proactively engage in governance of the company.

Dialogue between board members and shareholders needs to be strengthened or in some case formed and there should be a regular reporting mechanism to let shareholders keep their working contacts through a possibly reporting line with the board members.

- Establishment of independent or non-executive directors

Independent or non-executive directors should be included in the board of directors. It is suggested that the difference between 'non-executive' and 'independent' needs to be clarified.

There is considerable resistance to the idea that a non-executive director is not necessarily independent, nevertheless, this is an important distinction. Also non-executive board members should be capable of positively affecting executive directors or CEO to further engage in governance of the company.

- Independent non-executive directors should be included in the audit committee of the board.

The survey results indicate that considerable progress has been made in establishing audit committees in Iranian listed companies but this committee should include board members, non-executive managers, and also the internal auditor should be appointed by chairman and report to the chairman. Best practice, however, calls for an audit committee to be exclusively composed of independent directors; in most emerging markets, an argument can be made to aim for audit committees that are exclusively composed of non-executive directors. The inclusion of executives as members of the audit committee runs counter to good Corporate Governance practices. Thus there is a need to encourage companies to include non-executive directors as members of the audit committee.

- Iran's resources of competence in Corporate Governance should be developed.

It can be concluded from the survey that there is a dearth of appropriate skills to exploit best practice in

Corporate Governance. Although we need experts on Corporate Governance to expedite and facilitate adoption and expansion of Corporate Governance practices in Iran, we also need qualified directors with various set of skills to form the boards.

- Establishment of a nominations committee of the board should be considered.

33% of the respondents were of the opinion that the board is responsible for succession planning, as indeed in an overall sense. One the other hand there is no job market in Iran for the director, although the SEO has made a decision to implement a bylaw to ratify the qualification of the board member of listed company and put few regulations on the composition of the board. The board can set up a nominations committee largely comprising independent directors, to come up with a policy for board succession and search for new directors. For public companies, even those with a significant or majority family shareholding, this is important as well. It is recommended that Iran should develop best practice guidance on nominations committees of the board.

- Board and director evaluation should be developed

Only 17% of the respondents stated that the board had conducted a formal evaluation of its performance in the previous two years. Best practices however suggest that the performance of the board, of the board committees, of individual directors and board committee members, and of the chairs of boards and their committees should all be assessed at least annually.

Institutional investors should play an active role in implementation of Corporate Governance practices. Our survey noted a level of unease on the part of companies about the role of institutional investors. Successful Corporate Governance addresses the behaviour of stakeholders with respect to the companies in which they have stakes.

- Research on board meetings and board behaviour should be conducted.

In terms of the agenda, frequency and notice of the board meetings, compliance with the Code of Corporate Governance is common. It is recommended, however, that further research would be useful to determine whether Iranian boards are effective at determining the direction of the entity, overseeing management, and accounting effectively to their owners. These research studies should concentrate on reviewing board meeting practices and assessing the effectiveness of board meetings, the quality of discussions at these meetings and the appropriateness of their agendas.

- Enforcement should begin

In developing and implementing Corporate Governance, it is more reasonable to start from financial institutions. The Central Bank of Iran can pass regulations for approval of financial institutions' board members. For example, they can enforce that those with no professional financial management experience cannot enter the boards of these institutions. There might be some easier method of approaching such problems, like using some incentive based schemes to promote and internalize Corporate Governance in organizations. One of such schemes which are widely popular throughout the world is based on ranking organizations based on their Corporate Governance practices. We lack such a mechanism as for the moment in Iran.

Legislatures, regulatory bodies, courts and self-regulating professional organisations must establish, monitor and enforce legal norms actively and even-handedly. Private associations and institutes must develop and promulgate codes of conduct, particularly with respect to corporate directors, that raise expectations for behaviour and generate formal and informal sanctions for failure to meet these expectations.

- Education

Educational institutions should promote research on, and the teaching of, professional and managerial ethics. Institutions throughout government and society must educate and train people ranging from judges to regulators to managers to retail investors. Investment advisors and business media must constantly weigh information provided by companies and probe for additional information of interest to investors.

To a large degree, raising awareness means convincing people that Corporate Governance is in their self-interest. Many business leaders and controlling shareholders are thus being challenged to re-think their relationships with their companies and with the minority shareholders who lay claim to partial ownership in them. Such re-orientation in thinking requires not only a strong national commitment to Corporate Governance, but one that is also broad-based.

Thus the following approaches are recommended:

- The first focuses on director training and to make available material on functions, benefits, aspects, best practices, guidelines and case studies on Corporate Governance to provide understanding on how Corporate Governance can address some of the companies' issues.
- A second set of recommendations seeks to reduce or eliminate ambiguities by tightening standards for director independence, by making shadow directors liable for their actions, by increasing sanctions for violations of duties of loyalty and care and by advocating definition of a core set of related-party transactions (such as company loans to directors and officers) that should be prohibited entirely.
- Empowering shareholders to seek remedy for violations of their rights and to ensure director accountability. Mechanisms to discourage excessive legal action should not prevent or discourage collective action by shareholders with meritorious claims.

Finally and perhaps most importantly, Iranian business environment and its key players should distinguish between those entities who perform responsibly and those who do not, so that good Corporate Governance can bring about competitive advantage to the capital market and ultimately boost the investors confident.

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