



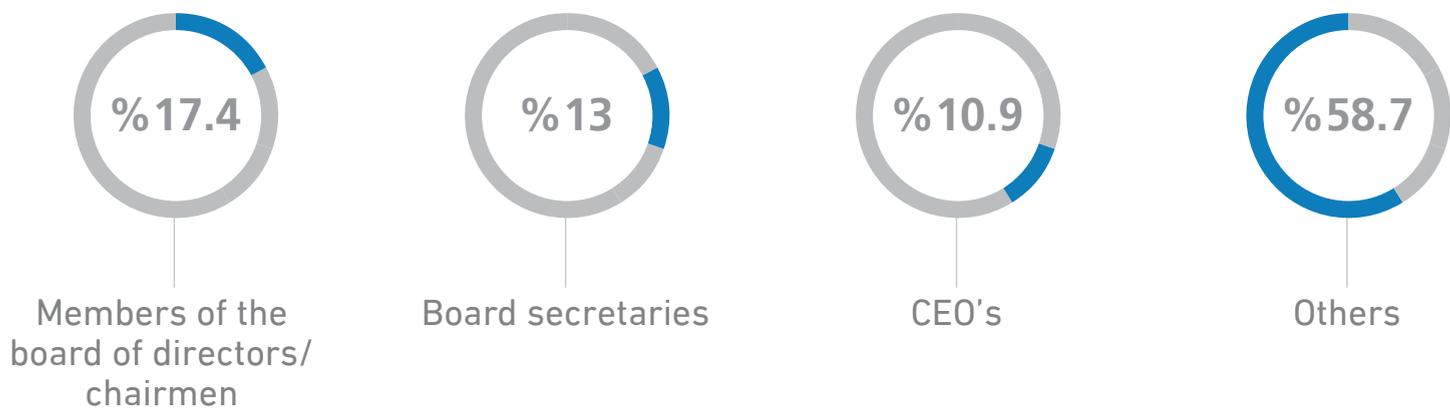
## **Independent Directors, Are They Really Independent?**

- 50% of directors in the listed companies boards are independent - Capital Market Authority.
- Independent directors are Not Independent Enough - World Bank.
- There exists an important link between the opposition and the breakdown of friendly social relations between the independent director and other members of the Board of Directors - Harvard University.

# Survey results conducted by HAWKAMAH solutions

HAWKAMAH Solutions conducted a survey on the role of independent directors in publicly listed companies. Members of the board of directors, secretaries, CEO and other professionals in the field of corporate governance participated in the questionnaire, and the results were as follows:

## Questionnaire Participants



## Question #1

**Do you think that the Corporate Governance Code is implemented in the publicly listed companies? ?**

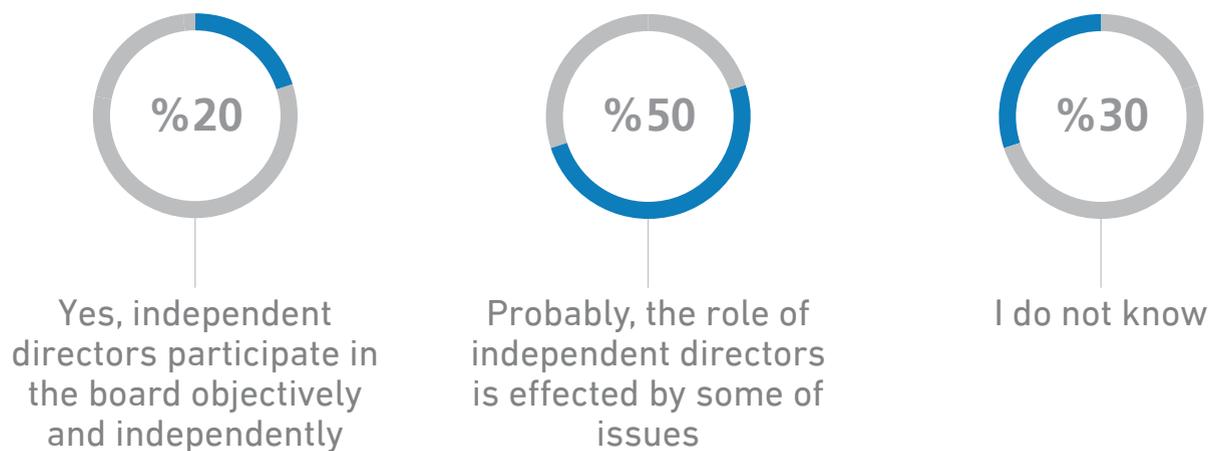
The question reflects the degree of awareness and implementation of the corporate governance code. **33%** of the participants reported that it is good and **67%** of the participants reported that there are differences in the level of awareness and implementation among publicly listed companies, which reflects the importance to increase support and efforts made towards raising awareness of governance.



## Question #2

**Do you think that independent directors of the Saudi companies boards participate in the decision-making independently and objectively? ?**

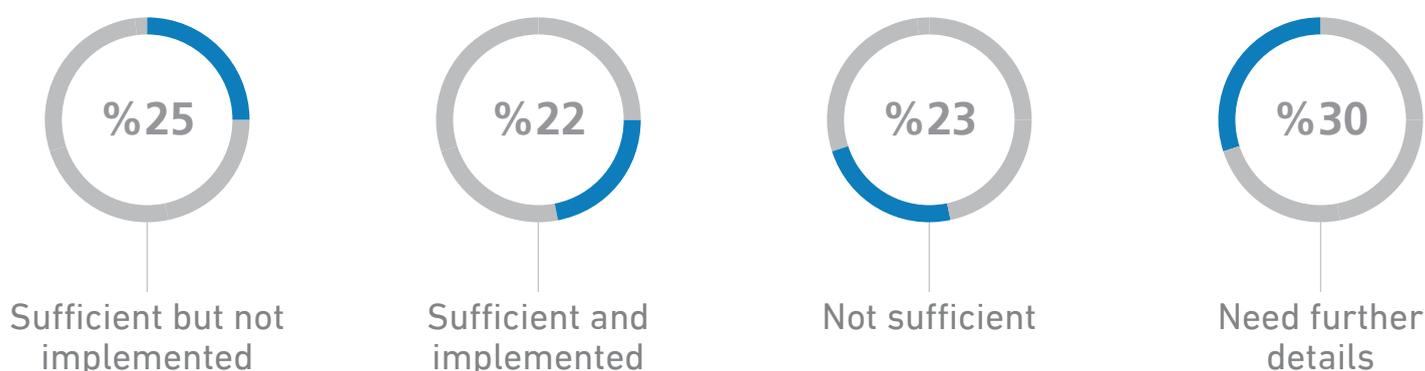
In the light of the importance of the role of independent directors in the companies, we asked a direct question to the participants; do you think that the independent directors of the Saudi company boards participate in the decision-making independently and objectively? The answer was that **50%** of participants reported that independence is affected by some symptoms in the first place. **20%** of participants reported that independent directors participate in the board objectively and independently. Followed by **30%** of participants answered that they do not know about the topic which indicates the importance of strengthening the role of the independent member in decision-making and strengthening his/her independence.



## Question #3

**Do you think that the provisions mentioned in the Corporate Governance Code regarding the independent directors are sufficient and implemented? ?**

The answer to this question was as follows: **25%** of participants answered that the provisions are sufficient but not implemented. However, **22%** of participants answered that they are sufficient and implemented. The rest of the participants reported that the provisions are not sufficient and there is a need for further details.



It is striking that the significant improvement in corporate governance standards in Saudi Arabia appears through:



the index of (strength of auditing standards and accounting standards)



the index of (regulation of conflict of interest)



the index of (shareholder governance)



According to the Global Competitiveness report issued by the World Economic Forum in 2019 and many international peer-reviewed corporate governance researches. Several initiatives aimed at strengthening the implementation of governance, through the role of independent members directors in the boards of directors of listed companies, and improving the disclosures of listed companies, as the number of independent members directors in the boards of directors of listed companies exceeds 50%, and this percentage is excellent according to several international peer-reviewed corporate governance research.

### Part 3: The Board of Directors

#### Chapter 1: Formation of the Board

##### Article 16: Composition of the Board

The following shall be taken into consideration when composing the Board:

- 1) the number of its members shall be suitable for the size and nature of the Company's activities without prejudice to paragraph (a) of Article 17 of these Regulations.
- 2) the majority of the Board members shall be of Non-Executive Directors.
- 3) the number of Independent Directors shall not be less than two members or one-third of the Board members, whichever is greater.

##### Article 17: Appointment of the Board members Board

- a) The Company's bylaws shall specify the number of the Board members, provided that such number shall not be less than three and not more than eleven.
- b) The General Assembly shall elect the Board members for the term stated in the Company's bylaws, provided that such term shall not exceed three years. Board members may be re-elected, unless otherwise provided for in the Company's bylaws.
- c) A Board member shall not be a member of the Boards of Directors of more than five listed joint stock companies at the same time.
- d) The Company shall notify the Authority of the names of the Board members and description of their memberships within five business days from the commencement date of the Board term or from the date of their appointment, whichever is shorter, as well as any changes that may affect their membership within five business days from the occurrence of such changes.

##### Article 18: Conditions for the membership of the Board:

A member of the Board is required to be professionally capable and has the required experience, knowledge, skill and independence, which enable him/her to perform his/her duties efficiently. He/she shall have the following qualifications in particular:

- 1) **Ability to lead:** He/she shall enjoy leadership skills which enable him/her to delegate powers in order to enhance performance and apply best practices in effective management and compliance with professional ethics and values.
- 2) **Competency:** He/she shall have the academic qualifications and proper professional and personal skills as well as an appropriate level of training and practical experience related to the current and future businesses of the Company and the knowledge of management, economics, accounting, law or governance, as well as the desire to learn and receive training.
- 3) **Ability to guide:** He/she shall have the technical, leadership, and administrative competencies as well as the ability to take prompt decisions, and understand technical

requirements and developments related to the job. He/she shall also be able to provide strategic guidance and long-term planning and have a clear future vision.

- 4) **Financial knowledge:** He/she shall have the ability to read and understand financial statements and reports.
- 5) **Physical fitness:** He/she shall not suffer from any health issue that may hinder him/her from performing his/her duties and responsibilities.

The General Assembly shall take into account, when electing members to the Board, the recommendations of the nomination committee and the availability of the personal and professional capabilities required to perform their duties effectively pursuant to this Article.

##### Article 19: Termination of a Board Membership

- a) The Company's bylaws shall specify the manner by which membership of the Board may be terminated. At all times, the Ordinary General Assembly may dismiss all or any of the Board members, even if the Company's bylaws provides for otherwise, without prejudice to the dismissed member's right for compensation if the dismissal was on an unacceptable reason or at inappropriate time. The General Assembly may also, s per a recommendation of the Board, terminate the membership of the member who missed three consecutive meetings without a legitimate excuse.
- b) Upon the termination of the membership of a Board member by any termination method, the Company shall promptly notify the Authority and the Exchange and shall specify the reasons for such termination.
- c) If a member of the Board resigns and has comments on the performance of the Company, he/she shall submit a written statement explaining such comments to the chairman of the Board and such statement shall be presented to the Board members.

##### Article 20: Issues Affecting Independence

- a) An Independent Director shall be able to perform his/her duties, express his/her opinions and vote on decisions objectively with no bias in order to help the Board make correct decisions that contribute to achieving the interests of the Company.
- b) The Board shall annually evaluate the extent of the member's independence and ensure that there are no relationships or circumstances that affect or may affect his/her independence.
- c) By way of example, the following negate the independence requirement for an Independent Director:
  - 1) if he/she holds five percent or more of the shares of the Company or any other company within its group; or is a relative of who owns such percentage.
  - 2) if he/she is a representative of a legal person that holds five percent or more of the shares of the Company or any company within its group;
  - 3) if he/she is a relative of any member of the Board of the Company, or any other company within the Company's group;
  - 4) if he/she is a relative of any Senior Executive of the Company, or of any other company within the Company's group;
  - 5) if he/she is a Board member of any company within the group of the Company for which he/she is nominated to be a Board member.
  - 6) if he/she is an employee or used to be an employee, during the preceding two years, of the Company, of any party dealing with the Company or any company within

The Saudi legislature is constantly making a series of amendments towards a better corporate governance system by stressing the implementation of regulations, fines and defamation of companies in cases of non-compliance, and this gives additional power to the relevant regulations that protects the rights of minority shareholders. In this context, the Capital Market Authority updated the governance regulations on 5/20/2019, where the third chapter deals with the laws of the Board of Directors. The regulations stipulate the proportionality of members of the Board of Directors to the size and nature of the company to ensure the number of members is not less than three (3), and not more than Eleven (11), provided that the majority of the members are not executive directors and that the number of independent members is not less than two (2) and not more than three (3). Also, in article 20 the regulations also elaborate on the Issues Affecting Independence in terms of owning shares, kinship, financial rewards, and others.



The new Companies Law stressed the rules that companies must follow and the necessity of implementing regulations to increase the confidence of current and prospective local and foreign investors, especially young investors who are looking to increase their investments over time. Therefore, the issue of governance has become one of the most discussed and concerning topics recently, and there has been a lot of talk about the concept and regulations of governance among companies in Saudi Arabia, especially after the successive news about the downfall of large family companies and the detection of cases of financial statement fraud; **financial and administrative failure in some other large companies.**

When analyzing the current situation in these companies, the role of the board of directors in general is highlighted without mentioning the role of the independent member, and it is one of the important mechanisms that the government regulation has paid special attention to bridge the gaps of manipulation and to reduce financial and administrative failure in companies.

In reference to the update made by the Capital Market Authority on the governance regulations, especially to Chapter Three on the laws of the Board of Directors; We find that there is a gap in the implementation,

So how can the quality of the independence of the independent director who is supposed to be able to exercise her/his duties, express his views and vote on decisions objectively and impartially, can be measured, so that the board of directors can take the right decisions that contribute to achieving the interests of the company and investors?

And how do we measure the extent of independence of these (independent) directors and the quality of their work with the repetition of the series of administrative and financial failures in companies, regardless of the formal follow-up of the rule without making sure of her/his independence and the quality of her/his work in the board of directors?

Do we need additional oversight systems to enhance the role of the independent directors?





A recent World Bank research paper on corporate governance in emerging countries reported that independent directors are neither sufficiently independent nor truly independent at all. Independent directors may also be a minority in many boards, so that they are ineffective in confronting executives or non-independent directors, and another scientific paper from Harvard Business School indicated the extent to which independent members oppose some of the decisions of non-independent board members or executives and found **an important link between opposition and the breakdown of friendly social relations between the independent member and the members of the board of directors**. The study also added that **opposition** increases the chance of the independent member leaving the labor market regardless of generalizations, so the independent director avoids open opposition.



With the presence of independent directors on the boards of listed companies, there are still frequent examples of the failure of some companies. Recently, one of the companies announced that the general assembly of the company had voted to dismiss two (2) independent members of the board due to the violation of laws and regulations and lack of transparency and disclosure. When considering the composition and classification of board members of another Saudi company, we find that it consists of six (6) independent members out of nine (9), including the chairman and his deputy, and until now the company suffers from financial and administrative failure and some cases in the courts.



Is choosing,,

**A governance framework from elsewhere through a process of cutting and pasting applicable to Saudi companies while tightening the application of regulations? Or do we need an independent member director in the listed Saudi companies, as in the case of foreign companies?**



Despite the legislator's knowledge that independent members are generally appointed from a closed circle or network and advertising such jobs is not available applicable, and in a more general sense, the independent member is elected through public social relations or close associates.

Usually, most countries derive their codes from the Corporate Governance Act in the United Kingdom and the Oxley Act 2002 in the United States, but good governance has a general framework and must be compatible with the surrounding environment and the culture of the organization and its privacy, otherwise, the full benefit will not be achieved.

One of the main tasks of independent directors is to make sure of three things:



managing risks



protecting the interests of  
shareholders, especially  
the minority



protecting the interests of  
companies in the long run



Because the law stipulates that the board of directors is responsible to shareholders for any financial losses resulting from mismanaging the company's affairs, and therefore we need a real change in the independent directors nomination process in which the sh/he is given a wider role along with many guarantees from the law, however some problems are possible. When the independent directors do not act in the way they should do, as in some companies. Therefore, the board of directors, especially the independent ones, must be evaluated to improve performance, obtain benefits, and achieve the goal.

**In the end,**

**Will Independent directors remain as a name without actual meaning?**

**And can they really be independent?**



**We hope that the regulators prevent the violations of corporate governance rules and enable the role of the independent member to play her/his role in protecting the interests of the company by providing greater clarity to stakeholders.**

# Haw'kamah Learning

Haw'kamah Solutions launched together with the Vision 2030, which inspired us the principles of Governance that the Vision itself entails, and through the extensive experience of the team of founders, we have recognized the need and the increasing demand for Corporate Governance, Control and Compliance services, and reducing risks in this era of the Saudi economy, which is characterized by the flexibility in legislation and the fast amendments processes in regulations and manuals to keep pace with the requirements of the Vision and its programs. The regulations on different aspects are changing and consciously updated, whether those related to the Corporate Governance of companies listed in the financial market, or the governance frameworks of the non-profit sector. Another significant drive for the establishment of Haw'kamah Solutions is the need to improve the control procedures in the government sector in accordance with best practices.

## Haw'kamah Solutions

Transferring knowledge and spreading culture in the areas of corporate governance, internal controls and compliance is an essential component of the Haw'kamah Solutions strategy. Just as the company enables its clients in the service delivery aspect to play their professional role through training, development, guidance and information sharing, Haw'kamah Solutions has a strategic goal of enriching the knowledge of the business community and those who are interested and responsible in their various roles in the entities to which they belong. Also, at Haw'kamah Solutions we take the societal responsibility of publishing distinctive and renewed content that keeps pace with the variables suitable for all levels and experiences, and works to communicate this content to the public through effective communication channels. Thus, as enabler to achieve the objectives above, Haw'kamah Solutions launched the Haw'kamah Learning website aiming at disseminating premium knowledge content to the target audience.



Corporate  
Governance



Control and  
Compliance



Organizational  
Development



Training

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