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A comparative study of good corporate governance codes between Indonesia and United Arab Emirates.

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Abstract: *The research is a comparative study of the corporate governance codes of two countries similar in nature in terms of the time of implementation of the corporate governance codes and highly differentiated in terms of levels of economic activity. The study is a comparison of the corporate governance codes of Indonesia and UAE. The code was revised and enacted in Indonesia in 2006 while the code for corporate governance became legal in 2006 for UAE. UAE is the country that is marked by very high levels of economic activity while Indonesia is a developing nation that is yet to come fully forth to the global economic forefront. The study brings forth an analysis of the difference in the basic code of corporate governance and also the factors that influence and impact the formation of such codes. Through such analysis of corporate governance codes, the study aims to highlight the positive aspects and also find out the scope for improvement in these codes after understanding the relevance and importance of corporate governance in nations.*

I. Research Background

Corporate governance is a blend of laws, rules and regulations as well as voluntary and appropriate practices within the private sector (Aldin et al., 2014). Research scholars like Kumar and Sharma (2006) and Ammanna, Oesch and Schmid (2011) pointed out that corporate governance can be considered as long term business sustainability mechanism for companies. Through incorporation of corporate governance codes, firms can do business in transparent manner and deliver long run economic value for shareholders. In order to implement corporate governance codes efficiently, firms need to show mutual and equal respect for the society as well as shareholders on the whole (Aldin et al., 2014). Sifuna (2012) defined corporate governance as combination of law and systematic approaches for monitoring actions of directors and board members in order to reduce agency risks. In simple words, corporate governance can be conceptualized as set of rules and procedures that can help companies to ensure ethical business operation and take care of interest of stakeholders. In recent years, emergence of financial frauds, corporate scandals, accounting scandals and misdeeds of corporate officers in companies like Worldcom, Enron, Lehman Brothers and Satyam Computer Services has increased the importance of having sound corporate governace codes for companies (Accounting-degree, 2014). In the core, corporate governance is being conceptualized as hybrid and broad topic that is being charecterized as mix of company laws and statutory legislation. Due to mixed nature of corporate governance, companies found it perplexing to decide whether to follow company laws or statutory legislations. In order to avoid such perplexities, OECD and Financial Reporting Councils have taken initiateves to coordinate and streamline statutory legislations and company laws into commonly understandable codes. Therefore, in order to avoid uncertainities and misunderstanding of scopes of corporate governance, companies need to follow corporate governance codes to implement corporate governance measures (Aldin et al. 2014; Sifuna, 2012). Corporate governance is the way in which company board undertakes and oversees the functioning of their companies through management, supervisors and high levels of authority. The corporate governance also makes sure that board members are held accountable for affairs of the company. This brings in implications for the company in terms of its behavior towards employees, stakeholders, customers, and its banks. It has been observed that sound levels of corporate governance provide integrity and efficiency that is reflected from financial market performance of the company (Madura, 2012). Mallin (2011) and Aldin et al. (2014) identified numers of benefits of practicing corporate governance for companies .

II. UAE and Indonesia: Corporate Governance Practices

In 2009, Securities and Commodities Authority (SCA) of UAE introduced new CG codes for listed local companies (Norton Rose Fulbright, 2011). Some of the key provisions in corporate governance codes are being practices in companies. 33% of directors in companies should be independent directors while designation of managing director and chairman should be occupied by different individuals. Meetings of the board of directors are being occurred at least 6 times annually. On the other hand, in order to implement corporate governance codes in robust manner, local listed companies in UAE need to form audit committee, remuneration committee and nomination committee with at least three non-executive directors (Norton Rose Fulbright, 2011).

Selection of compliance officer and members in audit committee must be evaluated on the basis of work experience, financial knowledge and credential of candidates. In UAE, listed companies need to follow corporate governance compliances while reviewing and publishing financial statements. Listed companies need to publish annual reports and financial performance statements for both shareholders and stakeholders. It is being mandatory for locally listed companies (apart from government agencies) to annual report of corporate governance practices to Securities and Commodities Authority. On findings of non compliance with CG codes by companies, SCA can impose suspension and financial penalties on the mentioned companies (Norton Rose Fulbright, 2011). The government of Indonesia had established its National Committee for Corporate Governance in the month of August in 1999 as a law under Ministerial Decree through Coordinating Minister of the Indonesian economy. This committee comprised about 22 people belonging from different sectors including legal, private sector, accounting division, public sector and financial sector. This committee got together to prepare Code for Good Corporate Governance in 2001 and since then, the document has served as a benchmark for referring to practices of sound corporate governance in Indonesian business sector.

The code for corporate governance in Indonesia has been formulated to serve the purpose of providing flexible standards in order to undertake corporate governance within businesses in Indonesia, instead of providing mandated regulations. It was expected that public companies as well as state owned corporations and companies that utilized public money for their operations were required to implement the code on an immediate basis; whereas, private companies were allowed time for implementation of these codes within their systems (Caron, Fiçici and Richter, 2012; Bruno, 2007). On the basis of above discussion, following research questions are being developed in order to address the research problem in holistic manner.

III. Research Methodology

The theoretical background serves as a premise for the development of relevance and importance of corporate governance code within the general context of all nations. The theory builds the basis on which the code for corporate governance was developed.

Secondary data sources like online articles, books and academic peer reviewed journals regarding corporate governance will be accessed for developing theoretical background of the research problem. For example, research works of Aldin et al (2014) and Caron, Fiçici and Richter (2012) will be accessed to understand cross country dynamics of corporate governance.

The research shall make extensive use of qualitative research to conduct this study. Qualitative research methods are often considered as more descriptive part of a scientific research methodology and as per opinions stated by academic scholars, qualitative research discipline promises to offer a more comprehensive study of the research problem compared to quantitative research study.

The study has chosen the particular research strategy after careful consideration and observation of multiple exogenous factors like, conveniences of data collection, macro-environmental matters, scope of the research and type of findings desired by the report. Research strategy was formulated so as to carry out data collection and collaboration from available sources of data samples. This data collected was then converted into information that is relevant and appropriate for the use of this study in an accurate and an unbiased manner.

The research strategy should ideally have two main types of functionalities

1. Identification of structural framework conducive to the research and formulation of the process map that shall help in carrying out the specific research.
2. Verification of data source authenticity so as to make sure that the research report is of high quality.

Academicians have advocated that a research strategy should ideally be framed in a logical pattern that shall address each of the research objectives. The structural framework for the particular research study can be presented as below:

- Alignment of research objectives with the specific research problem.
- Determination of research data set, selected studies and research sources after a proper test of confidence.
- Determination of costs and time schedule associated with the research report.
- Summarizing the data in a systematic and methodical manner
- Analyzing data in a qualitative manner and converting the same into valuable information relevant for the study.
- Verification of research results with the research question.

IV. Research Approach and Characteristics of the Study

The paper desires to test reliability of the assumption by firstly analyzing theory and then going about validating assumptions within the research paper. This is known as the inductive research pattern. Here, research paper analysis behavior and patterns help to arrive at definitive conclusions for questions that were initially set within the research paper.The qualitative study shall foreground behavior patterns, expert opinions and also subjective aspects within the scope of study in this research; this cannot be attained through the objective nature of a quantitative study. This study has chosen qualitative analysis for studying the code of corporate governance in UAE and Indonesia for the purpose of drawing comparison between codes of the two countries. A quantitative study fails to examine and represent the codes of corporate governance in a thorough manner. The inductive approach of the research paper is directed at developing a study that amalgamates the suggestions made by research scholars with a view to avoid any deviations from the research objectives and discuss key points within the literature review.

The primary focus of this research is to establish some sort of connection between the codes of corporate governance between UAE and Indonesia and also studying the degree to which such codes have been successfully implemented and reflected within the market sentiments of these nations.

The research has taken up the qualitative study approach so as to take a full measure of the exogenous variable and benefit from encompassing the different approaches of study presented within the study of existing literature so as to combine together a more comprehensive report.

V. Research Findings

Comparison

1.Culture, Ownership concentration and Law

Culture

UAE operates a separate corporate governance code for its large and medium corporations, its central banking concerns and its government owned entities. The Securities and Commodities Authority (SCA) operates and lays down rules of corporate governance for all listed companies. For the purpose of corporate governance within government owned entities, Emirate of Abu Dhabi has established Resolution 17 in 2010. The central banks have to adhere to a binding and a non-binding set of rules for corporate governance, which is set within the institutions. They function under a separate Corporate Governance Guidelines for Banks with considerable commonality in themes as per corporate governance code set out by the SCA.

Indonesia has a very unique system of business with a clear separation of duties of the board of directors and that of commissioners. The Dewan Komisaries is completely responsible for actions and activities of the Direksi. The Dewan Komisaris is responsible for maintenance of good corporate governance within the company. The members of this team are required to act as independently as possible and work in best interests for their respective organization. .

Ownership concentration

According to corporate governance codes in UAE, individuals are not allowed to perform dual roles of director and the chairman simultaneosly. 1/3 of board members should be independent in nature while existence of non-executive directors in the board is being prefered. On the other hand, 20% of the board members of the Direksi have to be independent for the purpose of increasing transparency and effectiveness of management. Furthermore, the Dewan Komisaris is to have 20% of their ownership in the hands of independent parties (ECGI, 2001).

Law

The law that governs the code for corporate governance in Indonesia was established in 1999 by the Minister of Economy under a Ministerial Decree; whereas, the law governing codes of corporate governance in UAE were formulated and laid down by Securities and Commodities Exchange.

Meetings

In Indonesian code of conduct, meeting of the supervisory committee or the Dewan Komisaris members should be held once in every month and the Direksi shall be entitled to read minutes of the meeting; whereas in case of UAE, meeting of the shareholders needs to be conducted once in every two months.

The similarity of both meetings is that such meetings shall be held for the purpose of decision makiung regarding to business activities and have to be in confirmity with the interests of the shareholders.

2.Stakeholder and shareholder interests

Interest of society and stakeholders

The purpose of corporate governance codes in Indonesian context is to ensure value maximization for shareholders through transparency, responsibility, reliability, fairness and accountability. The codes aim to encourage company's management to optimize the use of Direksi and Dewan Komisaris. It also aspires to motivate members of these bodies to act and take decisions with a sense of morality and in compliance with set rules and laws.

In UAE, the purpose of corporate governance codes is issued by the Securities and Commodities Authority and applies to all institutions and joint stock companies that are listed. These codes are not applicable to government owned concerns, foreign companies or central bank regulated concerns. The codes are aimed at providing high levels of controls and assessment mechanisms for company's management and require maintenance of shareholders and stakeholders interests (Celik and Amico, 2011; Mubarak, 2011).

Interest of shareholders

Disclosures

Disclosure and transparency norms in the context of UAE are stringent. Accounting standards that are followed are as per the IFRS and the GAAP norms. UAE companies are legally required to publish consolidated financial statements. Along with this, companies also need to publish non-financial disclosures like, corporate governance practices and their structures, qualification and experience of directors, remuneration scales for directors and other top executives, statements on any deviations from the standards of corporate governance structure prevalent within the country, ownership structure of the management, foreseen risk factors as well as a statement for the management discussion and its analysis. The disclosures, however, do not provide for any information on forward looking plans of the company.

In Indonesian context, all material information is to be disclosed within annual report of the company. Such information includes financial information, company short-term and long-term goals, objectives and business strategies, working status of major shareholders, audit evaluation reports from external audit teams, details of members who form the Dewan Komisaris and the Direksi, remuneration of key company officials and the system of corporate governance prevalent within the company.

Disclosures pertaining to director remuneration and for all major business decisions to the shareholder is common to both nations.

Rights of shareholders

The stakeholder's contract in line with the prevailing law shall be honored by the company as per Indonesia's code for corporate governance. Furthermore, any infringement of shareholder's rights shall be compensated in an appropriate manner (Gregory, 2002).

In principal, shareholders are to have opportunity for monitoring activities and offering input to the Direksi of the company. The company here is liable to provide all necessary information to its shareholders with a view to protect their rights. Cooperation is imperative between the shareholders and the company for shared benefits.

The rights of each shareholder are to be protected and each of them is free to exercise his right in congruence with procedures that have been laced by the company.

In case of UAE, shareholders have access to annual and semi-annual reports of the company, irrespective of size of their holding (Red Flag Group, 2013). UAE based shareholders have the right as well as opportunity to vote on distribution of profits. This provides them with sufficient disclosures pertaining to profit sums and decision making regarding use of these amounts. Distribution of profits is to be made within 30 days of agreement over the share of distributable profits.

Equitable treatment

In Indonesia, shares of the same kind shall be held equally within the company, which brings in the principal of equity among shareholders holding similar kinds of shares. Shareholders are, hence, allowed to vote in accordance with the number of shares and type of shares held. Each shareholder has an equal right to access complete and accurate information about the company in absence of any specific and justified reason for non-provision of the same. The company has no right to be partial to any segment of shareholders over others, under any conditions. The shareholders or members of Dewan Komisaris or the Direksi are not allowed to engage in insider trading practices.

In UAE, shareholders enjoy equitable rights in shareholding, information sourcing and voting for company affairs; and any violation of such basic shareholders rights can generate direct and individual action. Such violation can also initiate an action by a specific class of shareholding community. Irrespective of size of holdings, even a minority shareholder can demand for an inspection of records and books of the company. Insider trading is treated as an offence and the country has legal actions that allow for huge penalties and imprisonment for violation of the same.

3.Supervisory and managerial bodies

Committees

Indonesian supervisory body is the Dewan Komisaris and managerial body is the Direksi. In UAE, there is no such separation of supervisory and management roles observed. Both Indonesia and UAE have separate remuneration committee, nomination committee and audit committee to ensure transparency in the operations of each committee.

In Indonesia, each of these committees has a representative from the Dewan Komisaris and Direksi and these representatives fall within the category of independent directors. The remuneration committee has to provide for the company's remuneration system, stock option grants, compensation and redundancy schemes and pension rights. The nomination committee attends to the criteria of selecting officials for high executive positions within the company and formulating a system for making recommendations and assessments for the board. The audit committee frames an adequate structure for internal controls, improves financial disclosures and reviews the scope and independence of external audits.

In UAE, there are representatives from the board within the committees in form of at least two independent directors. There is no restriction on the number of directors who can represent within the independent committees. Even so, in case of the audit committee, majority of board participation shall include independent directors. The committees shall necessarily have three non-executive directors, where two of them should be independent. Within the audit committee, it is essential to have a financial and accounting expert.

The similarity between the UAE and Indonesia Corporate Governance code in both countries have remuneration committees who review the manner and scope fo remuneration for the directors and also have a system for reporting these within their public platforms.

Effectiveness

Indonesia

In the last few years, global stock indices have performed disastrously. Nonetheless, one such exception was Indonesia, where stock exchanges performed otherwise. The dismal global scenario was amplified by the European Debt Crisis. The Jakarta Stock Exchange had recorded a nearly 5% growth in 2011 when the Global Index had fallen by 10% and the Asia Pacific Index had slumped by approximately 18% (OECD, 2012).

At the same time, Indonesia was experiencing a financial boom, which might not have been reflected in dividend yields, but was definitely present within investor sentiments. The stock market in Indonesia was operating with high investor confidence, thereby turning highly resilient towards international turbulence in the financial markets. In addition to this, business sector of the country was getting highly organized and was swiftly implementing the code for corporate governance. Such reflection of sound corporate governance came through the investment grade accreditation of the country by Fitch Credit Rating Agency.

The degree of fairness in accounting practices along with transparency, responsibility and accountability had been established after the Asian financial crisis in 1997. The guidelines are set by the National Committee of Governance, operating since 2001. Corporate governance is being implemented in a two pronged approach; the first being the rules based way, whereas the second is ethics based approach.

The rules based way is primarily driven by regulations of the government, while the ethics based approach came through as a result of greater consciousness towards sustainable long-term business relationships and profit making.

Over the years, acceptance and implementation of corporate governance codes among blue chip companies has been rising from 53% of the companies in 2006 to 83% of the same in 2009. The relationship can be seen in the chart below.

UAE

UAE had started to focus their attention towards effective and international standards of corporate governance in 2007. The SCA had introduced Corporate Governance Regulations for listed companies in April 2007. The comprehensive code had come about in 2010 (Perrin and Bainbridge, 2011). The practice of corporate governance is still believed to be in its nascent stages in the country. The country holds immense strength in the family business structure and this has highly impacted effective implementation of corporate governance regimes within companies (Hassan and Halbouni, 2013).

The culture of UAE is the greatest barrier in effectual corporate governance implementation within companies. The shareholders are considered to be financial investors, rather than owners of the company. Their interests have been limited to short-term affairs of the company (SQU, 2007). The corporate governance codes do not provide for mandatory information disclosure about company's long-term perspectives. On the flip side, shareholders are naive and handicapped in terms of discharging shareholding rights. Infringement of shareholders rights has implications for offence only on paper and not in practicality. Voting rights, remuneration approval, director appointment and such other professional rights are not always obliged (Hassan, 2012). There have also been incidences of hidden shareholding block where it becomes difficult to determine the exact relationship shared by them with the shareholders. High degrees of family ties and predominance of relations raise the scope for insider trading and lack in detection and monitoring mechanism (Aljifri and Moustafa, 2007).

The law implementation and enforcement is very weak pertaining to the corporate governance regime. The regulators are finding it difficult to obtain relevant resources and this includes compliance with rules and regulations of the corporate governance code. The management of corporate within UAE is also very weak. The companies had been managed by family and kin. The concept of a management and of presence of independent and non-executive directors is very new; and culture of the country is finding it difficult to implement the same within the nation. The culture calls for high interdependency and interconnectedness in business deals and corporate affairs. There is still time for complete and effective implementation of corporate governance codes in UAE so as to reflect its true economic implications.

Conclusion

In terms of differences in cultures, the UAE governance has a separate set of rules meant for central banking companies, government corporations and large corporations that are privately held. This brings in some ambiguity in the differences in the codes for government owned entities. Strict norms might have been aligned for private institutions but state owned companies appear to be under high control of the government displaying less transparency in operations. In the context of central banks, such transparency is highly desired and hence there is a need to align the corporate governance codes for private institutions along with the central banking code.

The Indonesian culture has separation of the management board and the supervisory board where the Dewan Komisaris has the power to influence the decisions for the Direksi. The chairman and the directors are present within the Direksi and hence there is a need to state their rights in a more lucid manner for ensuring their independence.

In terms of representation and disclosure requirements, the UAE governance does not provide for any future looking policies corporate governance. This does not give a clear picture of the way in which the funds sourced shall be utilized (Dubaichamber, n.d.). The size of funds can be huge and such can be sought either from the debt sources or through equity allocations. Hence without knowing the reason behind the sourcing of such funds and also the manner of its utilization, it is difficult to predict the best practices within companies. In the Indonesian context, the corporate governance code practices and structures do not have any mandatory representation in the disclosure requirements. This is a deterrent for companies who cannot benefit from the positive impacts of reflection of corporate governance codes of a company like ease in sourcing of funds, good company image and brand building.

The use of proxies in the voting system in UAE allows for sufficient gap in voting process for making biased choices of representatives for executive committee members in order to make large business decisions and strategic action. This loophole can be easily capitalized upon by parties who want to alter the shareholding in favor of their decision. There is a need for an overseeing committee, which enables proper oversight of usage of such proxy voting systems and manages flow of proxies, such that votes do not get filtered in favor of desired decision of the company.

Shareholder's rights to decide over distribution share of profits bring in sufficient transparency in use of shareholders money in UAE; however, this also entails dilution of interests of the board regarding use of such profits (Zinkin, 2011). The board might want to utilize profits for expansion purposes, while the shareholders might decide over distribution. Such conflicts become difficult to manage.

The report findings suggest that UAE needs to be stricter with representation of directors as well as independent directors within the independent remuneration, audit and nomination committee. This is necessary in order to establish greater transparency in remuneration patterns of the top level executives, the ownership concentration of management committees and transparency in the nomination processes, such that relation biases are absent in case of family held businesses and greater lucidity is present in audit processes.

Indonesia makes a general statement regarding penalties for insider trading practices and allows for only disclosers to concerned authorities in the event of discovery of insider trading practices. UAE has strict laws and specified penalties for insider trading like, fine up to 100,000 Dhirams and imprisonment from 3 months to 3 years. This implies that penalties for insider trading are not very strict in Indonesia and need to be checked. Heavy penalties in corporate governance codes enable higher levels of compliance and adherence to desired practices.

The absence of a separate board and supervisory committee in UAE has given significant decision making power to the management board. This is a significant and remarkable loophole in the management decision making that provides pure reflection of the strength of the key shareholders within UAE companies. Such board has high membership of family members who are the key personnel running the business in UAE. The culture is highly paternal which is deterrent to business transparency, responsibility and accountability.

In the Indonesian corporate governance practice, the audit committee has a majority representation of independent directors from either the Direksi or the Dewan Komisaris in the audit committee which provides significant strength to the audit process. The mandatory requirement of an accounting and finance expert also allows for expert opinion regarding audit matters. This is one of the key strengths in the Indonesian corporate governance code.

Both Indonesia and UAE are in their nascent stages of corporate governance implementation. Although the history of corporate governance code in Indonesia dates back to 2001, the country has been in the bottom levels of the ACGA list for excellence in corporate governance. Despite this, the country, being a growing and developing nation, has shown significant improvements and strength in its mechanism of corporate governance since 2006 by staying much above the Global Index in the financial markets. This is one representation and it still has a long way to go before it becomes a hub for significant economic activity attracting huge inflows of foreign capital owing to strong corporate governance practices.

UAE on the other hand, has attracted huge financial capital in the past and has little record of corporate governance practice. It is seen as a major investment hub by most businesses. In order to retain the financial and investment interest of large multinationals, the country has adopted the corporate governance practice in 2007. The culture of the country becomes a problem in association with the corporate governance code. There is a need for greater awareness regarding the importance of such codes for sustaining business in the nation among both the companies as well as the shareholders. This can only be brought about by stricter implementation of laws and providing higher awareness to all.

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