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Palestine Economic Policy Research Institute

Enhancing Corporate Governance in Palestine

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2008

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- Promoting knowledge-based policy formulation by conducting economic and social policy research in accordance with the expressed priorities and needs of decision-makers.
- Evaluating economic and social policies and their impact at different levels for correction and review of existing policies.
- Providing a forum for free, open and democratic public debate among all stakeholders on the socio-economic policy-making process.
- Disseminating up-to-date socio-economic information and research results.
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- Strengthening economic and social policy research capabilities and resources in Palestine.

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This study was prepared by Palestine Economic Policy Research Institute (MAS) research team, particularly by the following researchers:

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Foreword

Corporate Governance plays an important role in increasing the competitiveness of shareholding companies through enhancing transparency, improving corporate management, ensuring the formulation of appropriate strategic decisions and ensuring fair treatment of shareholders, personnel, creditors and other stakeholders. Hence, reflecting on the decrease of funding costs and improving financial performance. On the macro level, corporate governance contributes in reassuring investors, and providing a suitable environment with acceptable earnings and risks, therefore enhancing the economy's ability to attract local and foreign investments.

This study measures Palestinian public shareholding companies' adherence to corporate governance principles, as issued by the Organization for Economic Cooperation and Development (OECD), the study aims to analyze the impact of such practices on corporate financial performance and recommends some policies related to the companies per se and others to providing competent Palestinian authorities with the bases of proper governance procedures and the establishment of a comprehensive Palestinian governance system. We hope that the analyses and recommendations will increase the competitiveness of these companies and help all stakeholders make sound investment, credit, service, administrative and financial decisions on the short and long runs.

I would like to extend my thanks to all those who contributed to this study. In addition to the research team, I would like to thank the Ministry of National Economy (MoNE), the Palestinian Capital Market Authority (PCMA), the Palestinian Stock Exchange (PSE), the Coalition for Accountability and Integrity (AMAN), the Center for Private Sector Development (CPSD), The Palestinian public shareholding companies, and all the experts we interviewed whose comments and ideas we benefited from.

I am also grateful for the participants at the workshop, as well as Dr. Atef Alawneh and Dr. Basim Makhool for reviewing and refereeing the study. Finally, I extend my sincere thanks and appreciation to the International Development Research Centre (IDRC), Canada, for funding this research and their ongoing support for the institutes work.

Dr. Mohamed Nasr
Director General

Executive Summary

This study analyzes the characteristics of Corporate Governance in Palestine through the presentation of the emergence and evolution of corporate governance, its goals and pillars. It also measures Palestinian public corporate adherence to corporate governance principles, as issued by the Organization for Economic Cooperation and Development (OECD). The study also aims to analyze the impact of such practices on corporate financial performance and recommends some policies related to the companies per se and others to providing competent Palestinian authorities with the bases of proper governance procedures and the establishment of a comprehensive Palestinian governance system. We hope that the analyses and recommendations will increase the competitiveness of these companies and help all stakeholders make sound investment, credit, service, administrative and financial decisions on the short and long runs.

Interest in Corporate Governance increased in a number of advanced and nascent economies in the past few decades, especially after the economic collapse and financial crises in a number of companies in different countries. Many studies attributed such collapse and crises to the weak governance structures or lack of any governance practices in these companies. As a result of the increasing interest in this concept, many international institutions endeavored to study and analyze corporate governance to provide some guidance to support companies' management in several aspects that would produce positive impact on the companies themselves and on the stock exchange markets where they are listed as well as on the economy in general.

Corporate governance grew gradually in past decades via experiences of different countries, moving from advanced to developing countries, including Arab states and Palestine. The corporate governance system, framework and procedures were established in different organizations to fulfill diversified needs, and it became necessary to devise standards for such practices to avoid any financial crises that could lead to any state to disaster.

Although governance does not have a unified definition, it has goals that identify its features including promoting transparency, improving corporate management, ensuring the formulation of appropriate strategic decisions, avoiding any bank crushes, ensure fair treatment of shareholders, personnel, creditors and other stakeholders, improve corporate financial performance, improve corporate social responsibility (CSR), cut down on capital cost. External and internal limitations for the enforcement of corporate governance were devised. The external ones refer to the general environment of investment like legislations and oversight while the internal ones refer to the rules and methods applicable within the companies themselves.

Out of these objectives and limitations, components of corporate governance emerged to ensure that companies achieve their goals as independent legal personalities seeking competition. The most important component may be the existence of laws and legislation that govern shareholders rights, presence of an audit committee in these companies, highly efficient internal administration systems and distribution of roles and responsibilities to all members.

Palestine was not far from this international trend. The Palestinian Capital Market Authority (PCMA) formed the National Corporate Governance Committee. NCGC was entrusted with the task of laying down a special governance system and consolidating it in Palestine. Several other Palestinian institutions played a core role in disseminating the culture of corporate governance in Palestine, which constitutes a key foundation to apply corporate governance as standard administrative and financial practices. These institutions include The Palestinian Monetary Authority (PMA), the Center for Private Sector Development (CPSD), the Palestinian Businessmen Association (PBA), the Coalition for Accountability and Integrity (AMAN), the Palestinian Stock Exchange (PSE), as well as the Palestinian Capital Market Authority (PCMA).

The study adopted a survey method via the distribution of a questionnaire to a sample of public shareholding companies. The questionnaire focuses on the principles of corporate governance to monitor Palestinian public shareholding companies adherence to corporate system. The analysis shows that the corporate governance index ranged between 27 – 42 points. In percentage figure, this will be 54% - 84%.

Results of the analysis show close results among the different economic sectors. The analysis showed that the average index of listed companies is higher than the non-listed by 7 points/50 (14%). The results confirmed results from previous studies, demonstrating that listed companies have higher corporate governance practices than other companies. By reviewing the average of sub-indexes of practice, we notice that disclosure and transparency is the most commonly practiced, followed by responsibilities of the Board of Directors, internal audit and control, shareholders rights, fair treatment and finally role of stakeholders.

The study examined the impact of corporate governance on their financial performance in two stages; using simple regression to identify the impact of change in independent variables represented in corporate governance practice on the dependent variable (financial performance). The second stage was the multiple regression by introducing control variables in the regression equation so that the goal will be to measure the impact of practicing corporate governance and control variables on the dependent variable.

The simple regression showed a retrospective relation between corporate governance and return on investment and growth of profits and credit property rights ratio. The multiple regression results revealed statistical relation between the practice of corporate governance and return on investment and growth in profits and the ratio of credit to property rights with the presence of control variables.

The study concluded that governance is a way that enables a society ensure that public shareholding companies are properly managed and that investors are protected and assisted in making their investment decisions. Corporate governance is not a mere survival approach. It is a strategy for prosperity that constitutes a significant guarantee for companies and economies in reason of the probable effect of governance on corporate financial role and their role in reducing the “agency cost”.

This means that practicing corporate governance at senior levels in the company will increase its ability to attract investments and support financial performance; it will also promote its ability to compete on the long run, better allocation of resources and maximization of return on investment in addition to accessing external funding and reducing the cost of funding, increasing revenues and profits and maximizing projects value added, not to mention reducing fluctuation of returns. This will allow companies to depend on loans for they will be able to fulfill specific financial obligations in the future; consequently, they can benefit from tax exemptions as a result of such loans.

Corporate governance in Palestinian companies is relatively good in comparison to other countries but their index is still low. This could be attributable to the practices of some companies, and others are external reasons that need to be taken into account. Based on the outcome of the study, we propose the following recommendations:

- Disseminate and promote corporate governance whereas stakeholders organize training programs that promote corporate governance practices.
- Accelerate publication of the Corporate Governance Manual by the Corporate Governance National Committee to present a standard practice and reference of corporate governance in Palestine.
- Companies, mainly those listed on the Stock Exchange, need to promote corporate governance to mitigate risk and the negative impact of the situation of political and economic instability in Palestine.
- Investors need to examine companies' commitment to corporate governance prior to making their investment decisions.
- Companies' boards of directors are advised to form the following committees: corporate governance, disclosure, risk management, internal audit while compelling external auditors to add parts in their annual reports on corporate governance
- Preparing additional studies in order to review corporate governance per sector taking into account the relative weigh of companies operating within each sector. Another study on the compatibility of the legal and institutional environment with the principles of corporate governance is also necessary to constitute a strong legal base of effective corporate governance.