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Corporate Governance Reform and State-Owned Entities in Morocco & Tunisia

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I. Introduction

In July of 2003, members of the World Bank Corporate Governance Forum and the Center for International Private Enterprise met with leaders of Middle-East and North Africa (MENA) countries with the goal of launching a regional initiative to evaluate corporate governance in MENA countries.[1] The outcome of this evaluation was widely known as the First Wave of Corporate Governance in MENA, which saw MENA countries work to elevate their awareness of good corporate governance practices and the positive impact that good corporate governance would have on their respective emerging economies.[2]

[1] Saïdi, N. (2004). Corporate governance in MENA countries. *Improving Transparency and Disclosure. Beirut: The Lebanese Transparency Association. p81.*
[2] Koldertsova, A. (2011). The second corporate governance wave in the Middle East and North Africa. *OECD Journal: Financial Market Trends, 2010*(2), 219-226.

This paper will explore the first wave of corporate governance in MENA with a focus on Morocco and Tunisia and review the outcomes of the first wave, with particular emphasis on the state-owned enterprise (SOE) governance in Morocco and Tunisia.

II. Regional corporate governance challenges

The MENA region contains many different economies. This variation is primarily due to different access to petrochemical resources and levels of western influence.[3] There are three distinct tiers of countries. The first tier of countries is the Gulf Cooperation Council (GCC) countries[4], which are all massive exporters of petrochemical resources. They thus have developed economies and strong governmental institutions. The second tier consists of countries with somewhat developed economies, but no petrochemical resources. These countries are more reliant on their own private sector, capital markets, and foreign investment for economic growth. Morocco and Tunisia both belong to this tier of countries.[5] Finally, the last tier of countries has very small economies as a result of ongoing political instability or late economic development.[6] These countries will have the least developed institutions. Despite the varying levels of institutional development, regional factors such as common heritage and cultural norms created similar corporate governance challenges in all MENA countries.

There are several region-specific issues that impede the development of modern corporate governance in Morocco and Tunisia. In no particular order, they include: the lack of effective regulatory and institutional frameworks, little transparency and mandatory disclosure, a

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[3] Piesse, J., Strange, R., & Toonsi, F. (2012). Is there a distinctive MENA model of corporate governance?. *Journal of Management & Governance, 16*(4), 645-681.
[4] These countries include Saudi Arabia, Kuwait, the United Arab Emirates, Qatar, Bahrain, and Oman.
[5] These countries include Egypt, Jordan, and Morocco, Tunisia, and other formerly colonized countries of North Africa.
[6] These countries include Iran, Iraq, Lebanon, Syria, Algeria, Sudan, Libya and Yemen, as well as the West Bank and Gaza

heavy influence of Sharia law which does not predispose the region to robust investor protection, and dominance of both state-owned and family-owned enterprises.[7] Each will be discussed in turn below.

(a) The lack of strong regulatory institutions

As emerging economies, MENA countries generally do not have the institutional strength to enforce state regulations.[8] Where institutions do exist, they can be subject to the ruling elites and other politically powerful parties and struggle to maintain independence in enforcement. This fosters corruption and bribery and leaves companies with little incentive to comply with any regulations that the government may try to impose. Regional initiatives, such as the I WATCH organization in Tunisia, have attempted to curb this. Furthermore, many countries in MENA, including Morocco and Tunisia, suffer from low accountability. This is largely an outcome of a high concentration of political and economic power in governing elites, who will share benefits to those close to them and take a strict approach to those that oppose them, both politically and financially. This creates feelings of a lack of dignity, social justice, and inequality by the populace, while those that benefit from the system have perverse incentives with respect to transparency and accountability.[9]

Regardless of how well thought-out or written corporate governance codes are, these codes will be meaningless in light of poor enforcement. Thus, the lack of strong regulatory institutions in Morocco and Tunisia posed a large threat to corporate governance modernization.

(b) The influence of Sharia law

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[7] Rossouw, G. J. (2005). Business ethics and corporate governance in Africa. *Business & Society, 44*(1), 94-106.
[8] Saïdi, N. (2004).
[9] Sarhan, A. A., & Ntim, C. G. (2018). Firm-and country-level antecedents of corporate governance compliance and disclosure in MENA countries. *Managerial Auditing Journal, 33*(6/7), 558-585.

Morocco and Tunisia both Islam, speak Arabic, and observe the same cultural and religious traditions and etiquette customs.[10] In countries such as these where Islam dominates, Islamic principles can exert a heavy influence on the economic, financial, and political landscape. All business and financial transactions, for example, are performed within the tenants of these Islamic principles and according to Sharia law.[11]

Sharia law theoretically sets a strong foundation for corporate governance. Islamic values suggest that resources are provided by God in the form of trust, and thus the individual is accountable to God for the honest use of the resources. Alongside this idea of strict accountability, Sharia law suggests that society has a right to know about the use and allocation of these resources. Translated to business corporations, this suggests that owners have an obligation to society to provide honest and fair information regarding corporate operations and transactions in order for society to make informed economic decisions.[12] Furthermore, Islamic tenets of universal brotherhood, unity, and trust suggest that owners show greater transparency and disclosure to their fellow man.[13]

Despite this advantageous foundation, strong corporate governance and investor protections have been slow to develop in Morocco and Tunisia. This is likely due to the fact that Morocco and Tunisia have taken a minimalist regulatory approach to corporations, as they believe that Sharia law is sufficient.[14] In this approach, corporations are expected to maintain compliance with Sharia law, but the exact requirements for compliance are not specified or

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[10] *Id*.
[11] Elasrag, Hussein. "Corporate governance in Islamic Finance: Basic concepts and issues." Available at SSRN 2442014 (2014).
[12] The idea of mandatory transparency is illustrated in the prohibition of *gharar*, which is a tenet of Islam associated with uncertainty, deception and risk. *Gharar* is prohibited in financial and business transactions by Sharia law.
[13] Sarhan, A. A., & Ntim, C. G. (2018).
[14] Elasrag, Hussein. (2014).

defined. This frequently results in outcomes that would be problematic in western corporate governance, but is not problematic according to Sharia law. For example, minimalist regulatory regimes under Sharia Law do not restrict concurrent board seat appointments. This inevitably creates conflicts of interest, as individuals regarded as experts in an industry generally hold seats on the boards of many competing corporations. While this would be strictly regulated in western corporate governance, it is not regulated by the minimalist regulatory approach. Instead, the minimalist approach relies on Sharia law, which states that individuals must self-regulate according to Islamic tenets on fairness and honesty. Whether or not individuals respect their Sharia law duties is beyond the scope of a minimalist regulatory regime, and it is further not investigated or enforced.

Additionally, Sharia law tends to view corporations as social entities, or entities that exist to benefit society.[15] This diverges from the western view that corporations are meant to exist as financial entities that maximize shareholder value. A main directive of "benefitting society" does not provide corporations with clear guidance when faced with business decisions. Where western corporations would be obligated to maximize shareholder value, corporations in Morocco and Tunisia under Sharia law do not necessarily have this strict obligation to their shareholders and may behave inconsistently. For example, a majority shareholder can theoretically justify maximizing his individual profit at the expense of other shareholders by donating a portion of his profits to religious or nonprofit organizations that benefit society.

[15] Ahmed, Habib, and Mohammad Umar Chapra. Corporate Governance in Islamic Financial Institution (Occasional Paper). No. 93. *The Islamic Research and Teaching Institute (IRTI)*, 2002.

Despite the challenges noted above, as Sharia law and Islamic tenets are not inconsistent with good corporate governance, a harmonized solution may exist for this issue by leveraging the foundational principles that benefit corporate governance.

(c) Adversity towards transparency and disclosure

In general, MENA companies including those in Morocco and Tunisia are strongly averse to disclosing information and offering transparency into corporate practices. While the reasons are unclear, transparency is a fundamental tenet of good corporate governance. Transparency and good governance are the two most important drivers for international investors.[16] Greater transparency also builds public and investor confidence in the operation of capital markets.[17] On the other hand, a lack of transparency and corporate disclosure can foster corrupt practices and does not incentivize companies to follow corporate governance guidelines the state may try to establish.[18] This will create the opposite effect: lack of confidence in the capital markets and a decline in investments. Thus, despite the conflict with the cultural tendencies of non-disclosure, increasing transparency and mandatory disclosure is a non-negotiable change that must be undertaken in the corporate climate of Morocco and Tunisia.

(d) State-owned enterprises

Finally, the dominance of SOEs and distinguishes the corporate landscape of MENA, including Morocco and Tunisia, from the Western world. This corporate landscape is not necessarily incompatible with establishing and maintaining good corporate governance, but can

[16] Saïdi, N. (2004).
[17] *Id*.
[18] Armstrong, P. (2001). Pan African Consultative Forum on Corporate Governance. *International Finance Corporation*, The World Bank.

be problematic for adopting standards that equal those of the Western world.[19] There are several reasons why SOEs complicate the reform for good corporate governance.

Milhaupt et. al. notes that on top of the usual agency issues that come as a function of mixed ownership, state ownership creates an additional layer of agency problems. The state itself is an economic and political organization.[20] As such, the interests shareholders may be at odds with the interests of citizens which the state is responsible for: the shareholders generally want to maximize profit, while the state's interests may aim more towards social welfare. Citizens can benefit at the expense of shareholders' ability to maximize value as a result of state ownership. Additionally, as regulator and controlling shareholder, the state faces a unique conflict of interest between regulating itself and operating the SOE.[21] The state is empowered to regulate itself as it wants, and can easily abuse its power as controlling shareholder at the expense of the minority shareholders without repercussions. While strong infrastructure can avoid this form of corruption and abuse of controlling shareholder power, as discussed above it does not exist in Morocco and Tunisia yet. Finally, the dynamic and cyclical nature of the state does not provide SOEs with long-term market strategies for profitability and competitive development. This is especially pronounced in countries that suffer from political instability and have a large number of political parties vying for power. A party that comes in power with a different set of beliefs can completely change the strategy and operation of a SOE from the previous regime – for example, a regime that abides more closely to traditional Islamic beliefs may scale back operations of

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[19] Saïdi, N. (2004).
[20] Milhaupt, C. J., & Pargendler, M. (2017). Governance Challenges of Listed State-Owned Enterprises Around the World: National Experiences and a Framework for Reform. Cornell Int'l LJ, 50, 473.
[21] *Id*.

tobacco and alcohol SOEs. This cyclical instability does not provide investors with faith that their investments will be stable and protected.

Overall, SOEs pose a threat to economic development by acting as risk factors that deter foreign investment. While SOEs are not mutually exclusive with good corporate governance, they provide some form of exception or loophole that may not result in good corporate governance practices being observed. Due to this, the solution likely resides in entity-specific regulations on top of the implementation of a good corporate governance code.

III. Outcomes of the first wave of corporate governance

(a) Success of the educational movement

By the end of the 2000s, the educational effort of the first wave had already borne fruit. The Hawkamah Institute of Corporate Governance (HICG) in 2006 led to the establishment of the Moroccan Corporate Governance Task Force.[22] As a further result of HICG's efforts, both the concept of corporate governance and the accompanying business case for its implementation were widely known and accepted by the end of the 2000s. While resistance to corporate governance continued, the core of the resistance had shifted from resisting the concept of corporate governance itself to resisting the actual corporate governance guidelines themselves. Koldertsova considers this fact to be soft evidence that the awareness-raising campaigns have succeeded.

More importantly, the receptivity and eagerness of the MENA region to corporate governance allowed the first wave to progress beyond education. At the end of the decade, 15 of 17 MENA countries had general corporate governance codes.[23] While only five of these codes

[22] Koldertsova, A. (2011).
[23] *Id*.

required mandatory compliance as of 2011, regulators in the MENA region see this as the next step in corporate governance evolution, and many are eager to move towards mandatory compliance.[24]

(b) Development of new corporate governance codes

In creating a corporate governance code, Morocco and Tunisia considered both a UK comply or explain approach and the US Anglo-American model of ex-ante rule and regulation. The UK "comply-or-explain" approach applies pressure on listed companies to conform themselves to good practices with mandatory disclosures and transparency or explain why they are not conforming to the set practices.[25] Disclosure and transparency of this explanation places companies under the scrutiny of investors, shareholders, stakeholders, and the public opinion, and companies therefore must maintain good corporate governance practices in order to succeed in soliciting investment and maintaining value. In this sense, the company's rationale is judged in the courts of the free market and public opinion, which will punish or permit companies to deviate from corporate governance standards accordingly. Meanwhile, the US Anglo-American model elevates corporate governance to rule of law with regulations and legislation (e.g. the Sarbanes-Oxley Act).[26] Companies are forced to adhere to corporate governance guidelines in an ex-ante fashion, and compliance is audited with mandatory routine disclosures and a high level of transparency. The system is mostly enforced through a system of punishments, where straying

[24] *Id*.
[25] Duhamel, J. C. (2015). The "comply or explain" approach as a Pascalian Wager. *Accounting, Economics and Law-A Convivium, 5*(3), 289-293.
[26] Sturm, Maria Elisabeth. (2016). Corporate Governance in the EU and U.S.: Comply-or-Explain Versus Rule, *European Union Law Working Papers, No. 16*, Stanford-Vienna Transatlantic Technology Law Forum.

from the permitted path may result in fines, sanctions, and even removal from public listing. Due to the extensive effort that enforcement requires, it is considered extremely costly.[27]

After the dust of the first wave settled, many of the MENA corporate governance codes used the comply-or-explain approach.[28] This was likely the preferred approach due to the lack of strong institutions in most MENA countries: with weak institutions, enforcement of the Anglo-American model would be nearly impossible. A comply-or-explain approach, on the other hand, allows the institution to serve as a partial judge alongside the informed public. Low investments and share price drops will likely have more effect on a corporation's adherence to corporate governance guidelines than a fine levied from a weak institution that is subject to bribery or corruption.

However, both Morocco and Tunisia chose to provide corporate governance recommendations and make compliance voluntary instead of adopting a comply-or-explain approach. Amico notes that both countries drafted their codes through a multi-stakeholder consultation process, which led to private sector-driven corporate governance codes. In comparison, the other countries had all referred solely to the stock exchange and securities regulators to develop their governance code.[29] While the recommendations provide a good starting place, the voluntary nature raises questions on the efficacy of these recommendations and whether they solve the problems of transparency and corruption. Nevertheless, while the general corporate governance code remains voluntary, these countries have established mandatory banking, SOE, and FOE specific codes that may help in these key areas.

IV. State-owned entity specific regulation

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[27] Saïdi, N. (2004).
[28] Amico, A. (2014). Corporate Governance Enforcement in the Middle East and North Africa.
[29] *Id*.

Despite the evolution of corporate governance and the impressive progress of the First Wave, only a minority of MENA countries have actually created specific codes regulating SOEs.[30] SOE reform is thus widely seen as a room for improvement in the region, and regulators are currently contemplating how to handle the SOE problem. OCED provides four guiding principles for SOE reform: (1) transform the state's role from management to ownership; (2) increase SOE autonomy vis-à-vis the state; (3) pursue corporatization and strengthen the role of boards; and (4) increase transparency with financial reporting/disclosure.[31]

This paper will consider Morocco, which has seen extensive and ongoing SOE governance reform with SOE-specific corporate governance rules[32], and Tunisia, which has lagged behind in SOE governance reform as a result of political instability[33]. Both have taken similar steps to meet OCED's four principles, and this comparative analysis will consider the success and room for improvement of each approach.

(a) Moroccan regulation of state-owned entities

Morocco has a more diverse and sophisticated SOE portfolio than Tunisia, and one of the most comprehensive ones in the entire MENA region.[34] Although Morocco only has a few fully state-owned enterprises, almost every industry in Morocco has a corporation where the state is a large or majority shareholder. As a country that has been undergoing economic reform since the 1980s, Morocco was a step ahead of most of its MENA counterparts by the time of the first

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[30] *Id*.
[31] Raballand, Gael J. R. F.; Veuillot, Gilles Marie; Habhab, Lydia; De Meneval, Philippe. 2015. Middle East and North Africa - Governance reforms of state-owned enterprises (SOEs): lessons from four case studies (Egypt, Iraq, Morocco, and Tunisia) (English). Washington, D.C. : World Bank Group.
[32] Amico, A. (2014).
[33] Raballand et. al., 2015.
[34] *Id*.

wave. Because of this, Morocco has had an extended amount of time to consider the proper reforms to balance the presence of SOEs with good corporate governance practices.

In the early 2000s, Morocco reformed the governance of its SOEs in line with the first wave of corporate governance.[35] These reforms primarily sought to adapt SOEs to new dynamics driven by privatization and liberalization, with the ultimate goal of growing both domestic and foreign investment. As such, the Moroccan Corporate Governance Task Force prioritized regulations that shifted the state's role from a manager to an owner and increasing transparency through regular mandatory disclosure.[36] This was done with three key pieces of legislation. First, Morocco enacted Act 69-00, which provides a comprehensive definition of what constitutes a SOE[37] and creates the Department of Public Enterprises and Privatization (DPEP) to oversee SOEs. The DPEP consolidated the government management of SOEs into one department where the government could harmonize management, consolidate strategic orientation, and generally act as a buffer between the regulatory arm and the ownership arm of the state. Most significantly, this consolidation of SOE management allowed for easy auditing of SOE corporate activity and monitoring of contracts the SOEs reward. Second, Morocco enacted laws that require regular mandatory disclosure of SOE corporate activity in 2011.[38] SOEs now disclose through both regular financial statements and an annual report. These reports are audited by the Moroccan Court of Accounts for accuracy and compliance. Finally, Morocco established and empowered a

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[35] *Id*.
[36] *Id*.
[37] There are three categories of SOEs in this definition: (1) state companies are those in which public bodies hold all the equity, (2) public subsidiaries are companies of which public bodies hold more than half the equity, and (3) semi-public companies are companies of which public bodies hold less than half of the equity. https://www.state.gov/documents/organization/229172.pdf
[38] See Law No. 62-99, the Financial Jurisdictions Code. Accessed online: https://www.state.gov/e/eb/rls/othr/ics/2015/241672.htm

board of directors and supervisory boards for SOEs, all of which are overseen by DPEP.[39] While these boards are not independent, the boards (with oversight from DPEP) help ensure that SOEs are operating competitively and the state is handling its controlling shareholder role appropriately.

These reforms have played a huge role in modernizing SOE governance in Morocco. The three pieces of legislation fulfill all four OCED principles for SOE reform: the boards provide for corporatization and transform the state's role from management to ownership, the MPEP increases SOE autonomy and board power, and the regular mandatory disclosure greatly increases the transparency.[40] As a result of Morocco's corporate governance effort, including the SOE reforms, Morocco has seen positive growth in economic metrics: FDI has grown around 4.4% annually and recently jumped up 12.2% in 2017[41], and Morocco has seen steady improvement in worldwide corruption indices[42]. While scholars agree these regulations have room for improvement (such as requiring independent boards), Morocco is widely seen as a good example of SOE governance in the MENA region.

(b) Tunisian regulation of state-owned entities

In contrast to Morocco, Tunisia only has state ownership in a few consolidated industries such as banking, transportation, and mining.[43] Since the mid-1980s, SOEs have primarily sought to achieve socioeconomic objectives of the state such as employment and income redistribution. Unfortunately, these socioeconomic objectives did not provide much guidance or strategic

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[39] *Id*.
[40] *Id*., Table 3.1.
[41] Morocco - United States Department of State. Retrieved: https://www.state.gov/e/eb/rls/othr/ics/2018/nea/281675.htm
[42] For example, Morocco is not ranked 81st out of 180 countries in the Corruption Perception Index published by Transparency International, which represents a jump of 9 spots from 2016 to 2017.
[43] Raballand et. al., 2015.

direction to these SOEs, and they soon found themselves with a discordant set of public policies that were “created in an ad-hoc manner over time, mainly in response to economic and social pressures.”[44] This problem was identified in the early 1990s, but political instability up into the recent Arab Spring of 2011 delayed action. As such, Tunisia generally lags behind other countries in SOE reform.

Nevertheless, Tunisia has attempted to implement several reforms similar to what Morocco has done. First, Tunisia created government institutions beyond the Ministry of Finance to help manage SOEs and increase SOE autonomy from the regulatory arm of the state. While this approach was widely reminiscent of the MPEP in Morocco, one key difference in the Tunisian approach is that a large number of small institutions with narrow responsibilities was created, in lieu of one large harmonized organization[45]. Second, Tunisia enacted the Financial Safety Act in 2005, which reworked the responsibilities of the board of directors in SOEs.[46] This act required the board of directors to publish regular financial statements and a year-end annual report and also required the board of directors to create an independent audit committee. With these reforms, Tunisia sought to improve the strength of the boards and create transparency through the mandatory disclosure of audited financials. However, the FSA was still subject to Article 10, 96-74 of the 1996 Act that formed the board of directors in SOEs, which provided that the board’s decisions would only be confirmed after “approval by the supervisory

[44] Raballand et. al., 2015, citing Letaïef, M. B. (1998). L'état et les entreprises publiques en Tunisie. Editions L'Harmattan.
[45] Raballand et. al., 2015.
[46] Ali Ahmadi, Abdelfettah Bouri, (2016) "The impact of financial safety act and corporate governance on the level of financial disclosure: Case of Tunis Stock Exchange firms", *International Journal of Law and Management, Vol. 58 Issue: 6, pp.618-633*, https://doi.org/10.1108/IJLMA-06-2015-0030

authority."[47] This created a situation in SOEs where the state was once again both supervisory authority and owner.

These reforms were helpful in improving SOE governance, but were not as effective as Moroccan reforms. The creation of many SOE management institutions made the institutions themselves confused regarding the extent of their responsibilities and resulted in inconsistent guidance and duplicitous work.[48] This confusion created further inefficiency when the state attempted to enforce the FSA. The new institutions complicated enforcement of the 1996 Act, as it was unclear which of the many SOE management institutions was responsible for approval[49]. The weak institutional power as a result of confusion also led many SOEs to either fully ignore or minimally implement the requirement for audit committees the FSA required. As of 2015, the last complete report on SOEs was 8 years old[50], a majority of Tunisian SOEs did not publish financial statements and year-end annual reports, and the audits that had been conducted generally contained some reservations about the SOE's financial position[51]. This has opened the door for some corruption and embezzlement.[52]

Today, Tunisian SOEs can still benefit from greater governance. Despite implementing conceptually similar corporate governance guidelines as Morocco, Tunisia's system of multiple controls has divested any individual institution with the sole responsibility of managing an SOE. Enforcement and compliance have suffered, and none of the four OCED principles are much improved as a result of the recent productivity. Nevertheless, Tunisia remains dedicated to the

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[47] Raballand et. al., 2015.
[48] Raballand et. al., 2015, citing Letaïef, M. B. (1998). L'état et les entreprises publiques en Tunisie. Editions L'Harmattan.
[49] Raballand et. al., 2015.
[50] *Id*.
[51] This was the case for three out of five SOEs studied in details in Banque Mondiale (2014). Raballand et. al., 2015.
[52] *Id*.

SOE governance problem. As of 2017, the European Bank for Reconstruction and Development (EBRD) reported that a broad reform strategy is currently under development by the new Tunisian government, with the goals of revamping the way which SOEs are monitored and run. This agenda includes increasing of transparency and disclosure, enhancing audits and controls, and providing the board with much needed independence. These aspirations are consistent with good corporate governance, and regulators are largely optimistic that Tunisia will be back on track soon.