

History of The Legal Developments of Corporations in Saudi Arabia

Abdulrahman A A Alzhrani

abzahrani@uqu.edu.sa abzahrani2@gmail.com

Assistant Professor of Law at Collage of Judicial Studies And Regulations – Law Department,
Umm Al-Qura University, Makkah, Saudi Arabia.

Summary:

The Arab Automotive Company was the first corporation in Saudi Arabia and was founded in 1928. Since then, the number of Saudi corporations had increased. In 1985, Tadawul (The Saudi Stock Exchange) was instituted under the supervision of the Saudi Arabian Monetary Authority (SAMA) and the base value of the index was 1000. This decision came as a response to accelerated growth in the number of Saudi corporations which had increased during the 1970s as the Saudi's economy developed.

Keywords:

Stock Market, Saudi Arabia, Companies Law, Corporation

1. Introduction

Since Saudi Arabia announced its Vision 2030, there are serious and sincere attempts to change for the better. For example, a 2017 report of The World Bank placed Saudi Arabia in the top 10 nations with regard to protecting minority investor interests. It is noteworthy that the ranking of Saudi Arabia in 2016 is 63 globally. This study is essential since it demonstrates how historically, Saudi Arabia has overcome economic and legal obstacles and reached the best legal practices in the corporate world.

2. History of Corporations in the World

The Russia Company, which was formed in England in 1553, was one of the first companies to be considered a joint corporation, (and arguably the first altogether) joint-stock company.¹ The British East India Company (EIC) was

established in 1600, and was more popular and extraordinary.²

Since the concept of a corporation was created by the Russia Company and the EIC, the development³ of oversight over corporations has come a long way. For example, by regulating the East India Company Act of 1773, the Parliament of Great Britain got ultimate control over the company because a governing Council composed of five members, and parliament was authorized to nominate three members.⁴

The Act of 1784 established a Board of Commissioners for the Affairs of India, also known as the four-member board is comprised of “Privy Councillors” nominated by the King, the Secretary of State, and the Chancellor of the Exchequer.⁵

Interestingly, the dual-board system is a German invention consisting of an independent, supervisory board of directors who are prohibited from serving as executives, and who monitor a board of senior executives who actually manage the company⁶. Germany adopted this system in their corporations in the 19th century, and it becomes mandatory after the Second World War.⁷

3. Corporations and the Stock Market in Saudi Arabia

The Arab Automotive Company was the first joint stock company in the Kingdom, and was founded in 1928.⁸

¹ See, e.g., Ron Harris, *The Formation of the East India Company as a Cooperation-Enhancing Organization* (Dec. 2005) (working paper), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=874406 (discussing the role of the English East India Company in advancing the development of enterprises in which strangers would invest).

² *The Corporation that Changed the World* by Nick Robins, a history of the East India Company, a rather unique original prototype of the idea.

³ Venkatesh Rao, *A Brief History of the Corporation: 1600 to 2100*. June 8, 2011. <https://www.ribbonfarm.com/2011/06/08/a-brief-history-of-the-corporation-1600-to-2100/>

⁴ Keay, John. *The Honourable Company: A History of the English East India Company*. Macmillan Publishing Company, New York p. 385(1991).

⁵ *Id*

⁶ *The Globalization Of Corporate Law - Americans Law*. N.p., n.d. Web. 09 Oct. 2018 <https://www.americanslaw.com/the-globalization-of-corporate-law>.

⁷ WÜRDINGER, H. and PENNINGTON, R., R., *German company law*, London, Oyez publishing, 1975, 37-38 Xiii + 249.

⁸ Al-Arabiya News, *When was the first Saudi joint-stock company established?*, 02Feb. 2017. <https://www.alarabiya.net/ar/aswaq/videos/power-lunch/2017/02/22/-%D8%AA%D8%AF%D8%A7%D9%88%D9%84-%D9%82%D8%B5%D8%A9-%D9%86%D8%AC%D8%A7%D8%AD-%D8%AA%D8%B9%D9%88%D8%>

Since then, the number of Saudi corporations had increased until 1975, when it reached 14 Saudi corporations.⁹ The transactions relating to the shares was not subject to any oversight or government supervision. Few brokers established stock offices. This period has been marked by great confidence among sellers, buyers, and brokers because there were no large numbers of investors, and it was easy to control all parties when any one of them breached his obligation as it would mean the end in the market.

The Ministry of Commerce, SAMA, and the Ministry of Finance formed a ministerial committee tasked with establishing the Stock Market in 1984.¹⁰ In 1985, Tadawul (The Saudi Stock Exchange) was instituted under the supervision of the Saudi Arabian Monetary Authority (SAMA)¹¹ and the base value of the index was 1000.¹² This decision came as a response to accelerated growth in the number of Saudi corporations which had increased during the 1970s as the Saudi's economy developed.¹³

The Saudi Arabian Stock Market, also known as the Tadawul All Share Index (TASI), has fluctuated between a low of 1,140.57 points in 1995 and a high of 20,634.86 points in 2006.¹⁴ During the early 2000s, The Tadawul All Share Index the TASI increased steadily, increasing 76% in 2003, 84% in 2004, and 103.7% in 2005. The TASI's market capitalization paralleled this trend, increasing in value by \$578 billion from in the five years from 2000-2005.¹⁵ There are many reasons why there was an insane rise in the market value of shares, for example, around this time many wealthy Arabs decided to withdraw

their investments from western markets and reinvest their wealth domestically.¹⁶

Moreover, Saudi Finance Ministry attempted to boost liquidity for banks by repaying the national debt at the time, so banks encouraged people by facilitating lending and reducing interest rates. They got ready borrowers "Saudi citizens" who have the appetite to invest in the stock market.¹⁷ When the Saudi Telecommunications Company (STC) had introduced the IPO of 30% in late 2002, many Saudi citizens were involved in it. Saudi Arabian citizens purchased two-thirds of the 90 million shares offered.¹⁸ In order to realize how Saudi citizens rushed to invest in the capital market at that time, there were only 40,000 active portfolios before IPO of STC and after that, half of the Saudi population involved in IPO of Yansab only.¹⁹

As a result of the flourishing of the Saudi stock market between 2002 and the beginning of 2006, there was emerged strongly of the concept of corporate governance mechanisms. For example, Ministerial Decree No. 2217 was issued on 3/1/2003 to strengthen and regulate the internal oversight and accountability of the joint stock companies there was a form of financial statements to Promote the principle of transparency and disclosure which has to be Fill out by corporations.²¹ However, some companies did not give accurate information reflecting the financial situation of companies because of the lack of experience, Neglect, or embezzlement. Despite earnest attempts to implement corporate governance mechanisms, the internal control mechanism was absent.²²

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⁹ Al-Shammari, Eid H, Corporate governance in Saudi Arabia Reality Ambition!, 3(2008)

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¹¹ <https://www.gulfbase.com/gcc/index/1?t=3>

¹² Trading Economics, Saudi Arabia Stock Market (TASI). <https://tradingeconomics.com/saudi-arabia/stock-market>

¹³ Josh Lerner, Ann Leamon, Steve Dew, *The CMA and the Saudi Stock Market Crash of 2006*, 2 (2017) https://cma.org.sa/en/Market/Documents/CMA_Crash2006_en.pdf

¹⁴While the Import And Export Product From Low And Middle ..." N.p., n.d. Web. 30 Oct. 2018 <https://www.coursehero.com/file/p45iobm/While-the-import-and-export-product-from-low-and-middle-income-countries-like/>.

¹⁵ Abdullah Al-Hassan, Mohammed Omran, Fernando-Luciano Delgado Fernández, *IPO Behavior in GCC Countries: Goody Two-Shoes or Bad to the Bone*,3 (2007) <file:///C:/Users/%D8%B9%D8%A8%D8%AF%D8%A7%D9%84%D8%B1%D8%AD%D9%85%D9%86%20%D8%A7%D9%84%D8%B9%D9%85%D8%B1%D9%8A/Downloads/wp07149>.

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¹⁶ Bader Abdulaziz AlKhalidi, "*The Saudi Capital Market: The Crash of 2006 and Lessons to Be Learned*", International Journal of Business, Economics and Law, vol. 8, issue 4 136(December 2015).

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¹⁹ Id

²⁰ Niblock, Tim & Malik, Monica,. *The Political Economy of Saudi Arabia*, 1st Edition, 218 (2007).

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<http://www.alrafey.com/main/articles.php?action=show&id=352>

²² Al-Shammari, Eid bin Hamed. *Corporate Governance in Saudi Arabia: Reality and Ambition!*. University of Damascus, 2008.

4. The Saudi Stock Market Crash of 2006

The first major Saudi Arabian stock market crash was in 2006. At the start of 2003, the market increased significantly, and there was the dramatic and sustained rise because of a sharp increase of additional investors who were unsophisticated and inexperienced, as mentioned above.

At the closing of 2005, the International Monetary Fund (IMF) concluded its report of Saudi Arabia's market with this sentence, "Authorities need to be cautious in light of the continuing strong increase in stock prices."²³ The collapse began on February 26, 2006, after closing at its highest of 20,634.86, and quickly lost about 13000 points²⁴ within three weeks. By the end of 2006, Tadawul reached its lowest point at 7,933.29 points and had lost approximately 65% of its value.²⁵

Before the crash, some investors exited from the stock market and made significant gains, but for the majority, the 2006 crash left a trail of destruction. Many people lost their jobs or sought psychiatric help. Some bankrupted people fell ill due to stress, lost their possessions, resorted to begging, and in some cases, committed suicide.²⁶

Unfortunately, disagreements and conflict of jurisdiction among SAMA, the CMA, and PIF obstructed some reforms in the stock market. Furthermore, the CMA's inexperience in dealing with markets inevitably resulted in the CMA issuing decisions, instituting procedures, and making statements hastily.²⁷ Unsurprisingly, these actions resulted in an unstable market and the loss of confidence on the part of investors.

Lack of transparency was another factor contributing to the 2006 stock market crash. Listed companies would refuse to disclose their financial statements. Banks and governmental agencies failed to adequately respond to these repeated violations.²⁸ In addition to the above, several financial crimes were committed, such as false statements, the manipulation of

prices, and insider trading. The Capital Market Authority has not performed its duty to deal with these crimes.²⁹ In short, the lack of oversight over board members and senior executives in corporations and lack of experience of a minority of shareholders were one of the main reasons for this collapse.³⁰

Contrary to some writers, I think that there were efforts and decisions before the crash to promote the principle of transparency, disclosure, and reduce corruption in corporations, but those efforts were not enough to prevent this collapse. For example, in 2005 the Capital Market Authority punished three traders found guilty of manipulating share prices for eight listed corporations with financial penalties and restrictions on engaging in the business of trading for three years. Subsequently the CMA created modifications in its policies and procedures to increase transparency and enforce disclosure of large transactions between investors, members of boards of directors, or senior executives³¹

It can be said that the collapse of the stock market in 2006 was the cause of much of today's development in corporate governance. Many critics, economists, and academics have talked about this collapse and contributed to improving corporate governance. After the crash, the Saudi government issued rules and decisions to benefit shareholders. Several regulations have been adopted to promote the principle of transparency and disclosure. Some regulatory measures have been developed. In 2006, the Capital Market Authority (CMA) issued a corporate governance regulation but was not obliged. In February 2017, the Board of the Capital Market Authority Issued the current Corporate Governance Regulations then it was Amended by Resolution of the Board of the Capital Market Authority in April 2018. The government has become more flexible in amending regulations that are considered inappropriate. For example, the Companies Law was promulgated by royal decree in 2015, and some articles were amended by the Royal Decree of 2019. Today, Saudi Arabia's Vision 2030 promotes the idea of oversight,

²³ International Monetary Fund (IMF), *Public Information Notice: IMF Executive Board Concludes 2005 Article IV Consultation with Saudi Arabia*, (December 5, 2005). <https://www.imf.org/en/News/Articles/2015/09/28/04/53/pn05161>

²⁴ Al-Twajjry, Abdulrahman A, *Saudi Stock Market Historical View and Crisis Effect: Graphical and Statistical Analysis*, J. Human Sciences, 34, 1, 9(2007).

²⁵ Saudi Stock Exchange "Tadawul", Annual Statistical Report 2006 at 15.

²⁶ Niblock, Tim & Malik, Monica., *Supra note 29*, at 218.

²⁷ Josh Lerner, Ann Leamon, Steve Dew, *The CMA and the Saudi Stock Market Crash of 2006.*, 6(2017) https://cma.org.sa/en/Market/Documents/CMA_Crash2006_en.pdf

²⁸ *Id*

²⁹ Bader Abdulaziz Alkhalidi, *The Saudi Capital Market: The Crash of 2006 And Lessons To Be Learned*, International Journal of Business, Economics and Law, Vol. 8, Issue 4, (2015) <http://ijbel.com/wp-content/uploads/2016/01/Law-102.pdf>

³⁰ Abo zaed, Hamdi Hamzah, *The Stock Market Crisis in 2006 is a Warning and a Call for Reforming*, Riyadh: Obekan Printing and Packaging 178-181 (2006)

³¹ Josh Lerner, Ann Leamon, Steve Dew, *The CMA and the Saudi Stock Market Crash of 2006.*, 5(2017) https://cma.org.sa/en/Market/Documents/CMA_Crash2006_en.pdf

transparency, and governance not only in the corporations, but also in all government agencies.

5. Comparison Between Previous and Current Saudi Companies Law

On July 22, 1965, Royal Decree No. (M/6) issued the Saudi companies law, and it was applied for 50 years.³² On November 11, 2015, Royal Decree No. (M/3) issued the current Saudi Companies Law, and in April 2018 there was an amendment for some articles.³³

It is noted that the new Companies Law in general form is a reformulation of the previous law; it looks like a modified version, but that does not mean there is no difference between them. There are many fundamental differences between the two laws. Many articles have been drafted or completely changed.

- The current companies law remedied with many of the legal problems which relate to sharia law in the previous law. Therefore, it is noted that at the end of many articles there is a phrase (according to the Sharia rules), unlike the previous law which did not provide this phrase. This indicates that there are serious attempts to narrow the gap between the Companies Law and decisions of courts that rely on Islamic law as the most important source.
- The current law added and removed some types of companies, For example, a company limited by shares, the company with variable capital and cooperative company, was removed, while the holding company and one person limited liability company were added.

6. Corporations in the Current Companies Law

According to current Companies Law, there are some essential amendments of corporations:

- Facilitated the formal procedures, such as facilitating the meeting of the general assembly for the next time, encouraging investment by reducing the minimum capital and number of shareholders to establishing a corporation.
- Institutional work became more developmental by giving more authorities to general assembly and boards of directors.

- Reduce financial corruption by enabling the regulatory bodies to play their monitoring role on corporations and putting a higher limit of remuneration given to the board of directors. ³⁴
- The current law solved some conflict between the Capital Market Law and Regulations for Companies about the corporation. For example, the listed corporations are under the supervision of the Capital Market Authority and the unlisted corporations are under the supervision of the Ministry of Commerce.
- In the new system, powers were given to the Ministry of Commerce and Capital Market Authority to intervene in the corporations in some situations. For example, when the general assembly cannot elect the board of directors, they can form a temporary committee with expertise and competence to supervise the management of the company.³⁵
- In the previous Companies Law, punishment was not more than one year in prison or a fine not exceeding (20.000) riyals. ³⁶ In the current Companies Law, penalty shall not exceed five years imprisonment or a fine not exceeding five years.³⁷
- The current law is distinguished by many procedures that are in the interest of the shareholders. So memorandum of association and bylaws of the stock company and any amendment thereto must be published on the official website of the Ministry.³⁸ Also, a third party may have access to these documents, and the extract obtained from and certified by the Ministry shall be valid vis-a-vis third parties.³⁹

The current law authorized the Ministry of Commerce and the Capital Market Authority to delegate one or more representatives to attend the general assembly of corporations as observers to ensure that regulations are duly applied.⁴⁰

³² Saudi Companies Law(1965), Royal Decree No. (M/6) Dated 22/3/1385H (corresponding to 7/22/1965AD) <http://www.idc.gov.sa/en-us/RulesandRegulations1/The%20saudi%20Companies%20Law.pdf>

³³ *Id*

³⁴ Saudi Companies Law, Art. 76.

³⁵ Saudi Companies Law, Art. 69.

³⁶ Previous Saudi Companies Law, Art. 229.

³⁷ Saudi Companies Law, Art. 211.

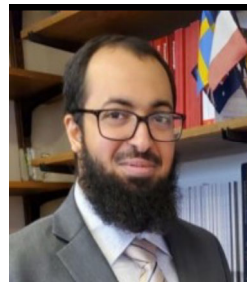
³⁸ Saudi Companies Law, Art. 13, ¶ 1.

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- [26] Saudi Companies Law



Abdulrahman Alzhrani

received the Bachelor's degree in Sharia (Islamic law) at Al-Imam Muhammad Ibn Saud Islamic University in Riyadh, Saudi Arabia in 2009, then he received the master's Degree in Legal Policy with a (Law) major from the Higher Institute for Judge Qualification at Al-Imam Muhammad Ibn Saud Islamic University in Riyadh in 2013. He got his second Master's Degree (L.L.M) in Legal Studies with a (Law) major From Case Western Reserve University in The US in 2017. Also, He has a Diploma in Criminal Law from CWRU. In 2020 he received a S.J.D from CWRU. Now, he is an assistant professor at Umm Al-Qura University. He is Deputy General Supervisor of the Legal Department at Umm Al-Qura University