WHAT ROLE FOR INSTITUTIONAL INVESTORS IN CORPORATE GOVERNANCE IN THE MIDDLE EAST AND NORTH AFRICA?

FLAGSHIP REPORT

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Abstract

While capital markets in the Middle East and North Africa have developed impressively over the past two decades, minimal empirical research has been done to shed light on their structure and dynamics. In particular, existing research and policy generally assumes that capital markets in the region are retail-based in terms of their ownership and that this very feature underpins their instability. Recent developments in the region, notably the designation of Qatar and the United Arab Emirates as emerging markets and the opening of the Saudi Arabia's exchange to institutional investment, highlight policymakers' interest to attract greater institutional capital to the region and can herald a new chapter in the development of capital markets in the region. This Flagship Report issued by GOVERN investigates the institutional investor composition of MENA equity markets. It is the first to empirically investigate and compare the ownership of public equity by different classes of institutional investors and explore the potential role of local and foreign institutional capital in Middle East and North Africa capital markets. In particular, the role of institutional investors in corporate governance is stressed considering the ongoing efforts of the regulators to improve the quality of governance in listed companies and the opportunities that institutional investor engagement presents. The role of sovereign investors and family offices, as the two largest categories of institutional capital in the region, is particularly stressed in developing local markets and improving stewardship levels.

Keywords: institutional investor, Middle East and North Africa, investor engagement, corporate governance, emerging markets, capital and ownership structure.

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Executive Summary

Investment attraction was one of the key reasons policymakers in the Middle East and North Africa countries have targeted a range of business climate reforms over the past two decades. While initially these efforts were targeted at attracting foreign direct investment, in recent years the development of capital markets has focused policymakers' attention on portfolio investment flows. This owes to a number of factors including the growing development of capital markets in the region, the establishment of financial centers across the region as well as the growing need to finance private sector investment and growth given the limits on the role of the public sector burdened by higher deficits.

Historically, capital markets in the Middle East and North Africa region were not seen as a key mechanism for financing corporate growth considering the predominant role of bank debt in corporate financing. The development of stock exchanges across the region was fostered by privatisations and the listing of a few large blue chip stocks, whereas smaller high growth companies did not traditionally seek equity finance through capital markets. Recognising the need to diversify domestic capital markets and support corporate growth and employment creation, stock exchanges and securities regulators have introduced a range of initiatives to attract family-owned and small cap companies to list.

While facilitating listings is critical, attracting institutional capital is equally important for the future development and stability of MENA capital markets as well as for the growth of companies listed on them. For the first time, this Flagship Report investigates the structure and evolution of institutional investment in the MENA region and in the individual Arab capital markets in order to provide recommendations on how institutional investment can be stimulated. To do so, we develop a custom database of institutional investors in the largest 600 MENA listed companies which account for 97% of the market capitalization of the examined markets.

Based on our classification, the report highlights the role of sovereign investors and family offices as two dominant categories of investors in the region, and the relatively low levels of investment by pension and mutual funds and insurance companies, which today are the main owners of publicly listed equity in developed markets. 30% of the largest listed companies in the region have a government shareholding and companies that have government stakes account for 62% of market capitalisation of the region's exchanges. In the GCC markets, the role of sovereign holdings, both direct, sovereign wealth funds and other sovereign investors account for more than half of the value held.

Unlike in developed markets, where family offices play a very minor role, families and holding companies can be considered a class of institutional capital in their own right and hence their impact on the market should be considered from the policy perspective quite separately from retail investors that dominate MENA markets. On the other hand, pension and insurance companies each account for less than 5% each of the overall market capitalisation examined, considering that domestic investments by these investors are rather insignificant.

The types and origins of institutional investors raise a number of dilemmas for policymakers but also highlight a number of opportunities for the ongoing development of capital markets in the region and the improvement of governance practices of listed companies. First, greater investment in public equity markets by institutional investors such as pension funds would deepen domestic equity markets, however would require an effort to develop these sectors domestically and review regulations governing their exposure to public equities.

Secondly, considering that foreign institutional investors currently account for less than 15% of the overall value held in the region, further options for attracting greater institutional investment should be considered. In this respect, the ongoing liberalization of foreign investment regimes in the GCC markets and notably in Saudi Arabia which is the largest equity market in the region, is commendable. To attract further foreign investor interest to MENA markets, better corporate governance practices in terms of board effectiveness, disclosure and shareholder relations are critical going forward.

For the past decade, policymakers in the region have made better corporate governance a priority for the development of local exchanges, adopting corporate governance codes, revising listing requirements and reviewing governance-related requirements contained in company legislation. Most jurisdictions have in recent years introduced comply-or-explain corporate governance codes and have further tightened provisions around board composition, disclosure, investor relations, and other important governance milestones. While the pace of regulatory change has been impressive, progress in changing the governance culture in the region has been stymied by the lack of investor engagement.

This owes to the fact that the region receives relatively little foreign investment and that dominant domestic investors in MENA markets – sovereigns and family offices – are not particularly active in terms of their ownership responsibilities. Domestic institutional investors generally do not vote their shares and do not disclose their voting results which is contrary to global trends where since the last financial crisis, stewardship by institutional investors has been under intense scrutiny and efforts by asset owners and managers to be more active in the governance space have increased considerably.

Policymakers in the region are aware of the fact that attracting institutional investment to the region's capital markets is crucial to facilitating IPOs as well as the growth of the domestic corporate sector. However, less attention has so far been paid on encouraging existing local and foreign investors to act as active and responsible shareowners. While stewardship codes and other initiatives meant to engage institutional investors in dialogue with their investee companies have proliferated globally, similar initiatives are yet to take root in the region.

Although the report does not recommend the development of a stewardship code(s), it does stress the need for local institutional investors, including notably sovereign investors and family offices which are most predominant in the region, to be more active in terms of voting and disclosure of key issues of their engagement. This is crucial in order to stimulate further governance change in the region by creating a homegrown investor demand for good governance. Insofar as current corporate governance practices are almost entirely inspired by national regulatory standards, executives and boards of MENA listed companies have adopted good governance structures with a view towards regulatory compliance.

A number of options are available to policymakers in the region to provide incentives to domestic investors to be active stewards of the region's corporate wealth in public equity markets. In particular, considering that the largest investors in listed companies are sovereign (SWFs, pension funds, banks, etc.), they can be required or encouraged to adopt essential principles of responsible investment outlined in the relevant international standards such as the UN Principles for Responsible Investment or the G20 OECD Guidelines on Corporate Governance. Collaboration between domestic and foreign institutional investors would also be essential to encourage to facilitate the sharing of experience among investors.

Introduction

Across the Middle East and North Africa (MENA) region, capital markets have an extremely varied history and currently find themselves at rather different points of development, whether measured by market capitalisation, depth of bond markets, liquidity or the sophistication of their regulatory framework. Although observers or investors less familiar with the region may perceive them as a single investment destination, subject to similar geo-political risks and economic drivers, stock exchanges in the region remain relatively insulated, subject to substantially different regulatory frameworks, and with varied levels of sophistication of the supporting market infrastructure.

Regardless of the level of their growth, policymakers across the region have made the development of active equity and bond markets a priority in order to underpin the establishment of financial centers and to support the financing of entrepreneurship in the region, on which much hope is pinned in terms of employment creation: arguably the most pressing socio-economic challenge in the region for decades to come. Over the past decade, whether in Saudi Arabia, Syria or Tunisia, significant efforts have been placed in developing capital market institutional and regulatory frameworks.

A key aspect of this reform has been improving the integrity and transparency of capital markets, fundamental to creating market confidence and attracting greater institutional funding to the region's capital markets, characterised by high levels of retail investment, prone to speculative and movements and shocks as was witnessed in 2006 in the markets of the Gulf Co-operation Council Countries. As a result, almost all regulators in the region have introduced and further tightened disclosure requirements related to issues such as insider trading and related party transactions, among others.

The introduction of the first corporate governance code in Oman in 2002 has ushered a new wave during which codes were introduced in all but one country of the region, in addition to specific requirements on banking institutions, insurance companies and in some cases, state-owned enterprises. Over the past 3 years, attention has focused on the enforcement of these codes and related regulations, as it was observed that the quality of their implementation has been uneven and driven by compliance requirements as opposed to substantive governance culture change.

A key particularity of markets in the MENA region is the lack of investor engagement and dialogue with listed companies on strategic and governance issues of importance, which owes primarily to the slow development of the domestic institutional investor community and to the low levels of exposure of foreign investors to MENA equity markets. This passive nature of local investors is inconsistent with global trends where engagement and activism have emerged as key areas in the corporate governance debate and a source of effort and at times concern by listed companies.

The objective of this report is to empirically investigate the nature of ownership of public equity by institutional investors in the region with a view to shed light on the role institutional investors in capital markets and to investigate mechanisms that could encourage better demand for market integrity and corporate governance by the investor community. To this end, an ownership database of MENA listed companies was developed to allow for a detailed analysis of the holdings by local and foreign institutional investors by type, ownership and other key features.

METHODOLOGY

Scope and geographic coverage

In line with the objectives of the research project, we sought to compile a complete dataset of ownership data on all companies with equity listed on stock exchanges of the Middle East and North Africa. *Ownership data on listed companies in the Middle East and North Africa is generally unavailable and tends to be unreliable* given that institutional investors do not report holdings and considering that there are considerable challenges in obtaining information on beneficial owners of listed companies. In addition, a number of markets in the region only require reporting of ownership above 10% which is higher than the internationally common 5% threshold.

For the purposes of the research, *approximately 1700[1] companies listed on 17 MENA exchanges were initially considered*. Subsequently, due to the lack of availability of reliable and complete data the sample was narrowed down to cover only the following, larger equity markets in the region: Bahrain, Egypt, Iraq, Jordan, Lebanon, Kuwait, Oman, Saudi Arabia, Morocco, Qatar, Turkey, Tunisia and the United Arab Emirates. Syria, Libya, Algeria and the Palestinian Authority were excluded from the analysis due to the lack of market data and considering the relatively small size of listed companies. [2]

Table 1 below illustrates the number of companies analysed from each market and their respective market capitalisation. Each of the jurisdictions included apart from the UAE has a single national stock market which simplified data collection.[3] It was decided not to examine the ownership of the entire sample due to data limitations, notably in terms of the completeness of ownership data, as well as the fact that the largest capitalised companies account for the vast majority of the overall market value in their respective markets.

In total, 600 of the largest listed companies in the region were selected for analysis as they account for 97% of the total market capitalisation of the selected markets. This implies that the remaining 668 firms represent only 3% of market capitalisation and hence their exclusion from the sample does not materially impact the overall results. For the exact breakdown of the firms selected from each market, please refer to the Table below.

Table 1. Scope of the data, as of March 2015

Stock Exchange	Total number of	Number of companies	% of companies	Market capitalisation of	Value held of the total	% of Value held analysed
Borsa Istanbul	309	127	41%	205	179	87%
Bourse de	89	36	40%	51	43	83%
Amman Stock	265	21	8%	19	14	71%
Bourse de Tunis	85	14	16%	6	4	70%
Egyptian	268	42	16%	50	34	67%
Bahrain Stock	48	19	40%	21	13	61%
Muscat Securities	130	20	15%	17	10	58%
Saudi Arabia	171	148	87%	518	301	58%
Dubai Financial	60	25	42%	85	48	57%
Iraq Stock	37	3	8%	0.5	0.3	56%
Abu Dhabi	66	39	59%	112	60	54%
Qatar Exchange	44	39	89%	181	87	48%
Kuwait Stock	224	60	27%	86	39	45%
Beirut Stock	29	7	24%	7	.8	11%
Palestine	49	0	0%	0	0	0%
Damascus	24	0	0%	1	0	0%
Bourse de Algiers	3	0	0%	0	0	0%

[1] For Saudi Arabia, UAE, Kuwait, Egypt, Tunisia, Qatar, Morocco and Turkey, we included all the listed companies available in Thomson Reuters. For the other markets, the largest capitalised companies are added in the sample: for Jordan, this included the top 100; for Bahrain, the top 40; for Oman, top 30 companies, etc..

[2] Arab companies listed on exchanges outside the region (i.e. London Stock Exchange) with no corresponding domestic listings (i.e. in the absence of a dual listing) were equally excluded.

3 In Iraq, a second stock exchange was launched in Erbil in 2015, however as it did not exist at the time of the study and as it does not have any listings to date, it was not considered as part of the study.

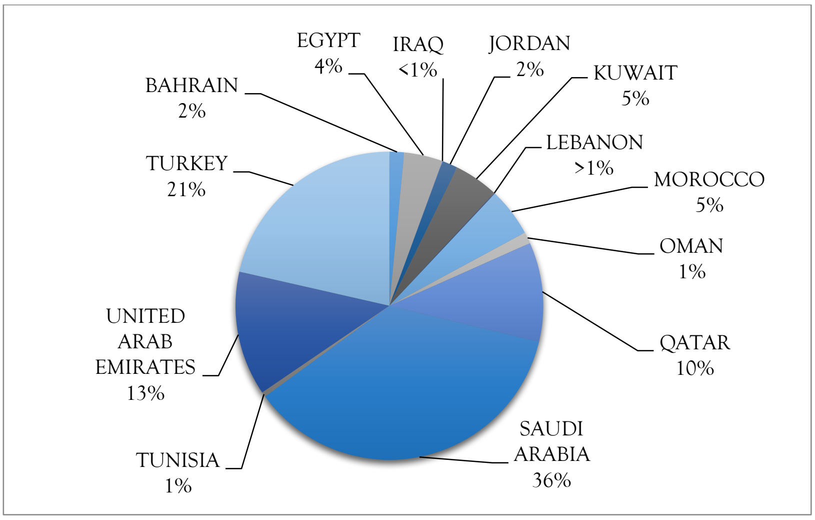
Notes: All listed companies are not covered in our sample due to database limitations.

Source: Thomson Reuters, Zawya, country stock exchange websites.

As can be seen from the above Table, the value of the holdings covered relative to total country market capitalisation in our sample varies by country. The most well represented countries in terms of market capitalisation relative to total market capitalisation are are Turkey, Morocco and Jordan.[4] *For the largest 600 largest listed firms, ownership information corresponding to 61% of the value held was collated from various sources.* The remaining 39% corresponds to free float and to a minor extent, ownership information not reported or not available publicly.

T*he ownership data collected is representative of the region's exchanges and the largest corporates*, however considering the large variance in the market capitalisation of the region's exchanges, the 600 firms analysed are skewed towards larger firms located in larger equity markets including Saudi Arabia (36%), Turkey (21%), UAE (13%) and Qatar (10%). Of the USD $833 billion holdings in the region considered for the purposes of this analysis (from the overall universe of USD $1,363 billion valuation of all markets), following is the split of the holdings analysed: USD $300 billion represents Saudi, $179 billion Turkey, $109 billion UAE, $87 billion Qatar, $43 billion Morocco, $39 billion Kuwait, $14 billion Jordan, $13 billion Bahrain and $10 billion Oman. Tunisia, Lebanon and Iraq investors hold a total value of USD $5 billion. The value of holdings as a percentage of the total value held in the region considered for this report is captured in Figure 1 below.

Figure 1. Value of Holdings, as % of the total



Source: Thomson Reuters, 2015.

DATA SOURCES AND CLASSIFICATION

Ownership and other data required for our analysis was collected from multiple sources, principally Thomson Reuters, completed by Factset for which full data was not available.[5] *A key challenge in analysing available ownership data in the region is the nature of investor classifications. Investors are often categorised based on the definitions of data providers that do not always reflect their provenance and their engagement strategy*, which was the ultimate interest of this research. Data was collected as of end of 2014.

[4] Given that the MKK (Central Registry Agency of Turkey) made the necessary data available and considering that it was better than data available through other data providers, we used this data. Aside from the fact that a different dataset was used for Turkey; within the Thomson Reuters database, the country with the best data being available is Morocco with 83% of ownership information available.

[5] For Turkey, the investor name, origin and ownership were obtained from the Central Registry Agency (MKK) based on a confidentiality agreement and corroborated with data (i.e. market capitalisation, value of holdings, etc.) from the Thomson Reuters database.

To address this challenge, investor classifications provided by data providers were reviewed and re-classified to reflect the ultimate origins of institutional investors. For example, a number of government pension funds were classified only as "government" which does not allow measurement of the extent of the investments of pension funds in MENA capital markets.

In order to be able to arrive at a dataset which would allow to classify each investor by type (i.e. pension fund, investment fund, etc.), provenance (i.e. domestic, Arab, international), and sources of funding (i.e. government or private sector), ownership classification was reviewed and manually re-classified according to investor categories below:

- Government and sovereign wealth funds
- Family offices, groups and endowments
- Banking institutions
- Non-financial corporations
- Pension funds
- Insurance companies
- Alternative investors and
- Asset managers

These categories reflect the nature of institutional investors present in the region. For instance, whereas Exchange Traded Funds (ETFs) is a large and growing category of institutional capital in developed counties, ETFs are minor investors in the region and are indeed not authorized in all jurisdictions. Likewise, although alternative investors such as hedge and private equity funds represent a growing percentage of market capitalisation in developed markets, considering that their participation in MENA markets is negligible, these investors are grouped under the category "alternative investors" without further differentiation among them.

The following Table provides further detail in the breakdown of investors by type and origin. Most investors were manually classified as private or government-backed, a subtlety which is not addressed by data providers and which is important in order to understand the scope and mechanisms of government control in MENA capital markets. The complexity of investor classifications allows to analyse data for the region and to conduct country comparisons to highlight regional differences.

Table 2. Investor Types

Investor Type	**Description**	**Investor origin**	
		Government	Private
Government and sovereign wealth funds	Covers all mechanisms of state ownership in listed companies, including not only direct stakes by the state but also holdings by SWFs, state-owned banks, pension funds and insurance companies.	Yes	No
Family offices, endowments and holding companies	Denotes substantial shareholdings by individual investors above 5% whereas all investments below this threshold are considered as free float	No	Yes
Corporations	Denotes investments by non-financial corporations whether privately or state-owned	Yes	Yes
Banking institutions	Covers all direct investments by banking institutions excluding their asset management branches	Yes	Yes
Insurance companies	Refers to investments by insurance companies whether private or state-owned	Yes	Yes
Pension funds	Refers to investments by pension funds whether private or state-owned	Yes	Yes
Asset managers	Refers to direct investments registered in the name of an asset manager even if the latter is a bank subsidiary	No	Yes
Alternative investors	Includes hedge funds, private equity, investment trusts and venture capital funds	No	Yes

Investment funds	Refers to mutual funds and other collective investment schemes and instruments	No	Yes

Notes: For Turkey, it is not possible to separate investors as private or public according to the data from MKK. We therefore add another category for Turkey called "other" for all the investor types excluding family offices and government investors. In the case of Turkey, for these two categories, we use the data from Thompson Reuters where have the public/private investor information. In the Gulf countries, we consider investments by the state as separate from those of the ruling families which are considered as private investments or as investments by family offices if exceeding the 5% threshold.

A certain degree of imprecision in the ultimate beneficial ownership of investors is inherent in this categorisation considering that pension funds and insurance companies invest in mutual funds. The following sectoral classifications were used based on Thomson Reuters industry definitions (refer to Table 3 below).

Table 3. Sectoral definitions

Economic sector	**Business sector**	**Industry group**
Energy	Energy	Coal
		Oil and gas
		Oil & Gas-Related Equipment and Services
		Renewable Energy
Basic Materials	Chemicals	Chemicals
	Mineral Resources	Metals & Mining
		Construction Materials
	Applied Resources	Paper & Forest Products
		Containers & Packaging
Industrial	Industrial Goods	Aerospace & Defence
		Machinery, Equipment & Components
	Industrial Services	Construction & Engineering
		Diversified Trading & Distributing
		Commercial Services & Supplies
	Industrial Conglomerates	Industrial Conglomerates
	Transportation	Air Freight & Courier Services
		Airline Services
		Marine Services
		Transportation, Ground
Cyclical Consumer Goods & Services	Automobiles & Auto Parts	Automobiles & Auto Parts
	Cyclical Consumer Products	Textiles & Apparel
		Homebuilding & Construction Supplies
		Household Goods
		Leisure Products
	Cyclical Consumer Services	Hotels & Entertainment Services
		Media & Publishing
	Retailers	Diversified Retail
		Specialty Retailers
Non-Cyclical Consumer Goods & Services	Food & Beverages	Beverages
		Food & Tobacco
	Personal and Household Products and Services	Personal & Household Products & Services
	Food and Drug Retailing	Food & Drug Retailing
Financial	Banking & Investment Services	Banking Services
		Investment Banking & Investment Services
		Diversified Financial Services
	Insurance	Insurance
	Real Estate	Real Estate Operations
		Residential & Commercial REITs
	Investment Trusts	Investment Trusts
Healthcare	Healthcare Services	Healthcare Equipment & Supplies

		Healthcare Providers & Services
	Pharmaceuticals & Medical Research	Pharmaceuticals
		Biotechnology & Medical Research
Technology	Technology Equipment	Semiconductors & Semiconductor Equipment
		Communications Equipment
		Communications & Office Equipment
	Software & IT Services	Software & IT Services
Telecommunications Services	Telecommunications Services	Telecommunications Services
Utilities	Utilities	Electric Utilities
		Natural Gas Utilities
		Water & Other Utilities
		Multiline Utilities

Part I. Overview of MENA capital markets

Institutional infrastructure

While capital markets in the Middle East and North Africa have developed impressively in the past two decades, spurred by privatisations and initial private offerings, they have not been subject to empirical research in terms of their ownership. This can be explained by their relatively small market capitalisation and difficulties in accessing information as some countries have only recently introduced reporting requirements in English and in accordance to internationally accepted disclosure standards. As larger markets of the region (i.e. GCC markets, Egypt and Turkey) mature, the quality of public information provided is gradually improving.

The regulatory and oversight capacity of securities regulators and stock exchanges in the region has grown remarkably in recent years, especially considering that in most markets securities regulators are relatively recent entities. Kuwait and Lebanon were the last countries of the region to establish a dedicated securities regulator in 2010 and 2011, respectively (refer to Table 4). Today, in all countries except for Bahrain and Egypt[6], the regulation and oversight of listed companies lies predominantly with the securities regulators.

Table 4. Regulators of Public Equity Markets in the MENA region

Country	Securities regulator	Date of establishment	Composition of the Governing Organ				
			Members Including Chair	Government	Central Bank	Other (public)	Other (private)
Algeria	Commission d'organisation et de surveillance des opérations de bourse (COSOB)	1993	6	3	1	1	1
Bahrain	Central Bank of Bahrain (CBB)	2006	N/A	N/A	N/A	N/A	N/A
Egypt	Egyptian Financial Supervisory Authority (EFSA)[1]	2009	9	4	1	0	4
Iraq	Iraq Securities Commission (ISC)	2004	5	5[7]	0	0	0
Jordan	Jordan Securities Commission (JSC)	1997	5	No	No	No	No
Kuwait	Kuwait Capital Market Authority	2010	5	N0	No	No	No
Lebanon	Lebanon Capital Market Authority	2011	7	7	2	5	0
Morocco	Autorité Marocaine du Marché des Capitaux	1993	Variable	N/A	N/A	N/A	N/A
Oman	Oman Capital Markets Authority (CMA)	1998	9	5	1	0	3
Palestinian Authority	Palestine Capital Market Authority (CMA)	2004	7	2	1	1	3

[6] Bahrain has a single regulator model and hence capital market regulation and supervision activities are undertaken by the Central Bank of Bahrain and the Ministry of Industry and Commerce. No dedicated securities regulator has been established. The Egyptian Financial Services Authority (EFSA) has supervision powers over non-bank financial instruments beyond securities markets.

7 In Iraq, the Chairman and Vice Chairman are full time posts, the other 3 commissioners can hold other jobs.

Qatar	Qatar Financial Markets Authority (QFMA)	2005	7	3	2	2	0
Saudi Arabia	Saudi Capital Markets Authority (CMA)	2003	5	5	0	0	0
Tunisia	Conseil du marché financier (CMF)	1994	10	2	1	3	4[8]
Turkey	Capital Markets Board	1985	7[9]	7	0	0	0
United Arab Emirates	Dubai Financial Services Authority	2004	10	1	0	7	3
	Emirates Securities and Commodities Authority (ESCA)	2000	6	_	-	-	-

Source: Websites of securities regulators and their annual reports.

The enforcement capacity of regulators has been gradually improving, driven by market developments such as the 2006 instability in Gulf equity markets as well as the growing institutionalisation and experience of securities regulators. The participation of regulators in international dialogue (e.g. IOSCO, OECD) and the establishment of regional structures such as the Union of Arab Securities Authorities (UASA) has also been useful in improving enforcement.

The Saudi CMA is arguably the most rigorous in the region in publishing their enforcement actions against listed companies, most of them related to corporate governance breaches. Some high profile enforcement cases such as Damas in the UAE highlight that appetite for enforcement is growing, although regulators remain reluctant to impose public or to raise the fines so that they act a serious deterrent (OECD, 2015). Some regulators, notably those operating out of the financial centers, are limited in their enforcement capacity by their jurisdiction.

The evolution of local security frameworks reflects not only the strengthening of securities regulators' capabilities but also the growing complexity of financial instruments being introduced in some markets and their growing supervisory experience. *In recent years, securities regulation frameworks, company laws and listing requirements have been subject to revision across the region as governments consider capital markets an integral part of broader financial sector development strategies.* The establishment of financial centers has placed a further emphasis on orderly securities markets.

The drive to improve the regulatory frameworks for listed companies was also motivated by the need to improve the transparency of local markets for foreign and local investors considering the historically low levels of public disclosure provided. The introduction of extensible business reporting language (XBRL) in the UAE and Saudi Arabia, the establishment of public disclosure platforms in Turkey and the UAE, the facilitation of immediate disclosure by exchanges such as the Egyptian Exchange (EGX) and the Palestine Securities Exchange (PSE) go hand in hand with improving the reporting obligations for listed companies.

The development of corporate codes has progressed rapidly in the region and recent years have seen a move towards "comply-or-explain" type provision and in some markets (i.e. Saudi Arabia, Oman and Turkey) a combination of comply-or-explain and binding provisions. To date, 11 out of 17 jurisdictions in the region have adopted a "comply-or-explain" corporate governance code and there has been a steady movement towards further tightening of provisions of these codes: whether in Egypt with a move from a voluntary to a "comply-or-explain" type code in 2016 or in Saudi Arabia where some provisions of the corporate governance code were moved from "comply-or-explain" to mandatory over the years.[10]

8 Three members must be chosen according to their qualifications, the law does not specify if they represent the public or the private sector.

9 In Turkey, at least one board member should have 10 years of experience at the Capital Markets Board of Turkey and at least one board member should have at least 10 years of experience in private sector capital market institutions (Art 119/2 of the Capital Markets Law).

10 In particular, countries of the Gulf Co-operation Council have in recent years moved towards mandating a number of key governance provisions, leaving less flexibility for companies to provide explanations of their governance regimes.

While in most countries, the majority of governance-related provisions are contained in corporate governance codes, recent revisions of company legislation (i.e. Kuwait in 2013, UAE in 2014 and Saudi Arabia in 2015) and listing requirements have resulted in tightened governance requirements for listed firms and for privately-held companies. For instance, in Kuwait, the Companies Law passed in 2013 introduced a range of investor protections such as the right by the Ministry of Industry and Commerce to appoint an auditor in specific circumstances and generally facilitating the exercise of shareholder rights such as timely access to shareholder registry.

As stock exchanges are gaining greater regulatory powers, listing requirements have been revised in a number of markets to render capital markets more attractive for capital raising.[11] The logic of these revisions is not necessarily consistent and reflects not only national regulatory frameworks and gaps that need to be addressed, but also the division of regulatory responsibilities between stock exchanges and securities regulators.[12] For instance, in Egypt listing rules are regularly amended to include provisions of the governance code in order to render them binding, in Kuwait new listing rules were issued in 2011 as part of a broader capital markets reform that followed the introduction of the CMA.

A notable trend across the region has been the introduction of differentiated standards for large and mid- or small-cap firms with a view to facilitate their listing. NILEX was the first dedicated SME exchange launched in the region in 2010 in Egypt, following which SME listing tiers were launched on the Dubai Financial Market (DFM) and Qatar Exchange (QE) in 2013 and 2015, respectively. So, far these efforts have unfortunately not resulted in the development of robust equity markets for growth companies. For example, in Egypt, NILEX has so far attracted approximately 30 companies with a combined market capitalisation of less than 1% of the overall exchange capitalisation (EGX).

The tightening of governance regulations and the introduction of rules aiming to facilitate capital raising for family firms and small- and medium size enterprises have highlighted a fundamental tension that policymakers in the region face. *While rigorous governance standards are important to attract foreign investment to the region – if they are set too high - they can arguably serve as a deterrent to issuance, limiting the role of public equity markets as an avenue for corporate financing.*

Considering this tension in objectives, policymakers appear to have taken a dual approach, by continuing to raise overall governance and market standards for large cap firms, while at the same time facilitating equity issuance by families and SMEs by making exemptions for these companies. The review of listing rules is accompanied by other measures intended to facilitate the IPOs in the region, such as for example, the reduction in minimum percentage of capital to be listed in an IPO from 55% to 30% of outstanding equity in the UAE.

Listing trends

These measures are intended to revitalise equity markets in the region which have not in recent years attracted many initial public offerings (IPOs) or secondary public offerings (SPOs).[13] *Following years of rapid development of equity markets, supported by a flow of disposal equity stakes in state-owned companies, the issuing pipeline in the region in the region has been relatively weak in recent years* (refer to Figure 2 below).

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[11] Unlike markets such as the United States, where listing requirements include a number of key governance provisions concerning for instance board independence requirements, listing requirements in the region are not a major source of corporate governance recommendations. That said, significant differences can be noted in terms of IPO requirements regarding quality of due diligence to be provided, sponsorship requirements, risk management systems and processes (Amico, 2013).

[12] In the MENA region, considering that most stock exchanges are generally state-owned, they have few self-regulatory powers with the result that those generally rest with national securities regulators. NASDAQ Dubai was last to transfer listing authority to the DFSA. Saudi Arabia's CMA is currently also in the process of transferring additional regualatory powers to Tadawul.

[13] Egypt stands out as a market that has been active in terms of capital increases, with a third of listed companies (i.e. 72 firms undertaking one in 2014).

Apart from Saudi Arabia where issuance has been robust over the years, markets in post-revolution countries such as Tunisia and Egypt have also been relatively active compare to the regional average.

Besides a few large disposals of equity stakes in state-owned companies such as the National Commercial Bank in Saudi Arabia – the second largest IPO after the Chinese Alibaba in 2014 –privatisation transactions have seen a rapid decline.[14] *Further disposal of stakes through public markets is currently not anticipated given that major stakes in large SOEs have already been sold in 1990s and that there is currently no political appetite for further privatisation of state-owned companies.* This is the case across the region in countries as diverse as Oman, Egypt and Saudi Arabia.

Figure 2. IPO volume and number in the last 5 years

	Number of issues	Gross Proceeds ($ million)
Egypt	15	1870
Jordan	6	38
Kuwait	5	332
Morocco	7	462
Oman	7	524
Qatar	4	4,469
Saudi Arabia	33	14,464
Turkey	92	3,305
United Arab Emirates	31	9,392
Total	**200**	**34,858**

Source: Thomson Reuters Deal Analytics, years 2011- 2015.

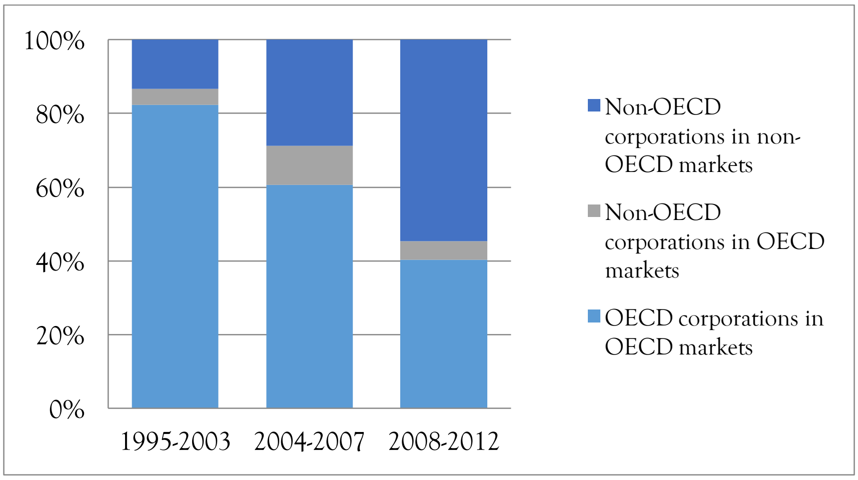
The leitmotif of low issuance in the region is not only the slowdown in the privatisation momentum across the region, but also the inability of regulators and exchanges to attract family firms to public equity markets, despite introducing lower requirements for family firms as well as SMEs. The challenge to attract family-owned businesses to public equity markets is a story of the entire MENA region and is hence one of the common objectives of local exchanges and regulators, though the mechanisms they have adopted to address this challenge have been varied. Arguably the only MENA jurisdiction that has succeeded in attracting family companies to list their equity is Turkey, where ownership by family offices accounts for 42% of the market capitalisation.

The low volume of IPOs in the region is in fact consistent with trends in developed markets, where both the number and the size of transactions have declined over the past decade. Whereas in the period 1993-2000, the OECD area had an annual average of about 1170 IPOs raising on average USD $133 billion annually, during 2001-2011, this number fell to approximately 670 IPOs raising $70 billion USD annually (OECD, 2013). *While consistent with the performance of developed markets which have been affected to greater extent by the global financial crisis, the low capacity of MENA exchanges to finance corporate growth is notable when compared with the performance of emerging markets.*

As the amount of capital raised by OECD companies fell by half over the past decade, the relative share of capital going to companies in non-OECD countries has grown. In particular, during the period following the financial crisis, equity flows to emerging market companies have increased further with the result that during the period 2008-2011, 63% of all new capital globally was destined to companies from non-OECD countries (ibid). *From initially providing less than 20% of all equity capital raised in the world, non-OECD markets have in the last 4 years provided almost 60% of all equity raised through initial public offerings during 2008-2011.* Figure 3 below demonstrates the relative share of equity raised through initial public offerings by corporations and its distribution between OECD and non-OECD equity markets.

[14] Disposal of stakes through the public equity markets was never the preferred method of privatisation in the region, with trade sales dominating (OECD, 2012).

Figure 3. Global shift in equity markets



Source: OECD calculations, based on data from Thomson Reuters, Datastream, stock exchanges' and companies' websites. Reproduced from Corporate Governance in Current Equity Markets, Celik and Isaksson, 2012.

The global IPO re-bound which characterised 2014-2015 has largely not been reflected in the MENA region, especially considering the volumes seen in the previous 5-10 years. Between 2005 and 2010, over 1500 companies were listed on MENA markets, though quite a number of them were subsequently delisted (World Bank, 2012).[15] In 2012, 11 IPOs were conducted in the region raising close to $1.2 billion USD. In 2015, the region hit its lowest IPO activity with 18 listings, raising a total of USD $4.2 billion (Thomson Reuters, 2015). Although it was widely expected that high market valuations in some marketplaces (especially in UAE and Qatar preceding their upgrade), combined with recent measures to dilute listing standards for family firms, would encourage them to list some stakes, this prediction has so far not materialised.

As local issuance has been relatively timid, a number of large blue chip firms have chosen to list abroad, principally on the London Stock Exchange, which currently has close to 30 MENA firms with listed equity (direct and through Global Depositary Receipts). This is perhaps the best illustration of the search for sizeable and stable institutional capital by corporates in the region and contradicts the thesis that bank finance provides sufficient funding for large firms. Interestingly, while MENA corporates have shown willingness to issue debt domestically, their appetite for foreign debt listings has not been matched by their equity listings.

Gradual opening of markets

As a result of slow growth of issuance, MENA equity markets – with the exception of Saudi Arabia and Turkey - are individually seen as being too small to attract the interest of global institutional investors (and by extension their asset managers). The shift to index investing that has characterised investment approaches of institutional investors domiciled in developed markets, further exacerbates the movement away from smaller markets and companies that might be listed on them.

MSCI, one of the largest providers of stock market indices, currently considers only 300 companies as part of its Arabian indices out of the total listed universe, based on selection criteria that is underpinned by market accessibility criteria, which includes openness to foreign ownership, ease of capital inflows/outflows, efficiency of the operational framework and stability of the institutional framework (MSCI, 2015). The number of firms tracked by the index providers already takes into account the upgrade of the UAE and Qatar to the "emerging markets"[16] and the opening of Saudi Arabia to qualified institutional investors announced by the Capital Market Authority in 2015.

15 Especially in Egypt, where in excess of 700 companies were delisted in early 2000 (OECD, 2014).

16 Only three markets in the region are qualified as "emerging markets": UAE, Qatar, and Egypt. Morocco was reclassified as a frontier market in 2013 and Saudi Arabia is considered as standalone market not classified as either frontier, emerging or developed. Reclassification is currently expected for 2017-2018.

As demonstrated by Table 5 which provides an overview of MENA equity markets, *the number of firms considered and tracked by foreign investors in the region is rather low, reflecting their small size, low free float, liquidity as well as foreign investor limitations which characterise the Arabian Gulf markets*. While market capitalisation to GDP tends to be quite high especially in Turkey and the Arabian Gulf, this figure hides the fact that listed markets are dominated by financial sector firms.

Table 5. Overview of MENA capital markets

Stock exchange	Abbreviation	Exchange ownership	Market classification	Number of listed companies	Capitalisation of listed companies (USD mil)	Market capitalisation /GDP (%)	Turnover (%)
Abu Dhabi Securities Exchange	ADX	State-owned	Emerging	104	93,767	26	16
Amman Stock Exchange	ASE	Public institution	Frontier	247	27,183	93	14
Bahrain Stock Exchange	BSE	State-owned	Frontier	44	17,152	66	1
Beirut Stock Exchange	BSE	Public institution	Frontier	10	10,164	26	4
Borsa İstanbul	BIST	Public institution	Emerging	363	247.6	30	
Bourse de Casablanca	CSE	Mutualised	Frontier	75	60,088	61	10
Bourse de Tunis	BVMT	Mutualised	Frontier	57	9,662	21	11
Dubai Financial Market	DFM	State-owned[17]	Emerging	60	93,742	99	48
Egyptian Exchange	EGX	Public institution	Emerging	231	48,683	21	34
Iraq Stock exchange	ISX	Mutualised	Frontier	85	2,874	4	N/A
Kuwait Stock Exchange	KSE	State-owned	Frontier	206	10,869	57	19
Muscat Securities Market	MSM	State-owned	Frontier	136	19,719	27	13
Nasdaq Dubai	ND	State-owned	Emerging	10	27,336	N/A	N/A
Qatar Exchange	QE	State-owned[18]	Emerging	42	125,413	72	19
Saudi Stock Exchange Tadawul	SSE	State-owned	Not classified	150	338 873	59	85

Source: OECD, 2012, Thomson Reuters, 2015, MSCI, 2015, Zawya.

In addition, few investors, foreign or local, have the appetite to track and invest in small and mid-cap companies in the region, especially considering that they are not subject to regular and diverse analyst coverage and that investors in the region do not have the capacity or incentives to track them. By some estimates, only about 12% of companies outside the main benchmark are followed by analysts (Elalfy, 2013). In Egypt, only 20 listed companies are followed by 5 or more analysts and 169 companies (73% of all listed companies) have no analyst coverage at all.

[17] 20% of the Dubai Financial Market shares are listed on its own market.

18 The Qatar Investment Authority holds 80% of the Qatar Exchange's shares, the remaining 20% are held by the NYSE Euronext.

A number of Gulf-based enterprises such as SABIC, Al Rajhi Bank and Qatar National Bank feature in the Financial Times' Global 500 list, highlighting that among listed companies, some regional champions are emerging on a global scale. On the other hand, large blue chip stocks often represent banks and state-owned enterprises which typically have key block holders and high investment barriers for foreign investors, hence representing little interest to them.

As a result, the number of stocks available for portfolio investment is low considering investment restrictions present in a number of countries. That said, the slow opening of Gulf markets to foreign investors – notably the opening of the Saudi Stock Exchange, Tadawul - has the potential to herald a long-term change in the ownership of these markets especially considering that the it is larger than all GCC markets combined. In Qatar, an Emiri decree raised ownership limits in listed companies in 2014 to up to 49%[19], from the previous limit of 25% and a number of companies such in Qatar have moved to raise foreign ownership limits in their by-laws.

Given the recent nature of these changes, it is difficult to estimate their longer term impact on the ownership structures of listed firms or their contribution to improving market. For instance, some research has expressed scepticism regarding longer term impacts of the upgrade of MENA markets to the emerging market status (Saidi et al, 2012). This is supported by evidence of other markets which suffered adverse consequences as a result of market upgrades. *Fundamentally, the ownership of GCC listed companies has been slow to change even after the relaxation of these limitations.*

Potential for growth

There is a significant potential for growth of capital markets in the region both by encouraging the listing of large cap companies and by facilitating equity financing to small, high growth companies, thereby bringing the composition of MENA equity markets closer to the composition of their underlying economies. While the emphasis thus far has been on bringing family conglomerates to list a share of their capital or at least of their subsidiaries, little attention has been paid to enterprises at early stages of development (i.e. growth companies). As demonstrated by evidence from developed markets, creating dynamic IPO markets for high growth companies is not only a matter of lowering barriers to listing for SMEs (Vermuelin, 2015).

Considering the importance of entrepreneurship to employment creation in the region, a more nuanced understanding of obstacles to listing is necessary. It ought to be specific to the type of the company as obstacles for listing by high growth, smaller cap companies are substantially different to challenges seen by larger, established family firms. This effort is especially timely considering that over the past 5 years, regulators and stock exchanges have already experimented with measures to attract listings and they did so in diverse environments and time periods.

In the United States for instance, in 1993-1997 period, small companies constituted 58% of all IPOs on average, while by 2014, they accounted for only 17% of the total. This slump prompted initiatives such as the JOBS Act in the United States, motivated by the significant drop in IPO activity in the US over the past decade. The JOBS Act aims to attract growth companies to the market by exempting them from some corporate governance requirements and allowing them to solicit investors easier. *Initiatives adopted globally to address the slump of listings of SMEs/growth companies globally would be relevant to consider, as they apply to the MENA ownership and regulatory context.*

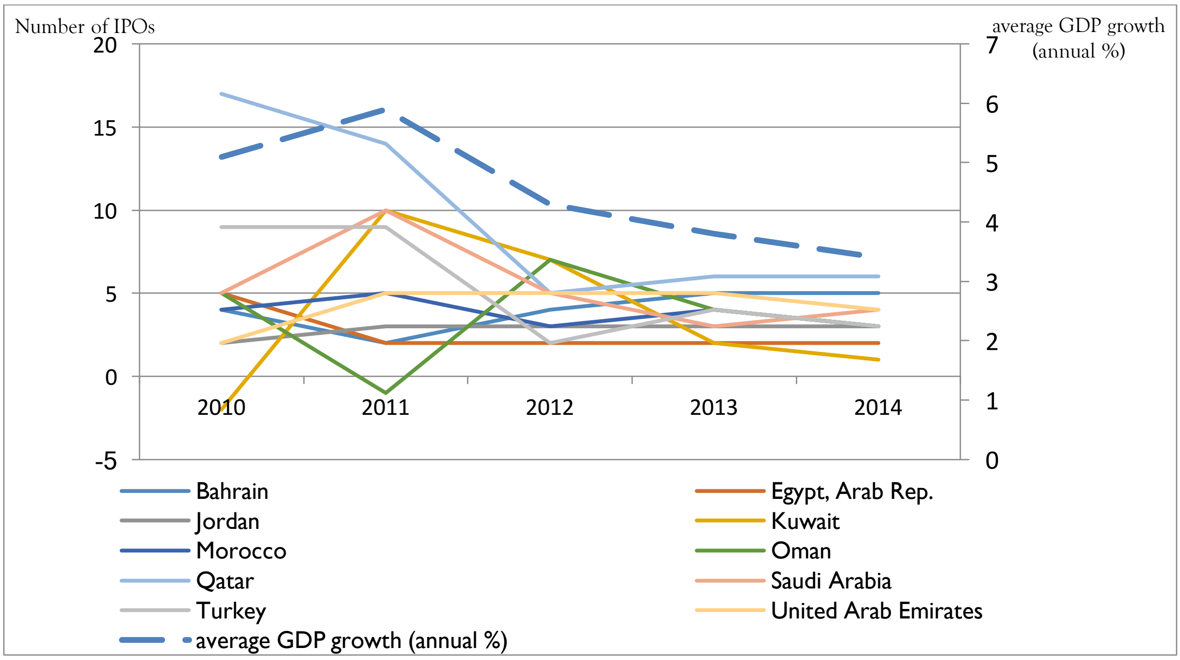
The MENA region has significant potential to list large corporates, provided that political stability coincides with a period of strong macro-economic fundamentals. While for governments the rationale for listing may be complicated by specific political calculus, family-owned firms many of which are currently transitioning to second generation owners could be convinced based on a positive track record of listing similar firms (Economist, 2015).

Yet, in the past few years, the speed of development of capital markets in the region has generally not kept up either with corporate financing needs or with economic growth, as highlighted by Figure 4 below, though some markets such as Saudi Arabia and Egypt have had a stronger IPO pipeline than the rest of the region.

19 The law also leaves the door open to majority foreign ownership of listed firms provided they obtain obtain approval from the Qatari cabinet. As part of the same decree, GCC nationals will be given the same rights as Qatari nationals.

Furthermore, equity markets in the region unlike developed markets such as the UK and the US do not facilitate the financing of growth companies that may be characterised by high intangible assets, limited historical performance and presence in non-traditional sectors. As a result, the rate of new firm creation in the region is the lowest globally, apart from Sub-Saharan Africa.

Figure 4. New listings and economic growth



Source: Thomson Reuters, World Databank.

While it may be tempting to argue that capital market development is not crucial considering that the level of sophistication of the banking systems, evidence provided by MENA-based firms listed on exchanges outside the region speaks to the contrary. *The London Stock Exchange (LSE) currently has approximately 30 MENA-domiciled firms listed on the Main Market and through Global Depositary Receipts*. This confirms the fact that local firms are looking for equity capital and are willing to abide by higher market requirements such as the LSE listing rules and the UK Combined Code, considered one of the most rigorous worldwide.

In light of the sizeable financing needs in the region, not least in infrastructure, developing capital markets remains a priority in most countries of the region. Their expansion is contingent on the success of attracting companies to public equity markets which requires both novel solutions and addressing known challenges. One of the known challenges to attracting firms to listing is the availability of institutional capital. While developed capital markets have over the last 50 years grown increasingly institutional in nature, the vast majority of MENA markets remain retail, especially in terms of trading activity.

Part II. Ownership landscape in the MENA

The participation of institutional investors in public equity markets globally has grown tremendously to become a defining feature of all developed markets. While in the mid-1960s, physical persons held as much as 84% of all publicly listed stocks in the United States, today they hold less than 40% (Celik and Isaksson, 2013). Likewise, in the UK, the portion of public equity held by physical persons decreased from 54% to 12% over the last 50 years, while institutional investors are estimated to hold 70% of all listed equity. In Japan, only 18% of all public equity was held by physical persons in 2011. This institutionalization of public equity markets, coupled with the diversification of asset owners (to include for example, hedge funds), has been subject to significant research globally.

In the MENA region, capital markets continue to be dominated by retail investors especially in terms of the composition of trading, but also in terms of their underlying ownership. This is a consequence of several factors, notably the concentration of wealth in the hands of few high net worth individuals, the slow development of the domestic institutional investor industry and the relatively weak interest in MENA markets by large foreign institutional investors. The fact that foreign institutional capital is not exposed to MENA equities is related to the fact that many of the region's markets are too small to attract foreign investors and that many of the larger blue chip stocks are closed to foreign investment.

Retail investors are estimated to account for 39% of ownership across the region and 42% in Saudi, 52% in Qatar, 55% in Kuwait, and 33% in Egypt. Their participating in trading is even higher. Although levels of retail investment in MENA are indeed higher than in developed markets, they are generally in line with other emerging markets such as China. Estimates of retail investment in the region are in fact exaggerated by the tendency to classify family owners as retail investors, whereas given their role in capital markets in the region, they should rather be considered as a separate category of institutional asset holders.

While retail investor dominance of MENA markets is known and considered as a key driver of market volatility[20], *the role of institutional investors as a source of long-term capital has not been unexplored and hence policies to attract them have so far not been impactful*. Understanding the actual and potential role of institutional capital is important for the future development of capital markets in the region not only from the perspective of augmenting investment flows towards MENA markets but also in terms of improving the quality of local markets, notably of their corporate governance.

Institutional investors' overview

The focus on retail investors in MENA markets has resulted in the lack of attention to existing sources of institutional capital. *Based on the compilation of ownership data for 600 largest listed companies in the region, the dominant role of sovereign investors and family offices as two largest sources of institutional capital stands ou*t, with the former holding over a third while the latter holding close to a quarter of the total value held by all institutional investors holdings in these firms (refer to Table 6 below).

While UAE (29%), Turkey (21%), and Kuwait (17%), followed by Egypt (9%) and Qatar (7%) accounts for the highest allocation of portfolio investments in absolute monetary terms, and when compared to market value, the following countries appear to be generating the strongest interest of institutional investors: Saudi Arabia (37%), Turkey (22%), UAE (13%), and Qatar (11%).

In terms of the market capitalisation, sovereign investors account for 41%, while family offices and holding companies for 26% of companies considered in the sample. Interestingly, corporations - the third source of institutional investment in the region - hold just over 10% of the total market capitalisation. These holdings a reflection of cross-ownership arrangements, listed subsidiaries and investments carried out by large state-owned enterprises in other corporates (e.g. SABIC investment in Saudi Arabia Fertilizers, Yanbu National Petrochemicals and in Saudi Kayan Petrochemical).

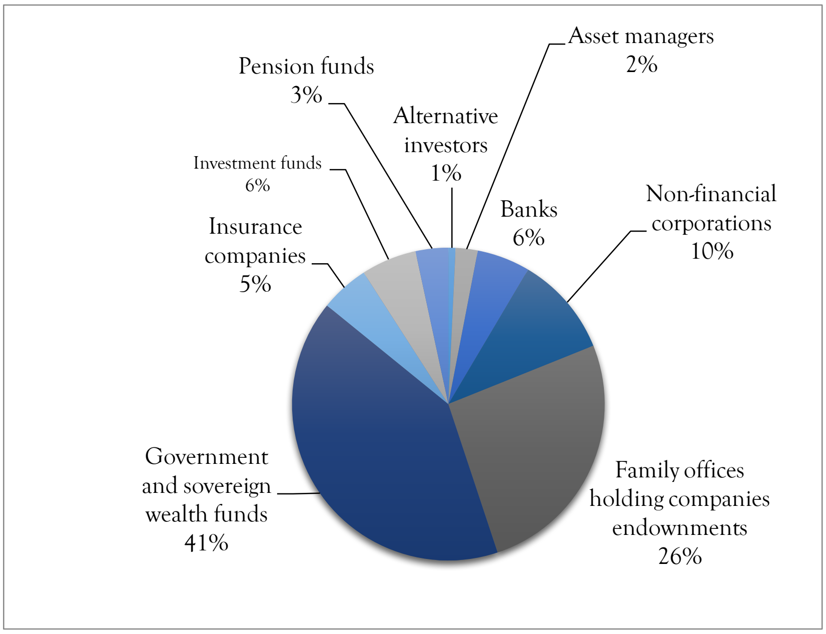
Whereas globally, investment funds are the single largest source of institutional capital with fastest growing assets under management, they are the fourth largest source of institutional capital in the region. The size of

[20] For instance, the Tadawul market index dropped by 30% during the stock market crash in 2006.

the MENA mutual funds industry was USD $60 billion as of December 2012, with almost 160 AMCs managing 865 funds. A number of markets such as Saudi Arabia have set the development of the mutual funds industry as a key objective and mechanism for the development of the capital market.

Also notable in the Figure below is the nascent role of pension funds and insurance companies which play a *key role in public equity markets in developed markets as the second and third largest source of institutional capital, respectively.* Unlike the OECD countries, where investors such as insurance companies and pension funds account for a dominant portion of ownership of public equity[21], these investors each account for just over 5% of the total holdings in the MENA region.

Table 6. Value of Holdings by Investor Type



Source: Thomson Reuters, 2015.

This is a reflection of the fact the *pension and insurance industry is relatively underdeveloped in the region.* For instance, private pension funds remain rare in the region and generally cover privileged employees of banks and insurance companies or members of professional associations (EBRD and World Bank, 2011). On the other hand, the insurance sector has been slow to develop due to the lack of compulsory insurance, weaknesses in the regulatory and supervisory regime and the predominance of state companies in some countries (ibid). Mutual funds have also been slow to develop in the region.

The level of the development of non-bank financial sector has been determining to its low exposure to public equities. The second factor limiting institutional investors exposure to public equities are national regulatory frameworks that restrict the exposures of different institutional investors to public equity more stringently than other jurisdictions, exacerbating the already conservative investment approaches of these investors. For instance, in Egypt, insurance companies may not allocate more than 5% of their investments in a given year to equity investments and cannot take a stake exceeding 20% in a listed firm (OECD, 2015).[22]

Pension and investment funds are also subject to similar portfolio allocation limits. In Egypt for example, 70% of the portfolio of all public and private pension funds is allocated to National Bank of Egypt (NBE) Investment Certificates, while equity investments account for less than 4% of assets under management. Likewise, equity investments of mutual funds stand at 5% of their total assets under management (AUM)

[21] In OECD countries, pension funds, investment funds and insurance companies have in the last decade more than doubled their total assets under management (Celik and Isaksson, 2013).

[22] That said, Egyptian insurance companies, unlike their peers in other MENA countries such as the UAE, are required by law to invest in domestic equities only unlike peers in other MENA countries such as the UAE which allow insurance companies to invest in foreign equities.

and less than 1% of the market capitalisation and – contrary to global trends – are in fact declining (Shawky and Amico, 2016). Partly reflecting this situation, only two of the largest ten institutional investors in the EGX are local (i.e. Misr Insurance and Misr Life Insurance).

The low levels of public equity investment by insurance companies, pension and investment funds stands in contrast with the evolution of portfolios of institutional investors globally. For instance, a recent OECD survey of 100 pension funds highlighted that an average portfolio was 52.1% invested in fixed income and cash and 31.5% in equities (OECD, 2014).[23] A review of the regulatory frameworks governing portfolio asset allocation of these investors could help increase their capital markets investments, diversify assets under management and potentially improve investment returns.

The almost insignificant role played by asset managers in public equity markets in the region is striking especially in the global context where in developed markets they have evolved as a class of institutional investors. Given the increasing outsourcing of asset management by large institutional investors such as sovereign wealth funds, insurance companies and pension funds, their size has risen quite spectacularly. Our data indicates that this global phenomenon is not reflected in the region's capital markets.

The potential for development of the asset management industry is significant given the high number of high net worth individuals and the size of domestic sovereign wealth funds.[24] Indeed, recent research demonstrates that MENA based SWFs are building internal asset management capacity to reduce spending on outside advisors. For instance, in June 2015, ADIA, the largest SWF in the region, announced that the amount of assets handled by external asset managers fell from 75% in 2014 to 65% in 2015. Based on current trends, it is plausible to suggest that this represents a longer-term trend where local SWFs will seek to build internal asset management capacity.

Alternative investors such as private equity and hedge funds appear to have the least significant role in public equity markets, with maximum 2% of overall value held in individual MENA markets. This is a reflection of the regulatory environment whereby a number of strategies commonly used by certain types of investors are not currently allowed in some MENA markets. For other types of alternative investors such as private equity funds, exit on public equity markets has not been the preferred route. In fact, there has been very few exits by PE investors (only 2 in Saudi Arabia as of 2016).

An interesting phenomenon is that in a number of companies, co-investment by different categories of institutional investors is common. For example, as demonstrated in Figure 7 which examines the example of the Saudi British Bank, the majority of shares are held by banks (56%), and the rest by family offices (31%) and insurance companies (14%). This example was selected given that it is representative of the ownership types in the region.

Table 7. Example: Saudi British Bank

Banks	56%
Family offices/endowments/holdings	31%
Insurance companies	13%
Total	100%

Source: Thomson Reuters, 2015.

[23] Pension funds based in Australia, South Africa, the United Kingdom and the United States had the largest allocations to listed equities.

[24] At the same time, the inherent tension is that the strategy of a number of financial centers in the region (i.e. Abu Dhabi Global Market, Qatar Financial Center) heavily relies on the attraction of global asset managers.

Origins of institutional investors

Further analysis of institutional investors highlights interesting characteristics regarding their provenance. As highlighted in Table 8 below, *local investors constitute a majority of investors in MENA capital markets with close to 80% of total holdings by institutional investors* (equivalent to USD $660 billion). Investments are driven primarily by government investors (41% of total investments in the region), followed by family offices (26%) and non-financial corporations (10%). While family offices are mostly local, private sources of domestic institutional capital are underdeveloped.

Though domestic and regional sources of institutional capital are fundamentally similar except for the role of banks, their allocation of investments is quite similar. *Contrary to common assumptions that the flow of portfolio investment is from capital-abundant GCC countries to oil-importing countries, our research does not support this hypothesis*. By volume, 20% of intra-regional investment is destined for Saudi Arabia, 16% in Morocco, 12% in Bahrain, 11% in Jordan, 10% for Turkey and Kuwait. In terms of the origin, regional investors are mostly from the UAE (27%), Qatar (18%), Lebanon (14%), Kuwait (11%), Jordan (10%), Bahrain (9%) and Saudi (7%).

Intra-regional investment portfolio flows account for only 6% of total investment. Intra-regional investment is dominated by sovereign investors, accounting for 31% of total intra-regional investment. This is significantly lower than the levels of intra-regional investment in other emerging market regions. For instance, in Asia, the share of intra-regional private portfolio investment increased from 15 to 23% between 2001 and 2013 (IMF, 2015), though it still stands at a third of the intra-regional portfolio investment in the European Union. These comparisons imply that initiatives to stimulate regional integration and facilitate regional portfolio investment flows have so far not succeeded, much like forays in regional trade and currency integration.

Foreign investors account for 15% of total value held by institutional investors in the region. Foreign investors are mostly present in the following investor categories: investment funds (37% of total foreign portfolio ownership), corporations (20%) and banks (17%). *Foreign investors, account for 14.5% of total institutional investment in the region which is lower than other emerging market regions.* European and North American institutional investors who are for instance the main source of foreign portfolio investment in Asia, are not for the moment active in the region. That said, *the largest investors in the region are US-based asset management companies* (i.e. Vanguard Group, BlackRock, and Templeton Asset Management).

While capital allocations of international institutional investors to emerging markets have grown significantly in recent years, the MENA region has not been a large recipient of these flows. Borsa Istanbul is the market whose share of foreign investors is the highest in the region (39% of the value held). As demonstrated in Figure 8 below, foreign investors invest in Turkey (57% of the total value held in the region), followed by Saudi Arabia (14%), Morocco (8%), Egypt (6%) and other Mena countries (15%).

Table 8. Holdings by Investor Type (as a % of total institutional investment)

Type of investor	Domestic	International	Regional	Total
Government/SWFs	38,04%	1,02%	1,96%	41,02%
Family offices/endowments, etc.	23,88%	0,78%	1,28%	25,93%
Non-financial corporation	6,76%	2,89%	0,71%	10,36%
Investment/mutual funds	0,36%	5,39%	0,00%	5,75%
Banks	1,25%	2,48%	1,72%	5,46%
Insurance companies	4,81%	0,12%	0,13%	5,06%
Pension funds	3,35%	0,03%	0,00%	3,38%
Asset managers	0,74%	1,32%	0,23%	2,28%
Alternative investors	0,25%	0,50%	0,00%	0,75%
Total	**79,43%**	**14,53%**	**6,03%**	**100,00%**

Source: Thomson Reuters, 2015.

The Table above also highlights that *some categories of institutional capital are virtually absent domestically*. For instance, local investment funds account for 0.4% of holdings analysed and local “alternative” investors for only 0.2%, figures that are extremely low when compared to developed markets where investment funds had the largest public equity allocations of all investors, with close to USD $30 trillion under management in 2011 (Celik and Isaksson, 2013). Considering that the majority of asset managers (58%) are foreign, equity holdings of local asset managers are also extremely low at 0.7%, whereas holdings of foreign asset managers are slightly higher at 1.3% of total holdings analysed.[25]

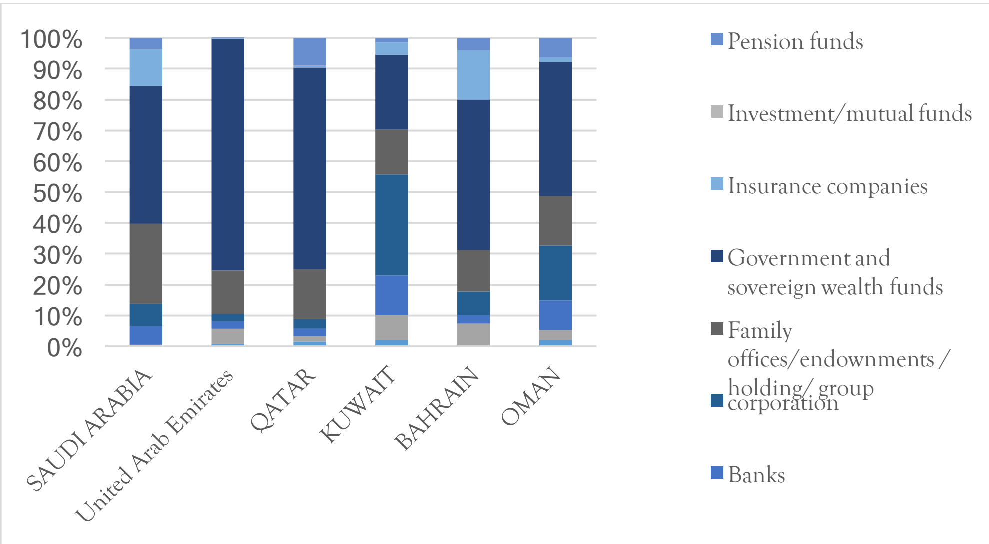
Likewise, investment funds are essentially all foreign at 94% of the investment category and their investments account for 5.7% of the total institutional capital in the region. Their investment allocations are focused entirely on Turkey. This reflects at once a wider concentration of foreign institutional investment in some MENA countries and the fact that foreign fund managers track Turkey more than other MENA markets.[26] These figures highlight an important opportunity to attract passive investment flows of investment funds to the region.

Regional comparisons

The segregation of data on Gulf-based and other markets in the region demonstrates a number of sub-regional differences. While sovereign investors play a dominant role in the region, in GCC countries sovereign investors are estimated to hold 53% of the overall value held by institutional investors in these markets, whereas in other markets of the region this figure stands at 25%. Another interesting difference is that *non-financial corporations have much higher holdings outside the GCC* (23%) while their holdings in GCC markets are only 8%. On the other hand, the role of family offices remains relatively unchanged between the two sub-regions at 21% in GCC markets.

Figure 5. Value Held, by Investor Type (%)

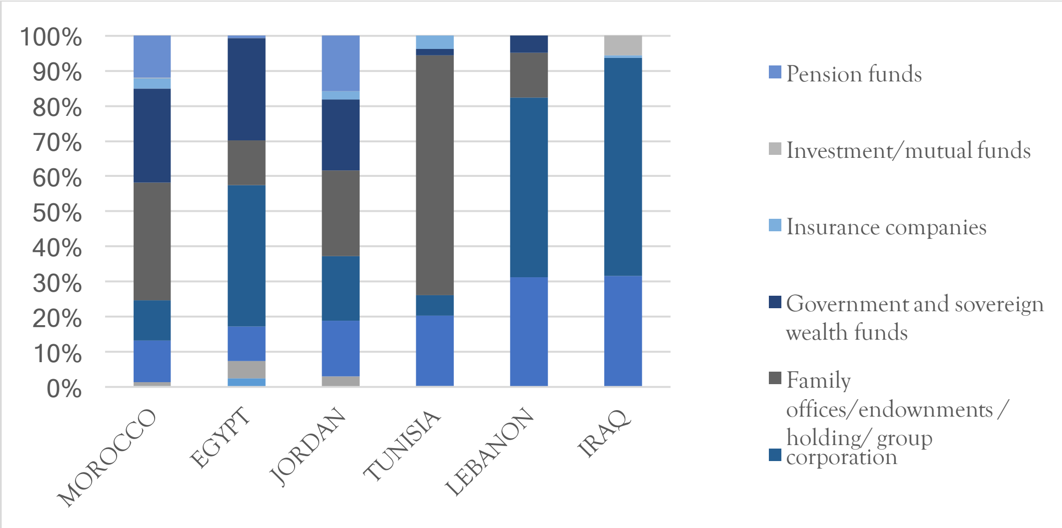
In GCC Countries



[25] Interestingly, the allocations of foreign asset managers where not proportionate with the total foreign investor exposure to MENA markets by country. Instead, the majority of allocations focused on: the UAE (29%), Turkey (28%), Egypt (14%), Qatar (12%), Saudi Arabia (5%).

[26] Turkey accounts for over half (57%) of overall foreign institutional investment, followed by Saudi Arabia (14%), Morocco (8%) and Egypt (6%).

Other MENA Countries



Source: Thomson Reuters, 2015.

The exact distribution of institutional investment varies significantly as illustrated in the Table 9 below. Also, *the variability of types of institutional investors is evident from the country data which highlights differences between Gulf-based markets dominated by sovereign investors, and other markets of the region such as Turkey and Egypt which tend to be more balanced in terms of the investor types.*

Table 9. Value of Holdings by Country

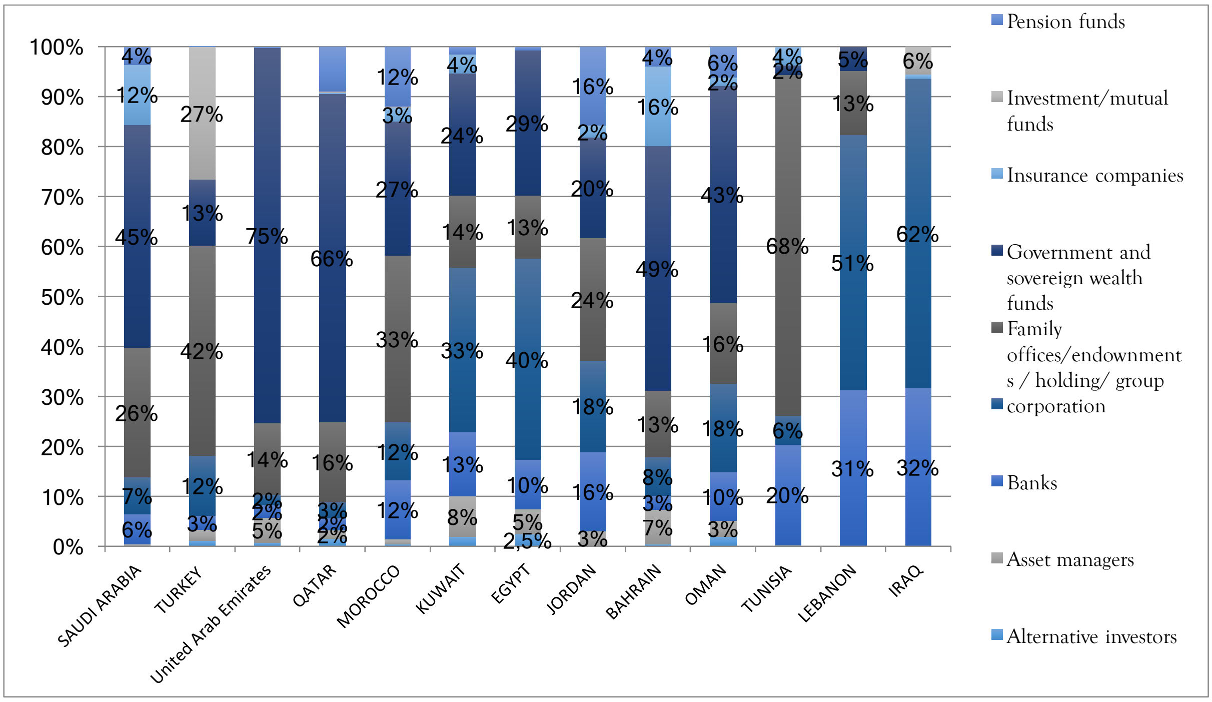
Country	**Value of Holdings (% of overall market cap)**
Saudi Arabia	17%
Turkey	39%
United Arab Emirates	12%
Qatar	11%
Morocco	33%
Kuwait	19%
Egypt	23%
Jordan	39%
Bahrain	23%
Oman	24%
Tunisia	21%
Lebanon	9%
Iraq	56%
Total	**275**

Note: Excluding the holdings by Families and Government and SWFs.
Source: Thomson Reuters, 2015.

For instance, sovereign investors are most prominent in Gulf countries: the UAE (75%), Qatar (66%), Bahrain (49%) and Saudi Arabia (45%) compare to the regional average of 41%. On the other hand, as can be seen from the Figures below, they are virtually absent in Tunisia, Lebanon and Iraq, which is a consequence of the absence of domestic sovereign investors[27] and relatively small capital markets.

[27] While both Tunisia and Iraq have a sizeable state-owned sector, SOEs in these countries are not investors in capital markets.

Figure 6. Value Held by Institutional Investors, in billion USD



Source: Thomson Reuters, 2015.

While there is virtually no difference in the participation of family offices between GCC and non-GCC countries, their exposure in individual markets differs. Perhaps surprisingly, the highest value held in terms by family offices (as measures by value held by country) is in Tunisia (68%), followed by Turkey (42%) and Morocco (33%), reflecting the listing of family-owned companies, whereas in the markets of the Arabian Gulf, family offices tend to hold relatively smaller stakes.[28]

The extent of investment by non-financial corporations also varies widely: from high in Iraq (62%), Lebanon (51%) and Kuwait (33%) to low in the UAE, Saudi Arabia, Qatar Bahrain and Turkey, which include almost all of the larger, more developed markets in the region. On the other hand, banks are the largest investors in Lebanon (31%) and Iraq (32%) and are generally absent in Gulf markets as well as in Turkey (2-6% of total institutional investment within each country). Investments by non-financial corporations are highest in Iraq (62%), Lebanon (51%), Egypt (40%) and Kuwait (33%).

The exposure of other non-banking financial sector actors to MENA markets is also rather variable, as demonstrated by Figure 6 above. For instance, in Bahrain, investment by insurance companies is higher than in the rest of the region, whereas investment by mutual funds is very low. This may appear inconsistent with the fact that Bahrain has the highest penetration of domestic mutual funds in the MENA region but can be explained with reference to investment regulations for mutual funds.

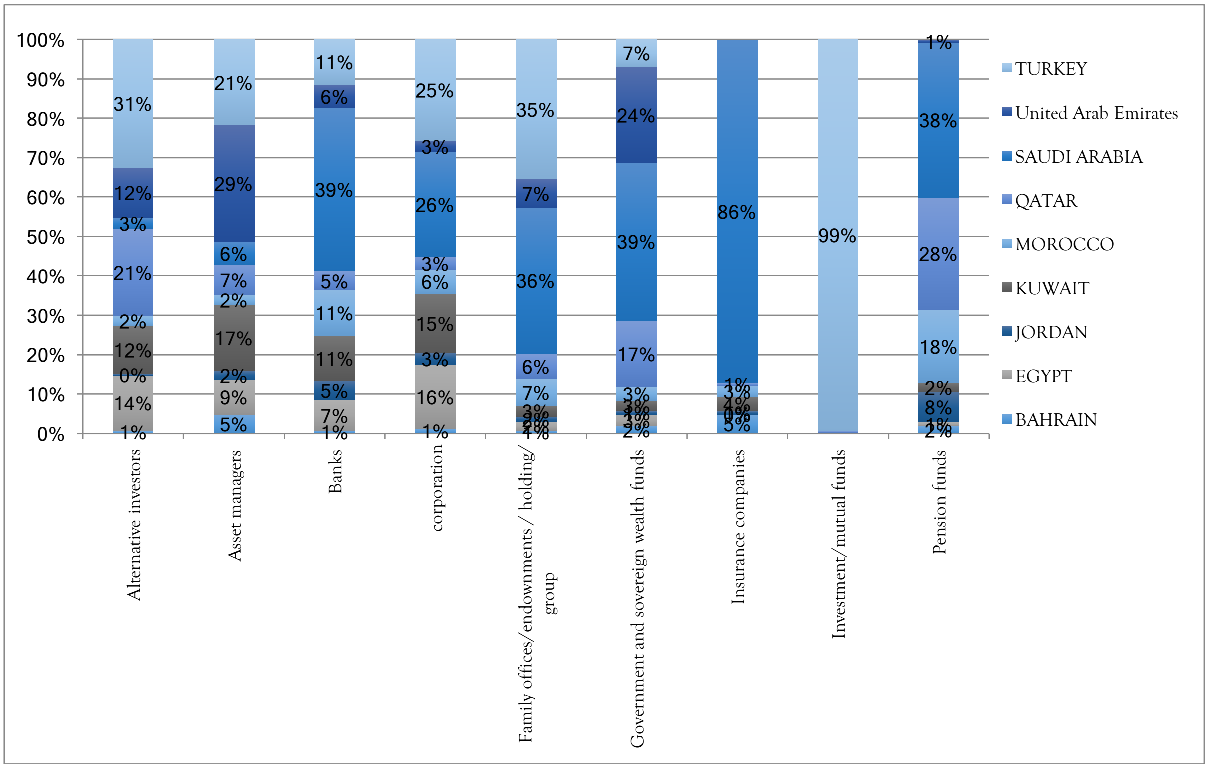
While certain types of institutional capital such as alternative investors and asset managers have relatively balanced portfolios as far as their geographical allocations are concerned, other types of investors demonstrate wide differences. The most striking is dominance of Turkey in the portfolios of investment funds. *Investment funds are in fact most present not in those markets where the level of the domestic investment fund industry is the highest, but where markets are most developed and open.* As such, investment funds are significantly present in only one market of the region Turkey (27%), significantly above the MENA average of 6%.

While pension fund investments remain low in both GCC and other MENA countries (4% and 8% respectively of the total institutional investor holdings in each of the two sub-regions), investments by

[28] This is line with the dominant role of sovereign shareholders in GCC countries and has implications for the future development of capital markets in GCC countries. In particular, given the dominant role of sovereign shareholders in GCC markets, the willingness of foreign investors to enter these markets may be affected.

pension funds are dominated by Saudi Arabia, reflecting once again the role of large domestic investors such as the Public Pension Agency. Likewise, while investments by insurance companies account for 7% of total value held in GCC and only 2% in other MENA countries, investments by insurance companies are concentrated in Saudi Arabia (86%), reflecting large equity investments by local insurance companies, notably the General Organisation for Social Insurance (GOSI).

Figure 7. Value Held by Institutional Investors, by category and by country ($)



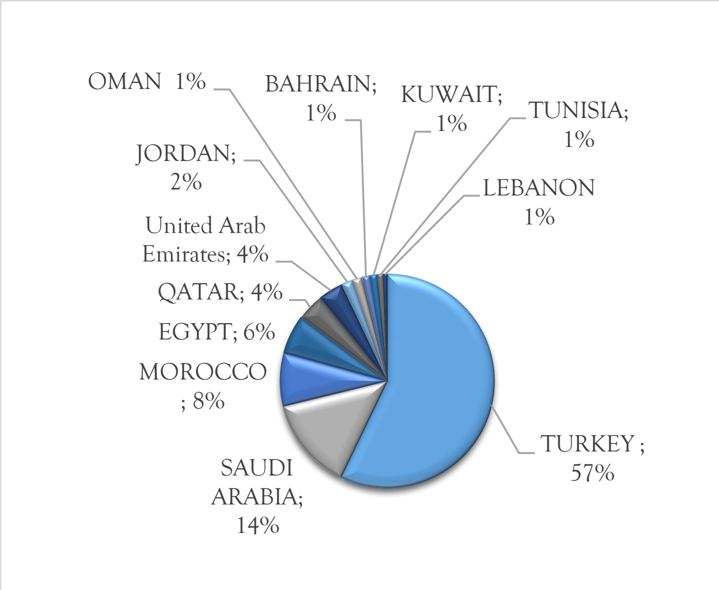
* Very small percentages (Oman, Tunisia, Iraq and Lebanon) are excluded from the graph for brevity.
Source: Thomson Reuters

Foreign investors

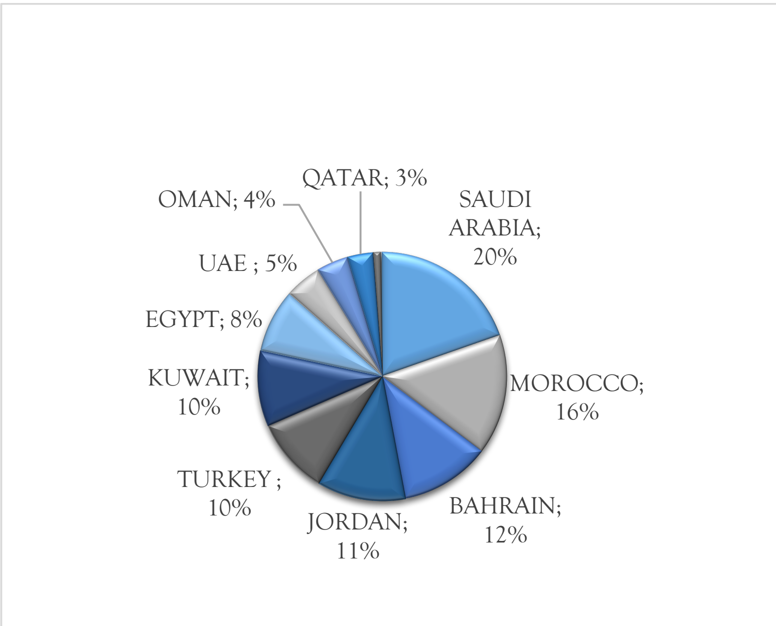
As of the date of the study, *foreign investment accounted for 14% of the value held in the region*. In absolute terms, the largest recipient of foreign institutional investment in the region was Turkey, capturing over half of total foreign investment destined for the region (57%), followed by GCC countries (26% of which 14% Saudi Arabia). Only 17% of the total investment flows was defined for all other markets in the region (outside of GCC and Turkey) while relative to the market capitalisation the picture is quite different.

Figure 8. Foreign and Regional Investment by country

Foreign Investment in MENA Capital Markets



Regional Investment in MENA Markets



Source: Thomson Reuters, 2015.

Regional investors accounted for 6% of the overall value held which is indicative of low regional integration in capital markets. In absolute terms, Saudi Arabia represented 20% of regional portfolio investment (refer to Figure 8 above), reflecting its position as the largest capital market in the region.[29] Morocco and Bahrain also stand out as countries with relatively high levels of regional portfolio investment at 16% and 12% respectively, followed by Jordan, Turkey and Kuwait.

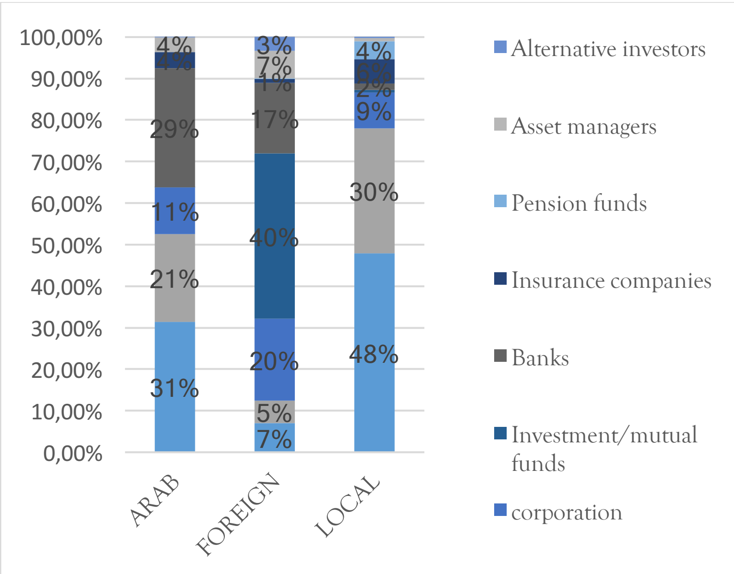
Table 10. Top Foreign Investors in MENA Capital Markets

Investor
HSBC Holdings PLC (UK)
Credit Agricole SA (France)
Hellenic Financial Stability Fund (Greece)
RBS Holdings NV (Netherlands)
Lafarge SA (France)
Orange SA (France)
Sumitomo Chemical Co Ltd (Japan)
Vodafone Group PLC (UK)
TeliaSonera AB (Sweden)
VimpelCom Ltd (Netherlands)

Source: Thomson Reuters.
Note: The table does not include individual investor information for Turkey.

As demonstrated by the Figure 9 below, there are wide differences between investor types when classified by their origin. While family offices account for 30% of local and for 21% of regional institutional investment, their role in terms of foreign investment is only 5%. This can be taken as an indication of low interest of foreign family business owners in MENA markets due to their perception of the region as a high risk destination and their lack of awareness of the exiting investment opportunities.

Figure 9. Investor types' holdings (%)



Source: Thomson Reuters.

Foreign investment is dominated by investment funds, corporations and sovereign investors, while regional investors are quite diverse. Notably, they include few mutual funds, reflecting the low level of development of this sector in most MENA countries. Investment funds and alternative investors as a category are purely

[29] While until recently Tadawul was closed to international investment, it has been open to investment by GCC nationals since 2007.

foreign investors, which highlights the intermediation of household savings into the capital markets is low. At the same time, these figures highlight the significant opportunity to develop these types of investors by reviewing obstacles in the regulatory framework that prevent their development.

These facts highlight important observations in terms of the current shareholding structure in the region and the potential for financial markets development. While the most significant source of domestic investment is sovereign, foreign portfolio investment is predominantly private. *This implies that with the opening of MENA markets to foreign investors, controlling shareholders such as sovereign funds and family offices will need to reconcile their interests with foreign shareholders who may have fundamentally different interests and approach to governance of their investee companies.*

The ultimate stability of this newly emerging shareholding structure in the region will depend on the ability of governments to distinguish between strategic, private investments and companies listed on local capital markets and which should hence be run as purely commercial enterprises. This will be arguably less complicated in some SOEs where governments retain minority stakes (i.e. Jabal Omar Development, Banque Saudi Fransi, etc.) as opposed to majority-controlled companies (i.e. Sabic, Maaden Emirates Telecom etc.) which although listed, remain at the heart of the sovereign development strategies.

In terms of corporate governance, foreign portfolio investors may face similar challenges in as they have faced in other markets characterised by controlled ownership in the hands of a few family groups. For instance, as engaged and activist investors have entered Asian capital markets, they have on occasion tried to uproot the existing governance arrangements such as cross-shareholdings and other mechanisms, which increase the gap between ownership and investment.[30] Their impact is limited by limitations of foreign portfolio investors, especially in GCC markets, though these have been significantly relaxed especially in Saudi Arabia and Qatar. As mentioned above, the opening of the Saudi market and market upgrades of UAE and Qatar have generated significant expectations in terms of inflows of foreign investment.

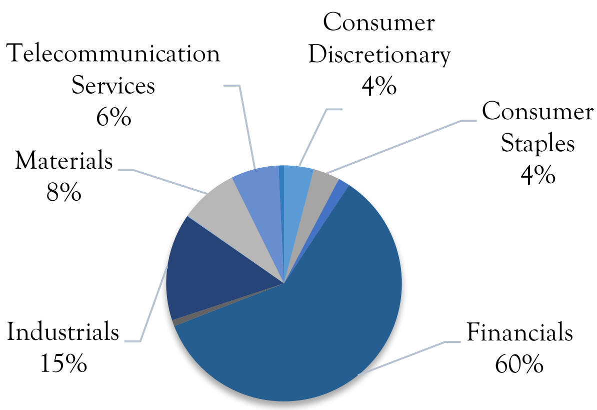
In the meantime, the volume of foreign institutional investment in the region has also been volatile in other parts of the region, *especially following political events in Egypt and Tunisia.* The Egyptian market had fluctuated by as much as 7% on a single day (following the change of the government on 25 January, 2011) and investment flows by portfolio investors have been significantly affected. Investments by foreign as opposed to regional investors have generally been more volatile which can be explained by a greater risk appetite of regional investors who also tend to have a better understanding of local markets and the potential impact of political events.

Irrespective of volatility of foreign investment, it is pertinent to take stock of the impact of foreign institutional investors on MENA markets so far. *Our research points to the fact that financial services and industrial sectors dominate the portfolios of foreign investors*. This is in part due to the fact that the financial services sector features most prominently in the market capitalisation of regional exchanges and that banks are some of the largest blue chip firms, but may be also a reflection of the fact that productive sectors of the economy are dominated by investments by the state and that foreign investors may have a low appetite to invest in these.

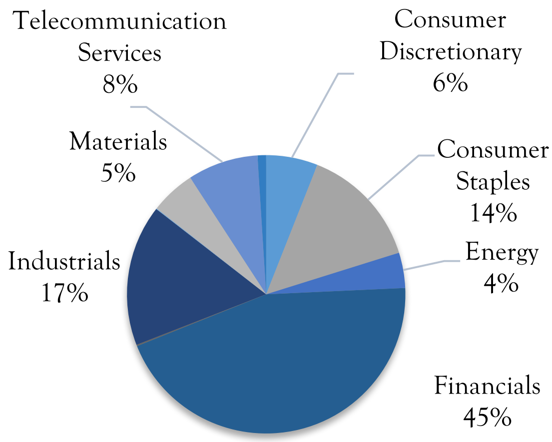
[30] For instance, in a recent case Elliott Associates, a US-based hedge fund attempted and narrowly lost its engagement at Samsung over an acquisition of a sister company (i.e. Cheil Industries' takeover of Samsung C&T) as it did not gain formal support of major domestic private and sovereign investors (FT, July 15, 2015).

Figure 10. Foreign asset managers and investment funds, sectoral orientation

Foreign Asset Managers



Foreign Investment Funds



Source: Thomson Reuters.

Sovereign investors

As mentioned, sovereign investors are dominant in terms of the value held in the region, in most markets apart from Kuwait, Egypt, and Turkey. Their investments represent both "legacy" privatisation stakes accumulated as a result of privatisations mostly carried out in 1980-2000[31] but also active investments made in recent years by sovereign funds and other sovereign investors (i.e. public pension and security funds). *Although it is known that state-owned enterprises and sovereign investment vehicles play an important role in the region's economies, the degree of state control of public equity markets is generally underestimated.*

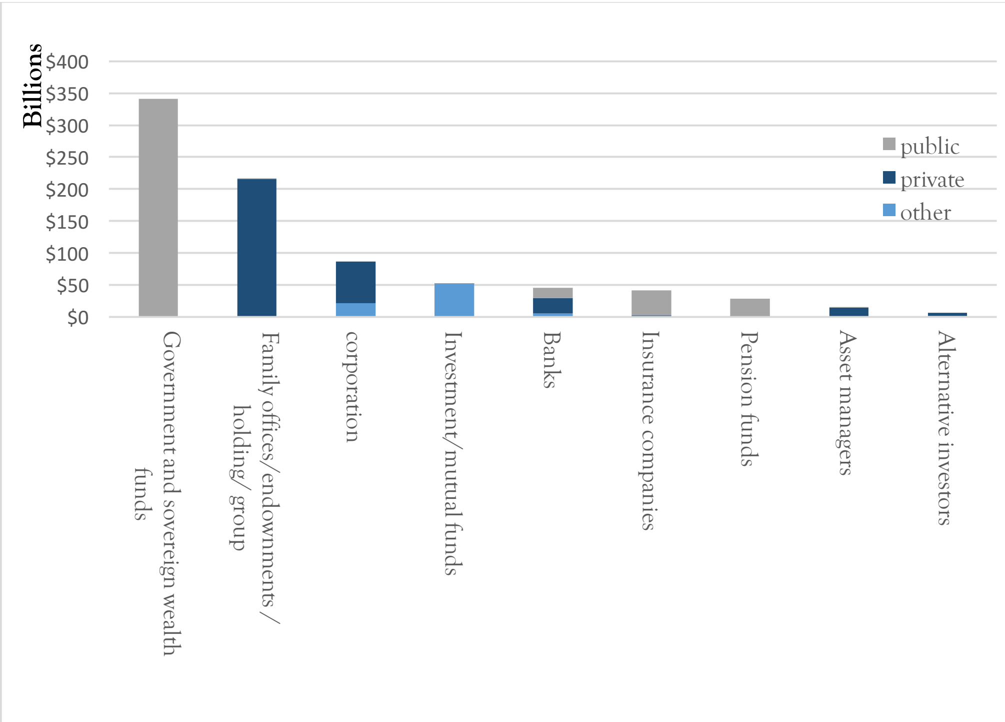
Classifying the 600 firms analysed as partially state-owned companies (PSOEs) with government ownership 10% and above) and state-owned enterprises (SOEs) with government ownership 50% and above, the extent of state ownership in capital markets is particularly striking. *Over 30% of the sample examined (235 firms)*

[31] Few privatisations in the region were done through the exit on the local stock exchanges. Egypt, Tunisia and Morocco were the largest privatisers in the region in 2000-2008 though the momentum has slowed down considerably in recent years.

have government shareholding exceeding 10%, of which 76 are majority state-owned. The companies in which governments in the region have stakes account for 65% of the overall market capitalisation of the region's exchanges. Of the 100 largest listed firms, 89 have government ownership exceeding 10% or above and 34 of these with over 50% government ownership.

These figures reflect both direct government and SWF investments which is defined as a category of investors. A further 14% of the SOEs' total value of is held by other types of investors such as banks, insurance companies and pension funds, which may be state-controlled and as such, which represent a source of indirect investment by governments. For instance, 95% of equity holdings of pension funds and insurance companies in the region are sovereign. These indirect holdings represent 10% of the value held in the region, in addition to 41% in value held by government investors and SWFs.

Figure 11. Value of holdings by sovereign and private investors



Source: Thomson Reuters, 2015.

State ownership in the public equity markets has been on the rise globally, with the result that 10 of the largest listed companies globally half have the state as a major shareholder. Given the size of domestic markets, Saudi Arabia ($517 billion), followed by the UAE ($197 billion) and Qatar ($181 billion) are the largest contributors to market capitalisation of SOEs and PSOEs in the region. In Saudi Arabia for instance, the largest investors with over USD $1 billion holdings where General Organization for Social Insurance, Public Pension Agency and the Public Investment Funds each holding stakes (exceeding the 5%) in 33, 20 and 18 listed companies, respectively (NCB Capital, Investor Tracker, January 2014).

The extent of state ownership is more accentuated in the region than in other emerging markets, on par with markets such as China and India. According to our research, *Saudi Arabia alone accounts for 43% of all government ownership in public equity markets in the region* (across PSOEs and SOEs), with 103 out of 164 listed firms that can be considered as purely private (i.e. with government ownership less than 10%).[32]

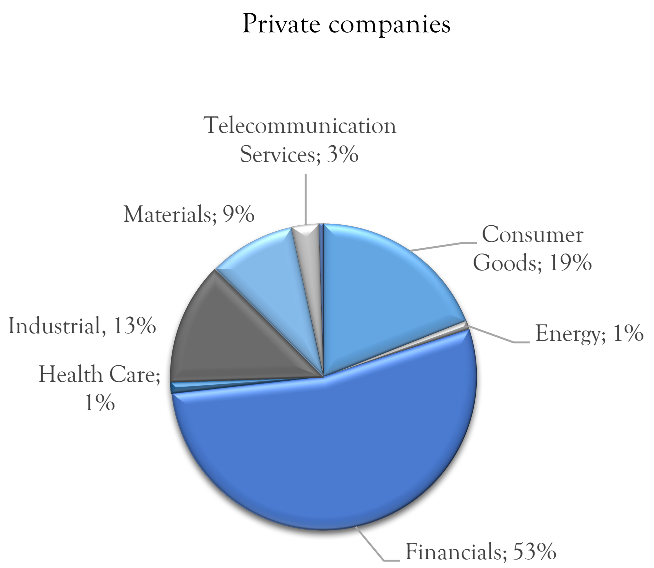
In terms of the highest number of number of listed SOEs, Egypt is ahead of Saudi Arabia and UAE. Saudi Arabia and the UAE on the other hand dominate in terms of the number of minority government held companies, followed by Morocco and Kuwait, demonstrating the willingness of governments to relinquish controlling ownership in these companies as part of developing local capital markets.

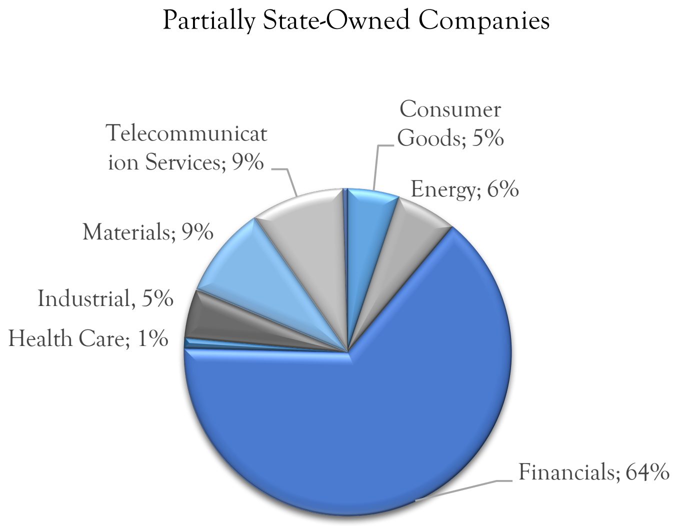
[32] In fact, Turkey stands out as the only large market in the region that is not characterised by high levels of sovereign investment, but by high levels of foreign investment.

Financial services, followed by materials and telecommunication services are sectors with the highest government participation, reflecting notably legacy holdings in privatised firms in these sectors which have historically tended to be large as well as the dominance of these sectors in the market capitalisation.[33] Indeed, the largest number of SOEs in the region are in the financial services sector (155), followed by materials sector (43 companies), telecoms and consumer staples (15 each). Over 64% of PSOEs and 30% of SOEs are in the financial services sector, demonstrating the willingness of governments to hold minority stakes in this sector[34] (refer to Figure 12).

On the other hand, *in the telecommunications sector, the vast majority of listed companies are majority-state controlled, demonstrating the strategic importance that governments attach to them across the MENA region.* The materials sector (which includes companies such as Saudi Arabian Mining Company, Abu Qir Fertilizers and Chemical Industries Company, etc.), is also notable in having a higher degree of majority government control, accounting for over a third of market capitalisation of listed SOEs in the region.

Figure 12. Sectoral Orientation of Private, PSOEs and SOEs, as part of market capitalization

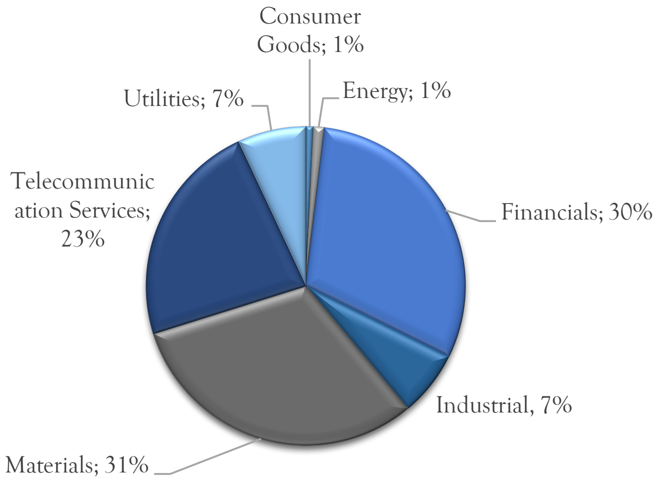




[33] For instance, the privatisation of the National Commercial Bank in Saudi Arabia in 2014 was the second largest IPO in 204 after the Chinese e-retailer Alibaba.

[34] Conversely, in the telecommunication sector, governments appear to hold to controlling stakes.

State-owned companies

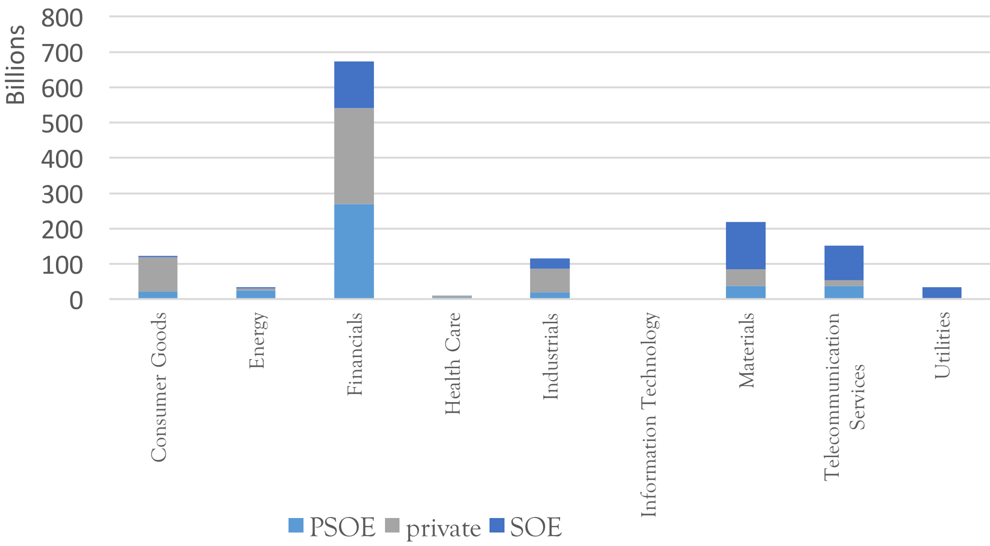


Source: Thomson Reuters, 2015.

It is it notable that firms in the financial, consumer goods and material sectors have both privately controlled and state controlled firms, implying a degree of competition between the state and private firms and potentially signalling the maturity of these sectors, at least from a competition perspective (refer to Figure 13 below). That said, state ownership overall appears substantially more concentrated than private ownership, in some cases to ensure a controlling blockholding for the state. For instance, in Saudi Arabia, the Arab National Bank has two major public investors which together hold a controlling block of 51% of shares, and in Oman, Omantel, has two sovereign investors which together hold 51%.

These examples point to a degree of coordination between sovereign investors which is often assured by governments especially privatisations whereby sovereign investors are allocated block holdings to ensure the state retains a specific stake. As a result, there are also multiple sovereign investors that have stakes in the same companies: for instance, the Public Investment Fund, General Organization for Social Insurance and the Public Pension Agency have stakes in STC (Saudi Telecom) and Sabic (Saudi Arabia Basic Industries Corporation), and the later has in turn investments in other SOEs such as Saudi Kayan**.**

Figure 13. Sectoral orientation of state shareholdings



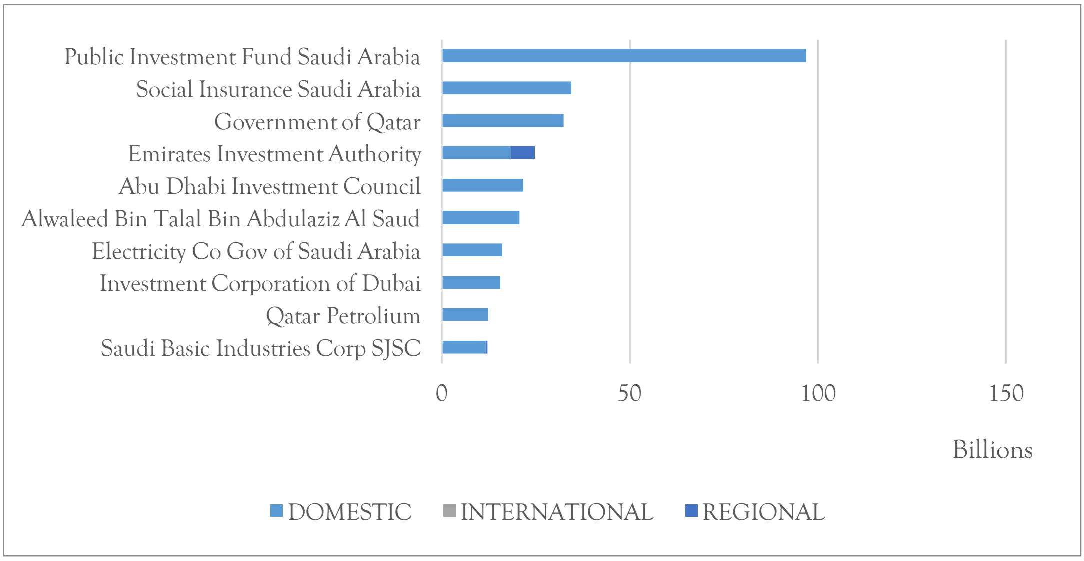
Source: Thomson Reuters, 2015.

Finally, it *is notable that the sectoral split of government shareholdings in the MENA region is substantially different from other markets*: for instance, in OECD member countries, 37% of listed SOEs are in electricity and gas industry, 33% primary sectors, and only 14% in finance (OECD, 2014). *In the MENA region, the largest SOEs are generally unlisted, reflecting their strategic nature: for instance, only 6% of MENA listed SOEs (in terms of value held) pursue in energy related activities*. This comparison points to the potential of further development of capital markets through disposal of stakes in sectors which remain under government control, should the market and political circumstances be conducive.

The largest institutional investors

The largest institutional investors in the region are all but one sovereign, either in the form of investment holding companies (i.e. Investment Corporation of Dubai), state-owned enterprises (i.e. Qatar Petroleum), or social security funds (i.e. General Organisation for Social Insurance).[35] (refer to Figure 14). Virtually all of these entities are domestic investors, whose investment strategies are generally oriented towards their local markets (i.e. GOSI towards Tadawul, Government of Qatar towards Qatar Exchange), with the exception of the Emirates Investment Authority which has a portfolio of investments in public equity in markets outside the UAE.

Figure 14. Largest Institutional Investors in the MENA region, in billion USD

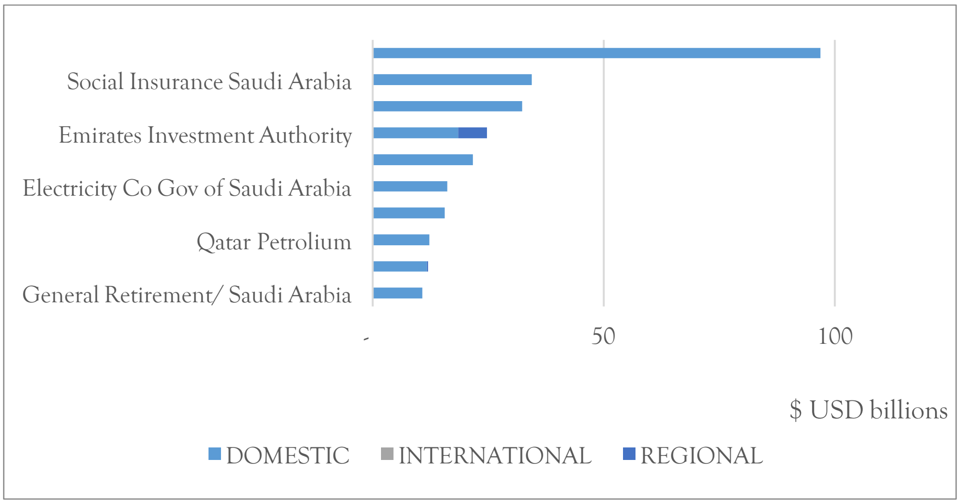


Source: Thomson Reuters.

The Public Investment Fund, a department of the Saudi Ministry of Finance, is both the largest investor in MENA markets and the largest sovereign investor by value held (refer to Figure 15 below). In fact, the five largest investors in the region's markets are all sovereign and correspond exactly to the largest five sovereign institutional investors. For the moment, there is virtually no foreign sovereign investment in MENA markets. Even Norway's Sovereign Wealth Fund, the largest sovereign investor globally, with an average stake of 1.3% of global listed company, does not appear to have any presence in the region (only 0.13%). This is noteworthy considering that MENA SWFs appear to be interested to foster collaboration with foreign SWFs. For instance, Mumtalakat, Kuwait Investment Authority and Mubadala have signed agreements with the Russian Direct Investment Fund (WSJ, 2014).

[35] In fact, when we filter for largest state-owned investors, this list is only marginally altered with the drop of Alwaleed of Bin Talal and the addition of the Saudi Public Pension Fund).

Figure 15. Largest Sovereign Institutional Investors

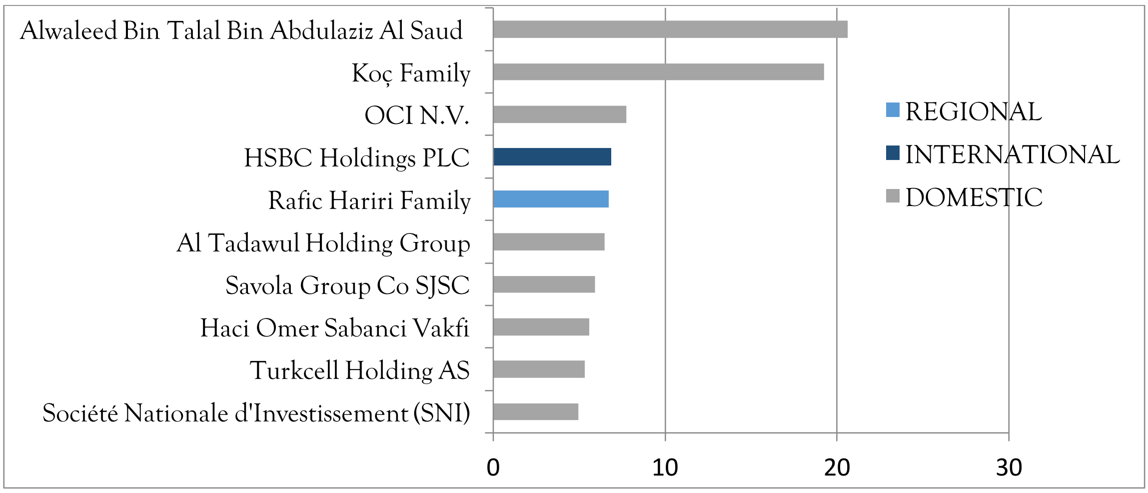


Source: Thomson Reuters, 2015.

The scale of private institutional capital in the region's markets is clearly dwarfed by sovereign sources of capital, both direct and indirect: while the largest sovereign investor's holdings are close to $100 billion USD, the largest private investor's holdings amount to just over a fifth of that. Of the the largest 10 private investors, the only foreign investor is HSBC Holdings, which reflects the dominant role of the bank as a broker, custodian, but also as an underwriter.[36]

Private institutional investors are dominated by family offices which is consistent with the fact that it is the second largest institutional investor category in the region. These family offices and holding companies have the highest representation of Turkish families (4 out of 10 largest private investors) reflecting the fact that Borsa Istanbul is dominated by families[37] but also features Saudi, Lebanese and Egyptian holdings. Unlike in OECD countries, where family offices play a very minor role, families and holding companies they control can be considered a class of institutional capital in their own right and hence their impact on the market should be considered from the policy perspective quite separately from the retail investors that dominate MENA markets.

Figure 16. Largest Private Institutional Investors



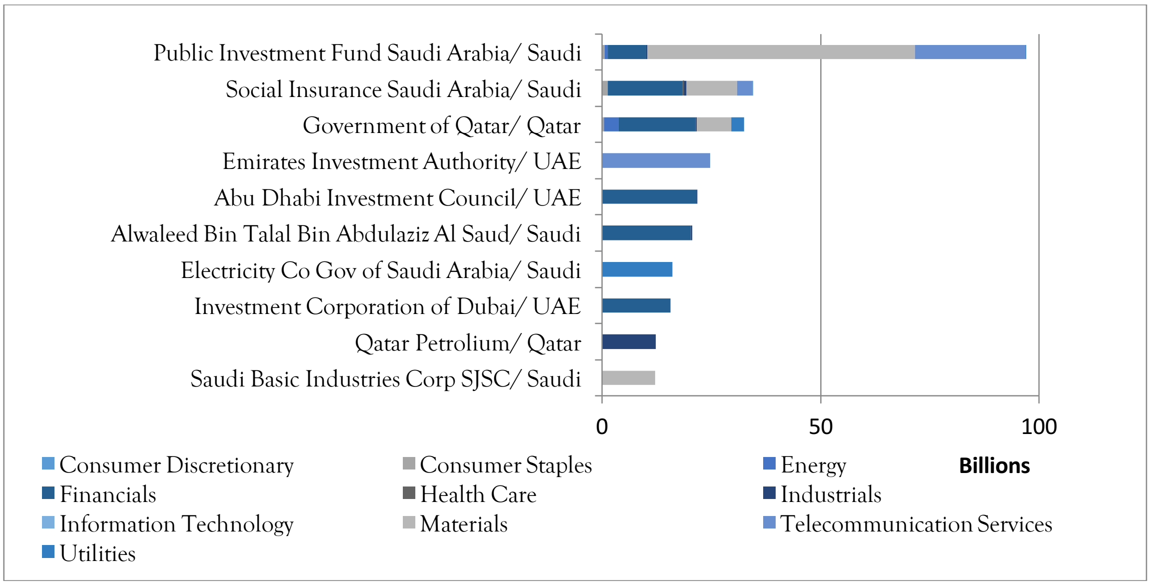
Source: Thomson Reuters, 2015.

36 In line with its dominant position in the reigon, HSBC reports to generate 10% of its group profits in the Middle East and North Africa (HSBC in MENA Investor Update, 1 July 2015).

37 Provide data on the dominance of families in Turkish market.

The holdings of the largest private institutional investors (i.e. predominantly family offices) are also quite concentrated from the perspective of sectoral orientation, with the notable difference that their holdings are concentrated in financial services sector (i.e. banks) and industry and – unlike sovereign investors - are absent in sectors such as materials. Sovereign investors interest in sectors such as materials is related to their own business model and orientation. For instance, it is unsurprising that SABIC's investments are virtually all in this sector. Likewise, Emirates Investment Authority's bias towards the telecom sector reflects in holdings of local telecom companies (i.e. Etisalat and Du) where it effectively acts as a holding company managing the state's strategic investments.

Figure 17. Sectoral orientation of largest investors, by value held in billion USD



Source: Thomson Reuters, 2015.

Sectoral orientation of investors

To some extent, the sectoral orientation of investments by institutional investors reflects the sectoral composition of the overall market capitalisation in the region. The financial services sector accounts for more than half of the overall market capitalisation, higher than in any other region other than Africa (World Bank, IBRD, 2011), followed by materials and telecom sectors. As a result, the four largest investor types (sovereign, family offices, banks and corporates) invest heavily in financial services: 34% of non-financial corporations and 55% of family offices investments are in financial services.[38]

Apart from the focus on the financial services sector, *the sectoral split of investments of the largest categories of investors is in fact quite dissimilar.* Family investors hold a diverse sectoral portfolio reflecting the listing of family companies operating in a range of sectors but also the increasing sophistication of family offices which have significant internal asset management capabilities and use actively professional asset managers.

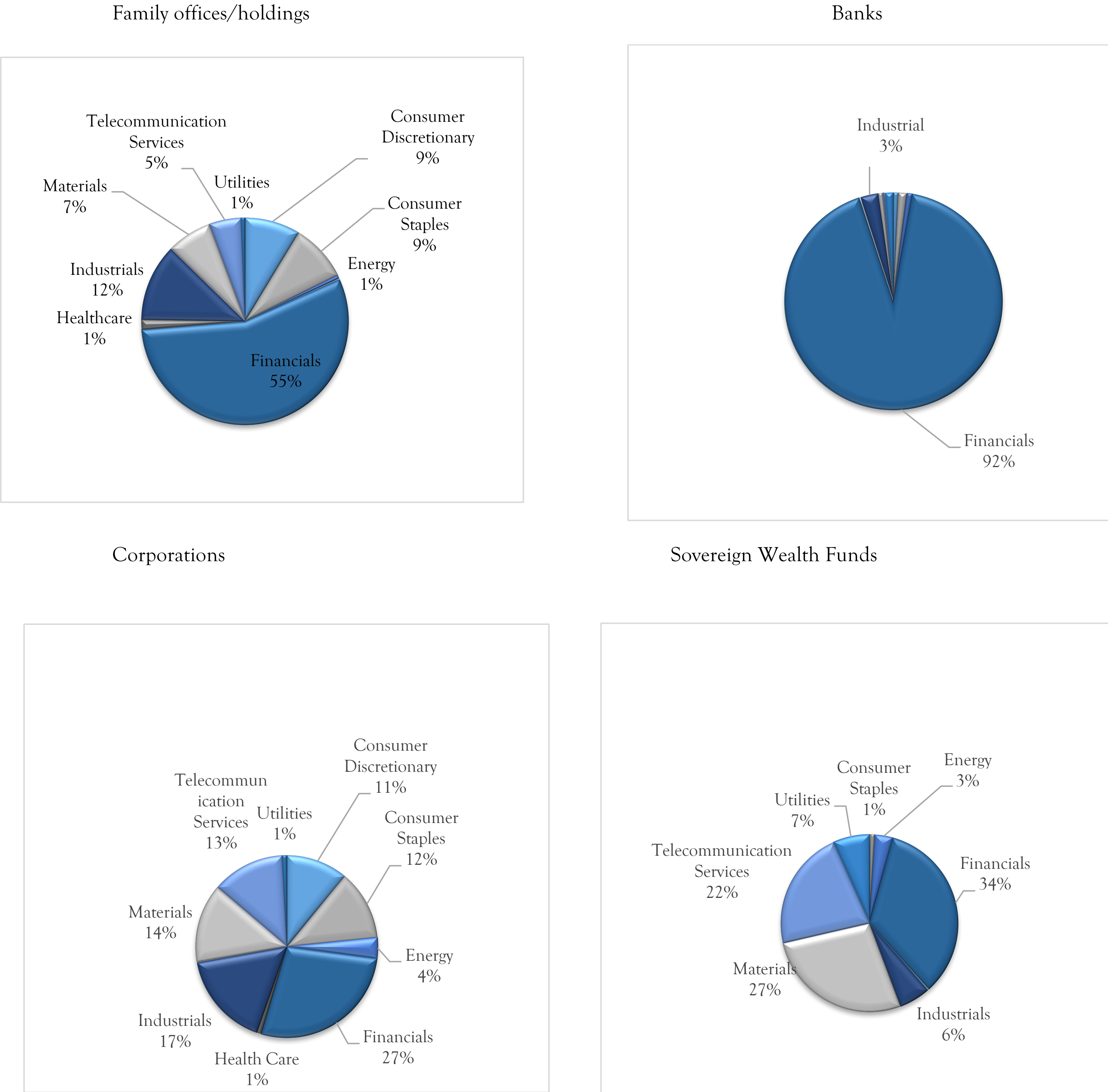
Non-financial corporations also invest evenly in similar sectors. Only non-financial corporations and sovereign investors invest in similar sectors in similar percentages. Likewise, in terms of investor origin, domestic, regional and international investors have similar sectoral allocations, with the exception of cross-border regional investment in the telecom sector (e.g. Etisalat investment in Mobily, listed in Saudi Arabia). On the other hand, some activities such as transportation and warehousing appear dominated by foreign investors (69%).

Further nuances can be noted when examining sectoral preferences by both investor type and origin. For instance, foreign investment funds invest in financials (45%), industrials (16%), and consumer goods (20%)

[38] A further 92% of banks portfolio investments are in this sector, which reflects both investments in subsidiaries and possibly equity holdings by mutual funds that operate as part of banks.

sectors. On the other hand, foreign asset managers focus on financials (60%), industrials (15%), materials (8%), and telecom (7%) as well as consumer goods (8%). Only consumer goods stands out as a sector which appears to have gathered more interest of international investors (14% of international investors' portfolio allocation), whereas local investors allocated only 9% of their overall portfolios to it and regional even less at 2%.

Figure 18. Sectoral orientation: holdings



Examining the sectoral preferences between domestic, regional and international investors, the cross-ownership in the telecom sector stands out particular, highlighting intense cross-border competition in this sector, with listed subsidiaries operating across the region (i.e. UAE's Etisalat's ownership of Mobily in Saudi Arabia). Foreign and local investor holdings of the industrial sector appear higher than those of regional investors. Consumer staples occupy a higher portion of the investment portfolio of foreign investors than of local or regional investors, which can be interpreted as the interest of foreign companies in investing in local firms serving local or regional markets.

The sectoral allocation of the largest investors is quite diverse, representing the diversity in their objectives. Generally speaking, Materials and Financial services sectors appear to dominate portfolios which seem relatively undiversified, representing a source of risk. In the case of sovereign investors, sectoral orientation reflects controlling "legacy" stakes in privatised companies and to a lesser extent active portfolio investments by family offices. One consequence of this is equity investments of these investors, unlike their private equity investments and investments in public equity outside in the region, do not reflect their emerging interest in supportive innovative sectors.

Overall it appears that international and domestic investor's sectoral holdings are rather similar; evenly for all sectors except for major investment in financials. However, regional investors concentrate on financials and telecom. Ultimately, these holdings and sectoral composition of public equity markets does not reflect the structure of underlying economies of the region. National Oil Companies (NOCs) are unlisted with the result that energy accounts for only 2% of institutional investor portfolio allocations while utilities for 3%.[39] *Further development of MENA capital markets is contingent on enabling capital markets to finance the real economy.*

[39] While petrochemical companies in GCC countries remain unlisted, recent discussions between the EGX and the Ministry of Petroleum in Egypt have resulted in the listing of one such company (Mobco).

PART III. STEWARDSHIP RESPONSIBILITIES OF INSTITUTIONAL INVESTORS

Institutional investment is essential to the development of capital markets in the region both to attract corporations to equity markets and to decrease market volatility linked to the short termist approach of retail investors. At the same time, institutional investors in MENA capital markets face a number of fundamental challenges, some related to the openness and liquidity of markets in the region, others related to the governance of the underlying companies. In light of these challenges, capital markets in the region are dominated by domestic sovereign and family investors whose ability to exercise their stewardship responsibilities are nascent.

Investors such as pension funds, insurance companies and investment funds which dominate global markets play a relatively insignificant role in capital markets in the region due to the small size of the respective industries and prudential limitations on their capital markets exposure. Foreign investor participation in MENA markets is limited by insufficient transparency of listed companies, as well as by the lack of liquidity and diversity of financial instruments. Even in Saudi Arabia, the largest and the most liquid market in the region, trading volumes are driven by relatively uninformed, speculative retail investors who while accounting for less than 12% of the underlying ownership, are responsible over 82% of the trading volume (Tadawul, 2015).

While the amplitude of market instability witnessed in the Gulf markets in 2006 has not been witnessed since, market fluctuations in the region are commonly attributed to the short-termist reactions of retail investors which dominate most markets in terms of the activity. A key manifestation of this are wide market fluctuations around oil price changes which while relevant to the local markets, should in principle have little practical impact on valuations of listed companies considering that petrochemical companies account for only 2% of the market capitalisation in the region.

While the institutionalisation of MENA equity markets is indeed relatively weak, the presence and hence the impact of retail investors is often exaggerated due to the classification of family owners and high net-worth individuals as retail shareholders, whereas in most markets they represent the second largest category of institutional capital in the region following sovereign investors. Indeed, a key theme explored in this report is that the region's equity markets differ widely from their global counterparts not only by the high presence of retail investors but also by the type of institutional capital that characterises these markets.

Whereas in developed markets investment and pension funds and insurance companies are the largest source of investment, the dominance of sovereign and family investors in MENA markets requires a different approach to addressing capital market development and corporate governance challenges. Notably, the fact that most MENA listed companies are controlled, either by a sovereign shareholder or a family founder, raises different governance challenges than those which have dominated policy discourse in American and European markets in recent years. The particularity of MENA markets lies not only in the controlled nature of listed firms, which can indeed be seen in other emerging and developed markets, but also by the type of institutional capital that characterises these markets.

Creating conditions for institutional capital to grow and become more engaged in MENA equity markets requires the adoption of approaches which fit the current realities of capital markets in the region. In this respect, salient facts that need to be taken into consideration is that most exchanges in the region remain state-owned, that most companies listed on them are controlled, that key investors are sovereign and family founders and that the levels of foreign investment in most markets remains relatively low. While individually, these conditions are common to a number of global equity marketplaces, collectively they imply that policy options for developing these markets ought to be tailored to their specific circumstances.

An underlying theme of this report is that further development of MENA equity markets is preconditioned on the growth of an institutional investor base, the development of which could help stimulate IPOs and SPOs. This is a worthwhile objective given the low levels of initial or secondary public offerings across the region resulting from the fact that family companies are reluctant to list their equity (preferring bank credit or private placements) and that governments have put a halt on privatisation activity. Diversifying and deepening institutional investor ownership is also crucial to improving investor stewardship, a theme that has dominated the corporate governance debate since the last financial crisis.

As explored in this report, the reasons for the slow transition to institutional ownership are essentially twofold and rooted in first, the slow development of local pension, insurance and mutual funds in the region and the low penetration of foreign investors in most MENA markets (with the exception of Turkey). *While attracting foreign pension and investment funds, insurance companies to the region is a longer term objective, contingent not only on the removal of foreign investment restrictions but also on market transparency improvements and the availability of liquid investment instruments, incentivising local institutional shareholders to engage with listed companies can be defined as an immediate priority.*

Local insurance companies, pension funds and investment funds are positioned to grow and with that the regimes that regulate their exposure to capital markets will be subject to review. In parallel, as recent experience demonstrates, the participation of sovereign investors in local capital markets has been increasing and hence their role as asset owners needs to be re-assessed. These domestic investors have both the capital and the intimate knowledge of local markets that positions them uniquely as change agent, able to engage with local companies to bring about a desired change in governance practices.

Thus far, domestic institutional investors, apart from family investors acting as corporate founders, have not acted as active owners of listed equity. As a result, the MENA region has some of the lowest participation in AGMs, estimated at just over 50% in Saudi Arabia for instance. This is a consequence of the risk and disclosure-averse corporate culture, the reluctance of certain investors to intervene publicly, but also the absence of incentives/requirements by regulators addressing the stewardship role of institutional investors. Currently, no country in the region apart from Turkey and to a smaller extent Oman has issued requirements or recommendations addressing the role of institutional investors in capital markets, which stands in contrast with global developments.

Table. Governance Related Responsibilities of Institutional Investors

Jurisdiction	National framework	Target institutions	Exercising voting rights		Managing conflicts of interest	
	(Governmental / Private / Mixed initiative)	i.e. mutual funds, pension funds, etc.	Disclosure of voting policy	Disclosure of actual voting records	Policy setting	Disclosure of policy
Algeria	None	N/A	N/A	N/A	N/A	N/A
Bahrain	G	International investors	R	R	R	R
Egypt	None	N/A	N/A	N/A	N/A	N/A
Iraq	None	N/A	N/A	N/A	N/A	N/A
Jordan	None	N/A	N/A	N/A	N/A	N/A
Kuwait	G	Investment funds	R,C	R,C	C	C
Lebanon	None	N/A	N/A	N/A	N/A	N/A
Morocco	None	N/A	N/A	N/A	N/A	N/A
Oman	G and P	Pension funds Mutual funds	R	R	R	R
Palestinian Authority	None	N/A	N/A	N/A	N/A	N/A
Qatar	None	N/A	N/A	N/A	N/A	N/A
Saudi Arabia	None	N/A	N/A	N/A	N/A	N/A
Tunisia	None	N/A	N/A	N/A	N/A	N/A
Turkey	G	Investment funds asset management companies			R	
UAE DIFC	No	N/A	N/A	N/A	N/A	N/A

UAE Federal	No	N/A	N/A	N/A	N/A	N/A
Yemen	No	N/A	N/A	N/A	N/A	N/A

Source: GOVERN research.

This stands in contrast to international developments. *Globally, stewardship-oriented initiatives have seen a level of heightened interest in Europe and North America, and to a lesser extent in Asia and Latin America.* Following the example set by the UK Stewardship Code, Italy, Japan, South Africa and other countries have followed suit in introducing further guidance to investors and asset managers concerning their responsibilities as owners in the capital markets. The International Corporate Governance Network (ICGN), an umbrella organisation for institutional investors worldwide, issued Global Governance Principles and the European Fund and Asset Managers Association has also published Principles for the exercise of ownership rights.

While the introduction of stewardship code style initiatives may be potentially premature or arguably irrelevant for the region[40], further incentives or recommendations are required to stimulate better engagement between the region's largest shareholders and management and boards of listed companies. For instance, requiring sovereign investors or their subset (i.e. state-owned pension funds) to develop voting policies and to report on their voting results to the securities regulator could usher a wave of change in the behaviour of both investors and listed firms in the region.[41]

It would also be timely given that a number of large asset owners in the region are looking to internalise their asset management capabilities, of which corporate governance could be component. Further, as the portfolio holdings of large sovereign investors are diversifying internationally, their needs for governance and engagement expertise is positioned to increase. At the same time, the availability of such expertise externally is lacking as few international proxy advisors and corporate governance consultancies have specialised expertise on the MENA region.

While Standard and Poor's in collaboration with the Hawkamah Institute has launched a corporate governance index in the region, this index does not appear to have attracted substantial interest by institutional investors. As most MENA countries are categorized as frontier or emerging markets, they receive little following by index funds and hence the resources dedicated to monitoring the quality of governance of their listed companies are small compare to other regions.[42]

Rather than providing a set of overarching corporate governance requirements summarised in a stewardship code to which investors should adhere, the experience of specific countries which impose different requirements to different institutional investors may be more relevant to the region. In Chile for example, pension funds are obliged to attend shareholder meetings and exercise their voting rights in cases where they hold more than 1% of a corporation's equity.

In other countries, institutional investors are required to participate and vote in certain resolutions such as on remuneration schemes (i.e. in Switzerland). In half of the OECD countries, regulators require or recommend at least one type of institutional investor to disclose their voting policies, while the the requirement or recommendation of disclosing actual voting records is less frequent. *Requiring large investors to develop voting policies would encourage reflection among domestic institutional shareholders as to their position on specific governance challenges in their local markets and in the region.*

Considering that sovereign investors have more resources and financial expertise, they may be, in the short term the most impactful source of "fiduciary capitalism" in the region and may appreciate an opportunity to

[40] For a broader critique of stewardship codes, refer to Wong, 2015.

[41] Indeed, the IMF recommended Saudi Arabia to disclose the investment policies, portfolios, and portfolio performance of the Public Pension Agency (PPA) and General Organization for Social Insurance (GOSI) in its Country Report in 2012.

[42] One of the largest proxy advisors globally, ISS follows only few large cap companies in the region, in 2014 covering 80 annual shareholder meeting in Egypt, 70 in Saudi Arabia, 43 in the UAE and 25 in Oman.

demonstrate their growing asset management capabilities and the lack of political motivations, of which they have on occasion been criticised. Requiring sovereign pension funds in the region to develop voting policies and disclose their board representatives and the quality of their engagement with listed companies would stimulate executives' and boards' interest in governance, and in the long-term, lead to better transparency of asset owners' own governance practices.

Such regulations can lead to the creation of in house governance governance and engagement capabilities in MENA pension and social security funds as have some large investors such as the California Public Employees' Retirement System (CALPERS) or the Canada Pension Plan Investment Board (CPPIB). Irrespective of whether governance surveillance is executed internally or outsourced, this could mean that sovereign investors are well positioned to lead governance change as local investors with knowledge of local equity markets.

As pension and mutual funds and insurance companies are positioned to grow in the region, their exposure to MENA capital markets is bound to grow, especially if policymakers review the regulatory regimes governing their exposures to public equity markets. Pension funds have particularly strong prospects for development given that the sector is dominated by state-owned providers in most countries of the region, as do insurance companies given the low rates of basic types of insurance such as vehicle or causality insurance.

As the regulatory frameworks for pension, insurance and mutual funds sectors develop, a greater portion of household assets will, in the longer term, be channelled to capital markets in the region. McKinsey estimates that MENA households hold $2.7 trillion USD of assets, of which only 14% are invested in fixed income and 18% in equities, demonstrating large potential for further development of capital markets, especially as pension, mutual fund and insurance sectors grow (McKinsey, 2015).

At the same time, participation of foreign investors in capital markets will increase, in particular in GCC markets as a result of the opening of Tadawul to Qualified Insitutional Investors (QFIs) and the upgrade of UAE and Qatar's markets to the emerging market status. The precise extent of the impact of this upgrade on foreign capital flows are difficult to estimate considering the recent nature of these regulatory changes and the flexibility left by the current regulatory framework for individual companies to revise limits on foreign investor participation.

Based on a detailed analysis of ownership composition in MENA public equity markets, this paper advocates that policymakers address the void of regulations addressing the stewardship responsibilities of domestic investors, starting with sovereign entities which have both the capacity, the mandate and the interest to as long-term investors. Improving demand for good governance practices by local institutional investors is a precursor for attracting foreign institutional capital. Supporting the collaboration between foreign and domestic institutional investors would also be crucial to facilitate the sharing of experience, and eventually, the collaboration among investors.

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