

**Capital Market Listing as a Window for ESG
Disclosure Requirements for Public Companies:
Corporate Governance Lessons for Saudi
Arabia**

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Abstract

As environmental, social, and governance (ESG) disclosure are dynamic in response to economic and regulatory conditions, “dynamic materiality” plays a crucial role in determining the nature of information that companies need to disclose. Therefore, this study argues that the rule-based corporate governance model of Saudi capital market regulations is incompatible with the dynamic nature of ESG disclosures, where regulations impose rigid obligations in some respects, while leaving ESG disclosures voluntary, resulting in significant differences in application between listed companies. In contrast, the UK governance model has principle-based approach, with ‘comply or explain’ disclosures principle, which gives companies greater flexibility to disclose their sustainability according to economic and regulatory variables. Thus, the absence of a flexible regulatory framework in the Saudi market may hamper companies' ability to adapt to global developments, limiting the effectiveness of ESG disclosure compared to more adapted models.

This study answers questions about the extent to which Saudi Arabia's rule-based governance model can support ESG disclosures given the dynamic materiality of ESG matters, and the potential to leverage the UK model in developing the Saudi regulatory framework in line with changing sustainability requirements. The study also proposes to address the current gap in the definition of materiality in Saudi capital market laws by exploring the possibility of adopting the concept of dynamic materiality to enhance the flexibility of disclosures and ensure their responsiveness to economic and regulatory developments. The study also tries to answer to the most important legal, social and economic challenges that the Saudi Capital Market Authority (CMA) may face when determined to impose mandatory ESG disclosures on companies listed in the Saudi Capital Market (Tadawul), in order to achieve the objectives of Saudi Vision 2030 in developing the financial sector and promoting overall ESG rank.

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Table of Abbreviations

Abbreviation	Full Term
CG	Corporate Governance
CMA	Capital Market Authority
CSR	Corporate Social Responsibility
ESG	Environmental, Social and Governance
EU	European Union
FSA	Financial Services Authority
FSDP	Financial Sector Development Program
GCC	Gulf Cooperation Council
GRI	Global Responsibility Initiative
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
KSA	Kingdom of Saudi Arabia
LSE	London Stock Exchange
OECD	Organisation for Economic Co-operation and Development
SAMA	Saudi Arabian Monetary Authority
SASB	Sustainability Accounting Standards Board
SDGs	Sustainable Development Goals
TADAWUL	Saudi Stock Exchange
TCFD	Task Force on Climate-related Financial Disclosures
UK	United Kingdom
UKLR	UK Listing Rules
UN	United Nations

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Chapter 1: Introduction

1.1. Background to the Study

This study aims to assess the extent to which Saudi Arabia's capital market can benefit from the UK model of corporate governance, specifically in terms of applying the principle of “comply or explain” and the concept of “dynamic materiality” in regulating environmental, social and governance disclosures (ESG). The importance of this study comes from the growing need for flexible and effective regulatory frameworks that support disclosure practices, contributing to enhancing transparency, attracting investments and developing the financial sector in line with the objectives of Vision 2030.¹

In recent years, the world has undergone a fundamental shift in understanding the role of companies in society, the focus now became not only on shareholder financial returns,² but also extending to companies' responsibilities to the environment, society and governance,³ which meet the wider stakeholders' groups expectations.⁴ ESG concept encompasses responsible investment, sustainable investment, ethical investment, and green management. The flexibility of ESG is demonstrated in its use of multiple terms to describe it, which allows it to meet the needs and preferences of different groups of investors, companies, and private parties. The term ‘responsible investment’,⁵ may be preferred by some to describe the social and environmental responsibility of companies and investments. The concept of ‘ethical investment’⁶ may be preferred by others who prioritise ethical and value-based standards when making investment decisions, while ‘green management’⁷ may concentrate on environmental measures and enhancing corporate environmental operations. It is possible that these different ESG explanations demonstrate that stakeholders have diverse expectations of corporations. ESG disclosures are designed to inform about the company's environmental performance, social activities, and company policies that pertain to

¹ Saudi Vision 2030 <https://www.vision2030.gov.sa/en/> accessed 14 March 2024.

² Rob Gray, David Owen and Carol Adams, *Accounting & Accountability: Changes and Challenges in Corporate Social and Environmental Reporting* (Prentice Hall 1996).

³ Charl de Villiers, Mary Low and Grant Samkin, ‘The Institutionalisation of Mining Company Sustainability Disclosures’ (2014) 84(1) *Journal of Cleaner Production* 51.

⁴ Philip Cochran, ‘The Evolution of Corporate Social Responsibility’ (2007) 50(6) *Business Horizons* 449.

⁵ Pedro Matos, *ESG and Responsible Institutional Investing Around the World: A Critical Review* (CFA Institute Research Foundation 2020).

⁶ Amina Buallay, ‘Is Sustainability Reporting (ESG) Associated with Performance? Evidence from the European Banking Sector’ (2018) 30(1) *Management of Environmental Quality* 98.

⁷ Stephanie Pane Haden, Jennifer Oyler and John Humphreys, ‘Historical, Practical, and Theoretical Perspectives on Green Management: An Exploratory Analysis’ (2009) 47(7) *Management Decision* 1041.

employee health and safety,⁸ human resource issues such as the percentage of job nationalisation, and equal employment opportunity, as stated by Freedman and Wasley.⁹ In addition, it discloses governance features such as board structure and member independence. In this regard, a study of Gillan et al.,¹⁰ impact the company's performance over time. For example, factors such as the company's adherence to environmental standards in manufacturing or its social policies in the workplace or the governance structure within the company can reveal valuable information about the company's strategy for managing potential risks and opportunities. Thus, by including ESG factors in investment analysis, transparency and comprehensive evaluation of the company's performance can be promoted, leading to informed and informed investment decisions.

Disclosure of ESG standards has grown in importance in global legal and economic regulations,¹¹ particularly in the European Union (EU),¹² and the United Kingdom (UK),¹³ where each country adopts different models in regulating such disclosures. While the UK has moved towards the adoption of mandatory principle-based disclosure, countries like Saudi Arabia continue to adopt a voluntary approach to ESG disclosure, raising questions about the effectiveness of this approach in supporting transparency and sustainability. Many researchers agree that current ESG disclosures suffer from variability and ambiguity. El-Hage¹⁴ noted significant gaps in voluntary disclosures, where companies rely on non-standardized self-reports, potentially misleading investors and creating inaccurate assessments of sustainability practices. El-Hage¹⁵ highlights the need to adopt a mandatory disclosure framework through which to reduce the risks associated with greenwashing and ensure investors' access to consistent and comparable information. Macey,¹⁶ on the other hand, discusses the rise of the ESG movement as a response to Governments' failure to address environmental and social

⁸ Charmaine Coetzee and Chris van Staden, 'Disclosure Responses to Mining Accidents: South African Evidence' (2011) 35(4) Accounting Forum 232.

⁹ Martin Freedman and Charles Wasley, 'The Association between Environmental Performance and Environmental Disclosure in Annual Reports and 10-Ks' (1990) 3 Advances in Public Interest Accounting 183.

¹⁰ Stephen Gillan, Andrew Koch and Laura Starks, 'Firms and Social Responsibility: A Review of ESG and CSR Research in Corporate Finance' (2021) 66 Journal of Corporate Finance 101889.

¹¹ Melissa Bergman and others, 'ESG Disclosures: Frameworks and Standards Developed by Intergovernmental and Non-Governmental Organizations' (2020) Harvard Law School Forum on Corporate Governance <<https://corpgov.law.harvard.edu/2020/09/21/esg-disclosures-frameworks-and-standards-developed-by-intergovernmental-and-non-governmental-organizations/>> accessed 16 March 2025.

¹² European Banking Authority, Final Guidelines on the Management of ESG Risks (January 2025) <<https://www.eba.europa.eu/activities/single-rulebook/sustainable-finance/guidelines-management-esg-risks?version=2024#activity-versions>> accessed 11 March 2025.

¹³ International Financial Reporting Standards (IFRS), IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2: Climate-related Disclosures <<https://www.ifrs.org/sustainability/tcf/>> accessed 11 March 2025.

¹⁴ Jad El-Hage, 'Fixing ESG: Are Mandatory ESG Disclosures the Solution to Misleading ESG Ratings?' (2021) 26 Fordham Journal of Corporate & Financial Law 359.

¹⁵ *ibid.*

¹⁶ Jonathan Macey, 'ESG Investing: Why Here? Why Now?' (2022) 19 Berkeley Business Law Journal 258.

challenges, which has led to a broader corporate responsibility in this area. Macey considers that increased demand for ESG disclosures reflects a cultural shift towards relying on the private sector as a source of sustainable solutions.

At the local level, sustainability practices have emerged as a priority in Saudi Arabia's economic policies, especially within the framework of Vision 2030 and the Financial Sector Development Programme (FSDP)¹⁷ launched in 2018. This program seeks to build a legislative and investment infrastructure capable of attracting capital and enhancing the position of the Saudi capital market globally, including raising its rating by international ESG rating agencies. This requires the development of a sustainable and binding disclosure framework that balances flexibility and compliance, and keeps pace with international standards, particularly as global pressures towards comprehensive climate risk disclosure, human resources policies and institutional governance grow. Despite growing interest in the disclosure of ESG in the Saudi market, disclosures in many sectors remain inconsistent,¹⁸ limited in scope and quality, especially with the absence of binding legal requirements.¹⁹ Epstein and Friedman²⁰ also confirmed that some disclosures are provided in response to competition or as a tool to improve the mental image. Legally, Gilan et al believe that the integration of ESG factors into investment decision-making is often based on non-financial data that is difficult to measure accurately, reinforcing the need for clear and effective legal regulation. In this respect, it should be noted that the financial system in the Kingdom of Saudi Arabia is based on the principles and provisions of Islamic Sharia, which constitutes a fundamental dimension that affects legal and regulatory analysis, and requires taking into account Sharia compliance requirements when evaluating proposed disclosure models. In light of this, this study is based on a comparative review between the Saudi and the UK legislations, in order to explore the possibility of aligning the UK model with the special characteristics of the Saudi market, analyse whether the proposed legislative amendments will contribute to enhancing the quality of disclosures, alleviate the disparity in ESG practices, and ensure greater transparency and accountability.

1.3. Research Questions

In view of the accelerated developments in the regulation of environmental, social and governance disclosures (ESG), the Saudi capital market faces challenges in adapting to global disclosure standards, especially with its adoption of a rule-based

¹⁷ Saudi Vision 2030, Financial Sector Development Program, <<https://www.vision2030.gov.sa/en/vision-2030/vrp/financial-sector-development-program/>> accessed 16 March 2025.

¹⁸ Maha Abu Hussain, Maha Alsayegh and Helmi Boshnak, 'The Impact of Environmental, Social, and Governance Disclosure on the Performance of Saudi Arabian Companies: Evidence from the Top 100 Non-Financial Companies Listed on Tadawul' (2024) 16(17) Sustainability 7660.

¹⁹ *ibid.*

²⁰ Michael Epstein and Martin Freedman, 'Social Disclosure and the Individual Investor' (1994) 7(4) Accounting, Auditing & Accountability Journal 94.

governance model. Therefore, this study seeks to answer the key research question: How can listing in the Saudi capital market, based on the rule-based governance model, contribute to facilitating the ESG disclosure requirements of publicly listed companies, taking into account the economic, social and legal challenges associated with this transition?

To answer the main question, the study addresses a series of sub-questions that help to reach a comprehensive answer to the study's main question. As disclosures extend to environmental and social dimensions as well as governance, this study answers the question to what extent do the differences between traditional governance and ESG disclosure requirements pose a challenge to public companies in terms of compliance and transparency? Focusing on the UK's principle-based governance approach and its adoption of the concept of dynamic materiality in determining the scope of environmental, social and governance disclosures, the study examines to what extent does the principle-based corporate governance framework contribute to enhancing the effectiveness of such disclosures? Finally, aiming to contribute to the legal literature on the Saudi capital market, this study answers the extent to which the Saudi capital market can benefit from the UK corporate governance model in applying the concept of the dynamic materiality of ESG disclosures and the principle of “comply or explain” in any reforms the CMA intends to take with regard to ESG disclosures?

1.4. Study Motivations and Objectives

1.4.1. Study Motivations

The shift towards sustainable investment has not evolved organically; There was even considerable pressure, including regulatory pressure,²¹ that affected even institutional investors to accelerate this shift. After the 2015 Paris Agreement, which is “a legally binding international treaty on climate change”,²² and the UN Sustainable Development Goals (SDGs),²³ more sustainable economies are needed, necessitating legislation modernization and public companies' involvement in achieving these goals.

²¹ McKinsey & Company, Agile Resilience in the UK: Lessons from COVID-19 for the ‘Next Normal’ (13 October 2020) <<https://www.mckinsey.com/capabilities/people-and-organizational-performance/our-insights/agile-resilience-in-the-uk-lessons-from-covid-19-for-the-next-normal>> accessed 13 September 2024.

²² United Nations Climate Change (UNCC), The Paris Agreement <<https://unfccc.int/process-and-meetings/the-paris-agreement>> accessed 18 July 2024.

²³ United Nations Department of Economic and Social Affairs, Sustainable Development Goals <<https://sdgs.un.org/goals>> accessed 18 March 2025.

On a governmental stage, many countries and governments, including the UK (Net Zero Government Initiative),²⁴ Qatar (GHG management strategy),²⁵ and the United Arab Emirates (UAE Energy Strategy 2050),²⁶ have introduced new legislation and policies to create a sustainable economy and reach zero emissions by 2050 and after. Saudi Arabia was one of these countries, and through Vision 2030, launched the Green Saudi Initiative,²⁷ which includes a circular economy strategy to reduce carbon emissions and achieve zero emission by 2060. This requires the involvement of public companies in the implementation of this strategy,²⁸ which means companies' obligation to disclose their climate information.

Besides the government level, states such as the European Union (EU) and the UK have recently mandated climate disclosures for public companies. The General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures²⁹ aim to enhance transparency and responsibility within financial markets, highlighting the importance of public companies' role in achieving sustainability goals. These legislative pressures also extended to institutional investors, putting pressure on public companies and controlling their environmental and social performance. In this regard, the UK has adopted the Stewardship Code 2020,³⁰ which encourages institutional investors to follow and monitor companies' adherence to ESG standards. Institutional investors, such as pension funds and investment funds, are increasingly asking companies to disclose their environmental, social, and governance practices to ensure the sustainability of their investments³¹. These investors recognize that ESG issues can significantly affect companies' financial performance, whether through risks, such as environmental disasters, or opportunities, such as sustainable innovations.

In the context of Vision 2030, Saudi Arabia seeks to play an active role in finance and international relations, stimulate foreign investment, forge financial partnerships

²⁴ 'The UK government aims to reduce all direct emissions from public sector buildings by 50% and 75% by 2032 and 2037 respectively, against a 2017 baseline. All UK emissions are to reach net zero by 2050.01"2023/12/. Department for Energy Security and Net Zero, 'Net Zero Government Initiative' (December 2023) <<https://assets.publishing.service.gov.uk/media/6569cb331104cf000dfa7352/net-zero-government-emissions-roadmap.pdf>> accessed 16 March 2025.

²⁵ Qatar Energy LNG, 'Sustainability and Environment' <<https://www.qatarenergylng.qa/english/sustainability/environment>> accessed 18 July 2024.

²⁶ United Arab Emirates Government Portal, 'UAE Energy Strategy 2050' <<https://u.ae/en/about-the-uae/strategies-initiatives-and-awards/strategies-plans-and-visions/environment-and-energy/uae-energy-strategy-2050>> accessed 18 July 2024.

²⁷ Saudi Vision 2030, Saudi Green Initiative' <<https://www.vision2030.gov.sa/en/projects/saudi-green-initiative/>> accessed 19 July 2024.

²⁸ Philipp Krueger, Zacharias Sautner, Dragon Tang and Rui Zhong, 'The Effects of Mandatory ESG Disclosure Around the World' (2024) 62(5) Journal of Accounting Research 1795.

²⁹ International Financial Reporting Standards (IFRS) Foundation, IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2: Climate-related Disclosures <<https://www.ifrs.org/sustainability/tcfd/>> accessed 8 March 2025.

³⁰ Financial Reporting Council, UK Stewardship Code 2026 <https://www.frc.org.uk/documents/8364/UK_Stewardship_Code_2026.pdf> accessed 8 August 2025.

³¹ Laura Starks, 'Presidential Address: Sustainable Finance and ESG Issues—Value versus Values' (2023) 78(4) The Journal of Finance 1345.

and participate in international financial cooperation. Saudi Arabia's efforts are summarised in the Financial Sector Development Program,³² which aims to position the country as a leading global financial centre and attract a wide range of private investors. However, Saudi Arabia's financial market faces challenges in applying ESG standards as there is no clear regulatory framework to ensure effective disclosure of sustainability information.³³ This challenge is closely linked to Vision 2030, which seeks to enhance the attractiveness of the Saudi capital market and increase foreign investment.³⁴ According to a study by Belahmidi et al ,³⁵ developing local frameworks for sustainable environmental management reporting and green classifications in developing countries in line with global standards may progressively support their access to these green investment funds. Thus, as investor demand for ESG reports grows, Saudi companies need to improve transparency and disclose their sustainable practices. This is not only to raise the attractiveness of the market, but also to realise Saudi Arabia's commitments under the Saudi Green Initiative and the Financial Sector Development Program, which aims to raise the attractiveness of the financial market by raising its indices with ESG agencies and ensuring compliance with the highest international standards in this area.

1.4.2. Study Objectives

The main objective of this research is to analyse the role of the corporate governance approach in facilitating ESG disclosure requirements for public companies in Saudi Arabia. This includes studying how Saudi capital market reforms benefit from the UK's experience in applying ESG standards. One of the sub-objectives of the research is;first, assess and compare regulatory frameworks to disclose ESG standards in Saudi Arabia and the United Kingdom. This goal seeks to understand the regulatory basis governing ESG-related disclosures in both Saudi Arabia and the UK, including differences and similarities between them. The purpose of this assessment is to identify effective methods and gaps within each framework, helping to understand how these frameworks are applied and impact public companies. Since the research question focuses on the role of listing in facilitating ESG disclosure, analysis of regulatory frameworks provides essential data to determine how this role can be effectively achieved and to learn lessons learned from the UK's experience that can be applied in Saudi Arabia.

Second, explore the challenges faced by Saudi Arabia's public companies in applying ESG standards. This objective is to identify and understand the obstacles to

³² Saudi Vision 2030, Financial Sector Development Program <<https://www.vision2030.gov.sa/en/vision-2030/vrp/financial-sector-development-program/>> accessed 16 Mar 2025.

³³ *ibid.*

³⁴ *ibid.*

³⁵ Claudia Belahmidi and others, 'Accelerating Climate Finance for Saudi Arabia's Net Zero Ambitions: Green Financing Frameworks' (2024) KAPSARC KS--2024-II20 <<https://www.kapsarc.org/research/publications/accelerating-climate-finance-for-saudi-arabias-net-zero-ambitions-green-financing-frameworks/>> accessed 18 March 2025.

Saudi public companies from effectively integrating ESG standards into their operations and disclosures. By identifying these challenges, research can provide recommendations to improve regulatory frameworks and policies, helping companies meet ESG disclosure requirements more effectively and contributing to enhancing the company's long-term value.³⁶ This goal is closely linked to the main research question as it looks at how to strengthen the listing role to facilitate these requirements by overcoming existing challenges.

Third, identify the gaps in the current literature and practice regarding the disclosure of ESG in Saudi Arabia and propose ways to improve. Making these recommendations is using data and results collected from evaluation, comparison and exploring challenges to develop concrete solutions that support public companies in the effective disclosure of ESG standards. This allows lawmakers and regulators to better understand the measures needed to stimulate improvements in this area. Achieving this goal directly contributes to answering the key research question by providing strong foundations for enhancing the role of listing in facilitating ESG disclosures, drawing on lessons from leading international experiences such as the UK.

1.5. Previous Studies and Knowledge Gap

Previous studies, such as those conducted by the CFA Institute,³⁷ and academic research such as the study of Abdulhalim and Al-Nusairat,³⁸ and Syed et al ,³⁹ provide valuable data on the impact and importance of social responsibility disclosure and ESG practices. However, these studies indicate limitations such as inadequate geographical representation and insufficient focus on specific markets such as Saudi Arabia. This explains the need for detailed research focusing on best practices in applying ESG standards and disclosures in the Saudi capital market and assessing the challenges and opportunities that can confront governance legislation and disclosures of public companies listed in Tadawul Saudi Arabia.

In short, by highlighting the challenges and opportunities associated with the disclosure of ESG in Saudi Arabia, and comparing it with international experiences such as the UK, this study aims to fill knowledge gaps and provide a framework for improving policies and regulations. By doing so, Saudi Arabia can strengthen its position as a financial market that supports transparency around sustainability practices

³⁶ Gabriel Badía, Francisco Gómez-Bezares and Luis Ferruz, 'Are Investments in Material Corporate Social Responsibility Issues a Key Driver of Financial Performance?' (2022) 62(3) Accounting & Finance 3987.

³⁷ CFA Institute, 'Survey of CFA Institute Members on Latest ESG Matters' (2021) <<https://www.cfainstitute.org/>> accessed 28 March 2024.

³⁸ Abdullah Abdulhalim and Ahmad Al-Nusairat, 'The Extent of Social Responsibility Disclosure in Saudi Corporate Financial Reports: A Field Study' (2018) 51(17) Journal of Humanities and Social Sciences 63.

³⁹ Ali Syed, Asem Alhomaiddi, Bader Almuhtadi, and Hoda AboAlsamh, 'The Impact of Social Performance on Financial Performance of Listed Companies in Saudi Arabia' (2021) Capital Market Authority <https://cma.org.sa/en/ResearchAndReports/Documents/ESG_Study.pdf> accessed 18 February 2025.

and corporate social responsibility, thus contributing to attracting more sustainable investments and promoting long-term economic growth.

1.6. Statement of Methodology

Current research is based on a mixed approach that combines doctrinal methodology, legal transplant approach, and qualitative analysis methodology to understand and analyse ESG performance disclosure requirements and their impact on Saudi Arabia's capital market. The following paragraphs will explain each methodology separately, clarifying the reasons for its choice and its role in answering study questions.

The use of a doctrinal methodology is utilized in this research to comprehend and evaluate the requirements for ESG disclosure and its impact on Saudi Arabia's capital market. Hutchinson and Duncan have defined the term 'doctrine' as a synthesis of numerous rules, principles, norms, interpretive guidelines, and values that explains, makes coherent, or justifies one section of the law as a component of a larger legal system.⁴⁰ According to Australia's Pierce Commission (1987),⁴¹ this methodology aims to systematically present legal norms, analyse their relationships, identify areas of difficulty and predict future developments. These definitions show the importance of doctrinal methodology as research tool in legal studies, focusing on the deep conceptual analysis of relevant legislation and jurisprudence⁴², which helps to understand the relationship between legal norms and their interpretation in the context of the broader legal system.⁴³ This approach has therefore been chosen because it allows a deeper understanding of legal texts and examination of legal theories and principles relating to ESG disclosures in the context of Saudi corporate law and the Corporate Governance Regulation of Public Companies listed in the Saudi stock exchange (Tadawul).

Mainly, the doctrinal methodology consists of two activities: collecting legal materials, and providing interpretive analysis of them.⁴⁴ Authoritative sources should be used to collect materials in the process of collecting doctrine research,⁴⁵ includes laws, treaties, case law, summaries, contracts and parliamentary history, as well as academic research.⁴⁶ This process may also require the inclusion of -non-legal sources,

⁴⁰ Terry Hutchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2013) 21(3) *Legal Education Digest* 83.

⁴¹ *ibid.*

⁴² S.N. Jain, 'Doctrinal and Non-Doctrinal Legal Research' (1982) 24(2/3) *Journal of the Indian Law Institute* <<http://www.jstor.org/stable/43952212>> accessed 13 March 2025.

⁴³ Terry Hutchinson, 'The Doctrinal Method: Incorporating Interdisciplinary Methods in Reforming the Law' (2015) 8 *Erasmus Law Review* 130; Deon Coetsee and Pieter Buys, 'A Doctrinal Research Perspective of Master's Degree Students in Accounting' (2018) 32(1) *South African Journal of Higher Education* 71.

⁴⁴ Sanne Taekema and Wibren van der Burg, 'Legal Philosophy as an Enrichment of Doctrinal Research Part I: Introducing Three Philosophical Methods' (2020) *Law and Method* January 1.

⁴⁵ Rob van Gestel and Hans Micklitz, 'Revitalizing Doctrinal Legal Research in Europe: What About Methodology?' (2011) *EUI Paper* 2011/05 <<https://ssrn.com/abstract=1824237>> accessed 24 July 2024.

⁴⁶ Amrit Kharel, 'Doctrinal Legal Research' (2018) *SSRN* 3130525.

such as texts on the social and economic context of the issues under consideration.⁴⁷ Interpretative analysis includes giving texts meaning and connecting them to each other to understand them as a coherent whole rather than separate parts⁴⁸. As part of the study of the impact of ESG disclosure requirements on the Saudi capital market, the jurisprudence methodology provides the tools to analyse legal principles and theories related to this subject. Through this methodology, the legal texts on ESG disclosures can be understood in an integrated manner and linked to the broader legal system of corporate law and corporate governance regulations, and local legal culture. The doctrinal approach also allows comparison of different legislation and schools of jurisprudence, as the comparative methodology has become an integral part of the jurisprudence methodology,⁴⁹ contributing to providing informed insights into the effectiveness of global laws and practices related to the disclosure and application of ESG in the Saudi market. Good jurisprudence research goes beyond description and analysis, proposing ways to improve the law, philosophy, and administration,⁵⁰ which this study needs to analyse the changing ESG issues affected by each country's local environments and social and economic conditions.

In order to answer the study's questions, the doctrinal methodology alone may not be sufficient to understand complex legal issues, so a supportive methodology, the comparative methodology of the legal implant approach, is often used. The legal transplant approach is based on the application of laws in a particular country (country of origin) in another country (recipients of the system).⁵¹ This approach is part of comparative methodologies because it requires an analysis of both countries' legislative systems, as well as an examination of social conditions, environmental, and historical factors that may affect the effectiveness of the transfer of laws. McEvoy⁵² refers to several purposes for the use of this method, including examining the possibility or need for harmonization of different countries' laws into a single law, and confirming the harmonization of national laws with international laws. Given these purposes, it appears that comparative law through a legal implant approach is not only a legal analysis tool, but also a framework for legal thinking and the provision of innovative legal solutions. Von Barr⁵³ discusses why lawmakers use comparative law, focusing on supporting already existing political decisions and providing inspiring solutions to narrow social problems facing domestic law. It is noted here that what distinguishes a legal transplant approach is that it not only compares similarities and differences between different legal systems, but provides a broader dimension to understanding the changing nature of the law.⁵⁴ The legal transplant approach allows the study of the

⁴⁷ Taekema and Burg (n 44).

⁴⁸ *ibid.*

⁴⁹ Hutchinson (n 40).

⁵⁰ *ibid.*

⁵¹ Mark Van Hoecke, *Legal Culture and Legal Transplants* (Routledge 2016).

⁵² Siobhán McEvoy, 'Descriptive and Purposive Categories of Comparative Law' in Pier Giuseppe Monateri (ed), *Methods of Comparative Law* (Edward Elgar Publishing 2012).

⁵³ Christian von Bar, *Comparative Law of Obligations* (Hart Publishing 2004).

⁵⁴ Tobias Goldbach, 'Why Legal Transplants?' (2019) 15(1) *Annual Review of Law and Social Science* 538.

causes and processes leading to legal reform and change, providing a comprehensive understanding of how laws adapt to different environments.⁵⁵ With this understanding, effective legislation can be developed in line with environmental, social, and historical variables,⁵⁶ enhancing the effectiveness of its application in new legal contexts.

Based on the aforementioned explanation, comparative methodology and legal transplant method were chosen because of the need to answer the fundamental research question about how Saudi stock market legislation can learn from the UK experience in the matters of ESG disclosures. Using both a doctrinal and comparative approach, Saudi and British legislation on ESG disclosures, identifying potential gaps and problems, and knowing the potential to leverage UK experiences to improve Saudi legislation can be analysed, enhancing transparency and responsibility and increasing the Saudi market's attractiveness to international investors. To achieve this objective, it is necessary to compare the scope and type of legislative powers that regulators have over financial markets in these countries, which enable them to enforce or restrict the disclosure of ESG cases. The UK is selected for comparison because of its progress in environmental disclosure and sustainability, making legislative changes in line with its sustainable development plan. These endeavours have led to new binding sustainability disclosure requirements by public companies listed in the UK.⁵⁷ The disparity in the legislative framework for disclosure between the two countries indicates the need to understand and study each country's diverse corporate governance systems, a key element of environmentally sound management that will be described in Chapter 3 of this study.

1.6.1. Study Sample Qualitative Analysis Methodology

Qualitative analysis methodology is an essential tool for understanding the meanings and interpretations associated with non-numerical data, especially in legal and social studies that require careful and in-depth analysis of texts and contexts. According to Miles and Haberman,⁵⁸ qualitative analysis includes a set of processes and techniques aimed at regulating non-numerical data, such as texts, documents and observations, to understand patterns and subjects that reflect the profound meaning of such data. Webley⁵⁹ supports this vision by emphasizing that qualitative analysis is a multifaceted

⁵⁵ *ibid.*

⁵⁶ Jaap Hage, 'Comparative Law as Method and the Method of Comparative Law' (2014) Maastricht European Private Law Institute Paper 2014/11 < <https://ssrn.com/abstract=2441090> > accessed 24 July 2024.

⁵⁷ UK Government, Task Force on Climate-related Financial Disclosure (TCFD)-aligned Disclosure Application Guidance – Phase 1 and Phase 2 (updated 21 March 2024) <<https://www.gov.uk/government/publications/tcf-aligned-disclosure-application-guidance/task-force-on-climate-related-financial-disclosure-tcf-aligned-disclosure-application-guidance>> accessed 24 July 2024.

⁵⁸ Matthew Miles and Michael Huberman, *Qualitative Data Analysis: An Expanded Sourcebook* (2nd edn, Sage Publications 1994).

⁵⁹ Lisa Webley, 'Qualitative Approaches to Empirical Legal Research' in Peter Cane and Herbert M Kritzer (eds), *The Oxford Handbook of Empirical Legal Research* (Oxford University Press 2010; online edn, Oxford Academic, 18 September 2012).

tool used to understand “why” and “how” rather than “to what extent”, enhancing its ability to deal with complex issues that cannot be explained by quantitative methods alone. Webley⁶⁰ shows the importance of qualitative methods, such as document analysis and in-depth observations, in interpreting meanings and patterns hidden in text data. In addition, scholars Chandra and Shang,⁶¹ and Argyrou⁶² noted that qualitative analysis is based on rich and diverse data that contributes to the detection of complex legal and regulatory dynamics and explain the functioning of the legal system in reality. This methodology provides a framework that allows interpretation of text data within its legal, regulatory and industry type contexts, making it ideal for studying ESG-related disclosures.

In this study, qualitative analysis was used as an essential tool to understand and analyse ESG-related disclosures provided by companies listed in the Saudi market. This approach allows interpretation of disclosures to understand the patterns and factors affecting them, focusing on the sample of companies listed in the parallel market “Nomu” and the sample of companies listed in the main market. Gioia⁶³ and Webley⁶⁴ support the importance of “letting the data speak”, reflecting the repetitive and emerging nature of qualitative analysis, which allows analysis of disclosures to identify patterns affecting the level of commitment and quality of reports.

In order to enhance the credibility of the qualitative analysis, a sample of 41 companies listed on the Saudi stock market “Tadawul” was selected, comprising 29 companies from the main market and 12 companies from the parallel market “Nomu”. Two companies were randomly selected from each major sector in each market, allowing wide representation of different economic sectors considering the segment of market -main or parallel-. Industries with no more than one company were also excluded to ensure comparability within the sector. This distribution helps assess whether the nature of the industry or the market segment affects the level of ESG disclosure, and contributes to understanding the extent to which the regulatory and economic environment affects the quality of voluntary disclosures.

Data have been collected from annual disclosures and ESG reports available via the official “Tadawul” website, enhanced by additional data from official corporate websites, to ensure the diversity and comprehensiveness of data sources. The data was manually organized using Excel sheets program to classify and compare disclosure indicators between companies. Thereafter, the data were organised using a framework that contributes to their systematic analysis to understand patterns and infer

⁶⁰ *ibid.*

⁶¹ Yanto Chandra and Lin Shang, ‘Qualitative Research: An Overview’ in *Qualitative Research Using R: A Systematic Approach* (Springer, Singapore 2019) https://doi.org/10.1007/978-981-13-3170-1_1.

⁶² Alexandros Argyrou, ‘Making the Case for Case Studies in Empirical Legal Research’ (2018) 13(3) *Utrecht Law Review* 95.

⁶³ Dennis Gioia, ‘The Long, Hard Road to Legitimacy for Qualitative Research: A Personal–Professional Journey’ in *The Routledge Companion to Qualitative Research in Organization Studies* (Routledge 2017).

⁶⁴ Webley (n 59) 11.

relationships between the variables.⁶⁵ The analysis relied on the objective analysis methodology (Thematic Analysis), through in-depth reading of the data, identifying recurring indicators within the axes of environmental, social and governance, and classifying them into main topics that reflect the level of commitment and quality of disclosure. To deepen the analysis, a comparative analysis was conducted to clarify the gaps between the different samples, as the results were compared between companies in the parallel and main market according to the level of commitment, with a view to reaching a comprehensive view on the quality of the disclosures and the factors affecting. However, some methodological limitations that may affect the results should be noted, including reliance on published disclosures only, which may obscure some undeclared practices. Qualitative analysis is also inherently influenced by the researcher's interpretation, despite efforts to adhere to methodological standards and achieve transparency. On the bright side, the abundance of data and its comparative analysis boost the reliability of the results and provide practical recommendations for bettering future disclosures in the Saudi market.

The justification for selecting a qualitative methodology is highlighted by the non-numerical nature of data based on texts and reports that require detailed interpretation and analysis, taking into account the legal context and type of industry, affecting disclosures and enhancing understanding of different impacts. Accordingly, this methodology contributes to providing a systematic framework for identifying key patterns and drawing conclusions that contribute to the development of recommendations to improve future disclosure practices in the Saudi capital market.

1.7. Structure of the Study

Chapter 1: Introduction.

This chapter presents the research background, the research problem, the central argument statement, the objectives and relevance of the study's topic, and its distinction from other previous studies. The chapter also clarifies the main and subsidiary questions to be answered in this paper, as well as the methodology to be followed in this research.

Chapter 2: Foundations of Environmental, Social, and Governance (ESG)

This chapter addresses the research question of the extent to which the difference between traditional corporate governance disclosure requirements and ESG disclosure requirements poses a challenge for public companies in terms of compliance and transparency. The chapter reviews ESG disclosure principles and models in local and international contexts, explaining the evolution of these standards and their impact on listed companies. It also discusses whether these differences represent regulatory

⁶⁵ Yanto Chandra and Lin Shang, 'Qualitative Research: An Overview' in *Qualitative Research Using R: A Systematic Approach* (Springer, Singapore 2019).

hurdles or challenges in achieving compliance, or whether they contribute to enhancing corporate sustainability and increasing transparency in financial markets.

Chapter 3: The Role of the Corporate Governance Framework in ESG Disclosures

This chapter answers the research question of how the corporate governance framework contributes to enhancing the effectiveness of environmental, social and governance (ESG) disclosures, with a focus on the UK's principles-based approach to governance and its adoption of the concept of dynamic materiality in determining the scope of these disclosures. The chapter reviews the relationship between governance systems and disclosure requirements, highlighting how the regulatory framework affects the quality and resilience of environmental and social disclosures. It also discusses the requirements for listing on the UK capital market, and the role of the “comply or explain” system in enabling companies to adapt to economic and environmental variables while ensuring a certain level of transparency.

Chapter 4: Saudi Arabia’s ESG Approach and Challenges

Chapter 4 focuses on regulating public companies listed in the Saudi capital market, while examining the regulations imposed by the CMA to achieve transparency and effective governance. It also reviews legal and regulatory challenges affecting the quality of disclosures, such as greenwashing. The analysis in this chapter is based on a sample of companies listed in the Main Market and the Parallel market (Nomu), with the aim of examining differences in the quality of disclosure and compliance standards, which helps to provide a clear view of the challenges and opportunities facing the Saudi market. The chapter provides an answer to a key part of the study's main question, looking at how listing on the Saudi capital market, under a rules-based governance model, can facilitate ESG disclosure requirements.

Chapter 5: Proposing an Effective Framework for ESG Disclosure for Saudi Capital Market:

This chapter answers the extent to which the Saudi capital market benefits from the UK governance model in applying the concept of materiality of ESG disclosure and the principle of “comply or explain” in any proposed regulatory reforms. The chapter provides a regulatory framework for ESG disclosure, drawing on the UK experience, by analysing the transferability of disclosure practices to the Saudi context using legal transplant methodology. The analysis is based on comparing the Saudi and the UK approaches, with a focus on identifying dynamic materiality of information required for disclosure under governance regulations. It also discusses solutions to the challenges that may face legislative reforms necessary to enhance transparency and sustainability, in line with Vision 2030 and improve the classification of the Saudi market in global sustainability standards.

Chapter 6: Conclusions

This chapter is devoted to summarizing the results of the study and emphasizes its central argument.

Chapter 2: Foundations of Environmental, Social, and Governance (ESG)

2.1. Introduction

This chapter reviews the differences between traditional corporate governance disclosure nature and ESG disclosure nature, focusing on public companies' compliance and transparency challenges. The chapter addresses the evolution of disclosure standards at the domestic and international levels and explains how the shift from focusing on financial factors only to integrating environmental and social dimensions has created regulatory gaps that may impede compliance or, conversely, enhance the sustainability and reliability of financial markets. The chapter is divided into two main parts; the first part reviews traditional regulatory frameworks for corporate disclosures and their evolution to include ESG standards, while the second Part analyses the impact of these changes on public companies, and their ability to adapt to new requirements, both from a legal compliance perspective and in terms of enhancing investor and stakeholder confidence. Through this analysis, the chapter seeks to answer the research question of how the differences between traditional disclosure and ESG requirements affect public companies' compliance and transparency, and whether these changes pose a regulatory challenge or an opportunity to promote sustainable practices.

2.2. Definitions of ESG Pillars

It is important to understand the different definitions of the concept of ESG because it plays an important role in guiding practices. Understanding the purpose of ESG disclosures helps guide companies and investors towards making the right decisions regarding investments and sustainability practices. Clarifying the definition can contribute to defining the goals and standards that companies should target as well as evaluating their performance and directing them towards continuous improvement. This section will therefore focus on clarifying the definition of the concept of ESG.

2.2.1 Definition Provided by International Rating Organizations or Agencies

The United Nations presents the 2030 Agenda for Sustainable Development as a common plan for peace and prosperity for people and planet, and includes 17 Sustainability Development Goals (SDGs).⁶⁶ These goals aim to call on all nations to work jointly in a global partnership to end poverty and deprivation, improve health and education, reduce inequality, promote economic growth, and work to preserve oceans and forests. This is clear from the breadth of the concept of sustainable practices, as it

⁶⁶ United Nations, Transforming Our World: The 2030 Agenda for Sustainable Development (UN 2015) <<https://sdgs.un.org/2030agenda>> accessed 19 March 2025.

encompasses the actions of individuals, companies, communities, and states in general. When discussing the sustainability practices of listed companies, it is important to acknowledge that these goals may not be in accordance with the business environment or vary from country to country. Looking at the objective of the UN (SDGs) and the indicators for evaluating sustainable corporate performance, the standards focus on three key pillars of sustainability: Environment, Social, and Governance.

In this context, the European Commission⁶⁷ has proposed a classification of sustainable investments based on several considerations, such as achieving circular economy policy, emission reduction practices, and protecting biodiversity. This classification provides greater clarity on what sustainable finance means and what new environmental and social management duties require. This step is an important effort that contributes to the development of the ESG disclosures concept by providing a clearer and more targeted framework for companies and investors. By classifying sustainable investments based on several criteria, companies can identify the environmental and social practices they adopt and are more committed to.

Also, the Global Reporting Initiative (GRI)⁶⁸ has defined a standard system of interconnected standards that allow organisations to publicly report on the impacts of their activities on environmental and social aspects in an organized and transparent manner. According to GRI, the foundation of Sustainability reporting for an organization is “to identify and prioritise its impacts on the economy, environment, and people - to be transparent about their impacts”.⁶⁹ This clarification is significant in the sustainability field, emphasizing the importance of analysing the effects of companies and institutions on the economy, environment, and society. Companies can take action to improve sustainability and increase their societal responsibility by understanding and transparently disclosing these impacts.

From the UK perspective, although market regulations and laws, including the Corporate Governance Code 2024⁷⁰ and the FCA's ESG Sourcebook,⁷¹ address many aspects of the environment, social responsibility, and governance, there is no specific or clear definition of ESG's concept within these regulations. Instead of providing a uniform definition, these regulations focus on encouraging companies to disclose their sustainable environmental and social governance practices in line with international standards such as GRI and SASB. This approach reflects the flexibility of the UK approach, providing a framework that allows companies to apply sustainability

⁶⁷ European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks COM(2018) 355 final (24 May 2018).

⁶⁸ Global Reporting Initiative, ‘A Short Introduction to the GRI Standards’ <<https://www.globalreporting.org/>> accessed 5 September 2024.

⁶⁹ *ibid.*

⁷⁰ Financial Conduct Authority, Environmental, Social and Governance (ESG) Sourcebook (August 2024) <<https://www.handbook.fca.org.uk/handbook/ESG/>> accessed 5 September 2024.

⁷¹ *ibid.*

practices in ways commensurate with their unique nature and circumstances, focusing on transparency and responsibility without imposing a firm definition of ESG.

In this context, Chiu⁷² commented that the UK Financial Conduct Authority is reluctant to provide fixed definitions of the ESG concept, given that the definition may be incompatible with future industrial developments. This frequency allows for greater flexibility, as industrial developments and diversified stakeholders can guide companies in choosing the frameworks they use to classify their investments as sustainable investments. In addition, exchange indices have been recognised as voluntary frameworks that can be used to assess performance in multiple areas such as human rights, environmental sustainability, anti-corruption and supply chain standards. These indicators provide important performance standards for companies and investors in terms of sustainability, enhancing the ability to achieve transparent and responsible business practices.⁷³ Thus, the UK approach reflects a balance between flexibility and encouraging transparency, without imposing specific tariffs, while allowing companies to adapt to variables and rely on voluntary frameworks and international standards to enhance their sustainability and governance performance.

On the Saudi side, the ESG Disclosure Guidelines of the Saudi Tadawul⁷⁴ explains that the ESG term means a wide range of considerations that can affect a company's ability to implement its business strategy. It also points out that these factors may sometimes be called “non-financial factors” or “additional financial factors”, and emphasises that how a company manages these factors has undoubtedly financial implications. The definition reflects a comprehensive understanding of this concept and has also shown that these practices directly affect companies' business performance and contribute to long-term sustainability. With regard to the environmental aspect, the concept refers to the importance of managing environmental issues such as climate pollution and water use.⁷⁵ These issues not only affect companies' environmental performance, but also play a critical role in mitigating environmental risks and enhancing companies' ability to adapt to future challenges. Companies that manage these aspects are more resilient to environmental crises and comply with international and domestic environmental policies.⁷⁶ This concern for the environment reflects the importance of strategic planning for natural resource management and reducing harmful emissions, which promotes long-term ecological sustainability. Socially, the concept focuses on the company's performance in managing social issues such as

⁷² Iris Chiu, ‘Investor Stewardship and ESG at Companies – New Developments’ (2020) 41(6) Company Law 155.

⁷³ *ibid.*

⁷⁴ Saudi Exchange (Tadawul), ESG Disclosure Guidelines (2021) <<https://www.saudiexchange.sa/wps/portal/saudiexchange/listing/issuer-guides/esg-guidelines>> accessed 5 September 2024.

⁷⁵ David Broadstock, Roman Matousek, Matthias Meyer and Nikolaos Tzeremes, ‘Does Corporate Social Responsibility Impact Firms’ Innovation Capacity? The Indirect Link between Environmental & Social Governance Implementation and Innovation Performance’ (2020) 119 Journal of Business Research 99.

⁷⁶ *ibid.*

customer responsibility, health, and public safety.⁷⁷ These aspects point to the importance of achieving employee benefits and ensuring a safe working environment, which promotes business continuity and avoids potential social crises⁷⁸. Good handling of these aspects reflects companies' commitment to their responsibilities to society and enhances stakeholder confidence. A focus on the social dimension shows that successful companies in this area are able to build sustainable relationships with the community, employees and customers, increasing their long-term stability. In terms of governance, the concept focuses on issues such as anti-corruption and risk management, which are key elements in ensuring a company's financial stability and enhancing its resilience to crises.⁷⁹ Good corporate governance is not only a key element in enhancing transparency and accountability, it also helps to manage financial crises effectively. Adherence to sound governance rules contributes to building trust between investors and other stakeholders and enhances the company's stability in financial markets.

Through The Saudi Tadawul's definition, ESG indicators appear to reflect a significant interest in promoting sustainable and responsible practices in financial and economic markets. Evaluating companies' performance in these three aspects is not only about achieving environmental or social gains, but also contributes to building more sustainable institutions that are capable of responding to financial and environmental crises.

2.2.2. The Concept of ESG in Scholarship

In the corporate and business law literature, it is equally difficult to obtain a definition of ESG with global agencies and organizations specialized in ESG. Harper⁸⁰ defines the term ESG by clarifying its uses, saying that it is used to refer not only to sustainability measures or specifically ESG practices, but to all non-financial factors that can have an impact on the financial performance of a business, such as corporate governance, labour and employment standards, human resource management, and environmental practices.

The 2009 Social Investment Forum (SIF)⁸¹ also sees ESG as Socially Responsible Investment (SRI), whereby it is based on environmental, social, and corporate governance standards to generate long-term, competitive financial returns with a positive societal impact. It means the process of financial investment that takes into account the social, environmental, and corporate governance implications - and/or investing in the activity of the local community and shareholders. According to

⁷⁷ David. Broadstock, Kalok Chan, Louis Cheng and Xiaowei Wang, 'The Role of ESG Performance During Times of Financial Crisis: Evidence from COVID-19 in China' (2021) 38 Finance Research Letters 101716.

⁷⁸ *ibid.*

⁷⁹ *ibid.*

⁸⁰ Harlan Harper, 'Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk' (2016) 41 Journal of Corporation Law 647.

⁸¹ US SIF Foundation, Annual Report 2009 <https://www.ussif.org/files/Publications/2009_SIF_Annual_Report.pdf> accessed 7 September 2024.

Sparkes,⁸² Socially Responsible Investing (SRI) is unique in that it combines financial goals with social responsibility. This distinction separates SRI from both traditional investing, which focuses solely on a financial return, and charitable giving, which requires no financial return. It is noted that the definition of SIF and Sparks addresses ESG from the perspective of responsible social investment and focuses on the ethical and social dimension, while Harper's definition addresses ESG as a non-financial performance analysis tool linked to corporate management.

In accordance with the UN (SDGs) and definitions in the investment and financial law literature in this section, This study defines the ESG Framework as a comprehensive corporate governance strategy and guiding its financial investments in a way that ensures that investors' targeted profits are achieved, while preserving the environment and not disrupting its balance, and coexisting in line with the social and economic norms of the State in which the company operates. More precisely, this strategy seeks to harmonize financial return with environmental and social responsibility to ensure sustainable development and a positive contribution to the local economy. It has been pointed out in other literature that ESG is sometimes understood as a comprehensive governance framework that integrates environmental, social, and governance factors into investment decisions, and aims to promote long-term value growth, as defined by Li et al⁸³ who described ESG as an investment philosophy that seeks long-term growth in value, a concrete and comprehensive governance method. It is noted that the definition of SIF and Sparks addresses ESG from the perspective of responsible social investment and focuses on the ethical and social dimension, while Harper's definition addresses ESG as a non-financial performance analysis tool linked to corporate management.

In a critical review of Matos,⁸⁴ ESG is viewed as an investment approach that takes into account environmental impact (such as carbon emissions), social impact (such as employee satisfaction), and governance factors (such as board structure), reflecting the integration of non-financial data into investment decisions. Singhanian and Saini⁸⁵ also divide ESG-related investing into three main directions; ESG integration to improve return and risk characteristics; values-based investing to align investment with personal principles; and impact investing to achieve tangible social or environmental impact. However, a review of ESG rating systems in the literature revealed that the use of ESG scores varies among researchers, sometimes used as a measure of sustainability and other times as an indicator of financial performance or disclosure, reflecting a

⁸² Russell Sparkes, *Socially Responsible Investment: A Global Revolution* (John Wiley & Sons 2003).

⁸³ Tong Li and others, 'ESG: Research Progress and Future Prospects' (2021) 13(21) Sustainability 11663.

⁸⁴ Pedro Matos, *ESG and Responsible Institutional Investing Around the World: A Critical Review* (CFA Institute Research Foundation 2020).

⁸⁵ Mansi Singhanian and Neha Saini, 'Institutional Framework of ESG Disclosures: Comparative Analysis of Developed and Developing Countries' (2021) 13(1) Journal of Sustainable Finance & Investment 516.

multiplicity of conceptual frameworks.⁸⁶ Studies have also shown that different ESG classifications often vary in their results and do not have strong congruence,⁸⁷ which calls for caution when using them as a standardised indicator.

To sum up, the aforementioned information shows that the definition of ESG is still not unified and agreed upon, and varies depending on the context and industry in which it is applied. This difference can be due to the breadth of the ESG framework, which makes many current or future corporate actions fit into it, making it difficult to define a precise definition of the concept. This situation may affect the development and progress of the concept in line with advanced sustainability practices. This conceptual multiplicity may also influence the development and progress of the concept in line with advanced sustainability practices, and increase the need for critical analysis when used in legal research or regulatory decisions.

2.3. The Relationship between the ESG Concept and Other Concepts in the Literature of Listed Companies

This section addresses the fundamental relationship between environmental standards, society, and governance (ESG) and associated concepts such as corporate social responsibility (CSR) foundations. The study's objective is to explore the overlap or autonomy of ESG standards compared to CSR, reflecting their potential impact on the development of a comprehensive sustainability framework. This chapter is an attempt to answer the question: Can ESG transform the concept of social responsibility and governance, or remain differentiated concepts?

2.3.1 Linkages between ESG and CSR

The concept of corporate social responsibility (CSR) historically originated in the early 20th century as a corporate response to society's demands for a positive social role.⁸⁸ Initially, the main focus was on philanthropy and voluntary social contributions aimed at improving the company's reputation and enhancing its image in front of the community. CSR was considered to be an unregulated and non-legally binding approach,⁸⁹ as companies were choosing to contribute to social issues based on their desire to improve their image and increase their association with local communities.

By contrast, the concept of ESG later evolved, especially in the 2000s, as a regulatory and investment tool aimed at providing clear and measurable criteria for

⁸⁶ Anne Clément, Emmanuel Robinot and Laurent Trespeuch, 'The Use of ESG Scores in Academic Literature: A Systematic Literature Review' (2023) 19(1) *Journal of Enterprising Communities: People and Places in the Global Economy* 92.

⁸⁷ Ryan Trahan and Bruce Jantz, 'What is ESG? Rethinking the "E" Pillar' (2023) 23(7) *Business Strategy and the Environment* 4382.

⁸⁸ William Frederick, *Corporation, Be Good! The Story of Corporate Social Responsibility* (Dog Ear Publishing 2006).

⁸⁹ *ibid.*

evaluating companies' ESG performance.⁹⁰ While CSR was based on voluntary orientation, ESG relies on transparency and the disclosure of sustainable practices as part of the company's core strategy. ESG is an investment standard that arises from the notion of responsible investment, defined according to the Principles of Responsible Investment (PRI) as “responsible investment involves considering environmental, social and governance (ESG) issues when making investment decisions and influencing companies or assets (known as active ownership or stewardship)”.⁹¹ Therefore, investors use ESG as a strategy to assess corporate behaviour and future financial performance. As an investment concept focused on assessing institutional sustainability, the three key factors of ESG help in the process of investment analysis and decision-making.⁹² In addition, ESG contributes to measuring the sustainability and social impact of business activities. According to the European Banking Authority (EBA), ESG factors are “environmental, social or governance matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign or individual”.⁹³ Thus, ESG goes beyond being merely a voluntary, charitable or even a disclosure standard, it is an investment philosophy aimed at achieving long-term growth in the value of the company through comprehensive and concrete management that takes into account economic, environmental, and social benefits.⁹⁴ ESG is an integral part of risk analyses and financial investments, as investors consider that following ESG standards contributes to enhancing the company's sustainability and reducing environmental and governance risks, thereby supporting investment decisions and promoting sustainable growth.

Studies suggest that defining a unified concept of corporate social responsibility and ESG practices is complicated given their different objectives and applications. Campbell⁹⁵ acknowledges the difficulty of identifying socially responsible behaviour for the company, and emphasises the need for companies to adopt responsible social behaviour, with a focus on avoiding damaging stakeholders and repairing any harm that may occur to society and the environment through their activities.

⁹⁰ Robert Eccles, Leo Lee and Judith Strohle, ‘The Social Origins of ESG: An Analysis of Innovest and KLD’ (2020) 33(4) *Organization & Environment* 575.

⁹¹ United Nations, Principles for Responsible Investment (PRI): What is Responsible Investment? <<https://www.unpri.org/introductory-guides-to-responsible-investment/what-is-responsible-investment/4780.article>> accessed 7 September 2024.

⁹² CFA Institute, ‘Environmental, Social and Governance Issues in Investing: A Guide for Investment Professionals’ (2015) Center for Financial Analysis, London.

⁹³ European Banking Authority, Report on Management and Supervision of ESG Risks for Credit Institutions and Investment Firms (June 2021) <https://www.eba.europa.eu/sites/default/files/document_library/Publications/Reports/2021/1015656/EBA%20Report%20on%20ESG%20risks%20management%20and%20supervision.pdf> accessed 7 September 2024.

⁹⁴ Tong Li, Ke Wang, Toshiyuki Sueyoshi and Dongdong Wang, ‘ESG: Research Progress and Future Prospects’ (2021) 13(21) *Sustainability* 11663.

⁹⁵ John Campbell, ‘Institutional Analysis and the Paradox of Corporate Social Responsibility’ (2006) 49 *American Behavioral Scientist* 925.

In this context, Margolis, Elfenbein and Walsh,⁹⁶ criticise this approach as it provides a minimum level of responsible behaviour, and they stress the importance of defining the type of social responsibility that management assumes.⁹⁷ Margolis et al opinion highlights the need for a deeper understanding of the impact of corporate leaders' values and ethics on their contribution to social responsibility.⁹⁸ This understanding promotes the application of ESG standards that not only avoid harm, but seek to reduce negative environmental and social impacts and promote good governance. On the other hand, in Vincent⁹⁹ point of view, environmental responsibility is at the core of corporate social responsibility, but he notes that there is no agreed definition of environmental social responsibility. He defines it as the companies' commitment to managing their environmental impacts in a way that balances biodiversity with human diversity. Focusing on the environmental aspect as a key element of CSR, Vincent explains that the absence of a uniform definition further complicates this concept. This view stresses the importance of environmental management, noting that its integration into an integrated framework with financial management enhances companies' environmental and social responsibility. Carroll argues that corporate social responsibility encompasses economic, legal, ethical, and charitable dimensions, focusing on companies' economic role and commitment to laws, ethics,¹⁰⁰ offers a classification of social responsibility covering these multiple aspects. These views highlight CSR's critical role in driving companies towards more sustainable and responsible practices.

Analysis of the views of Campbell, Vincent and Carroll shows how effective management of financial and operational resources within the corporate social responsibility framework can enhance shareholders' financial returns while maintaining environmental balance and ethical commitment. Campbell's proposed concept of 'avoidance of harm' can be criticised as being associated with a CSR concept that is relatively outdated, where the primary focus of companies has been to refrain from harming society and the environment through their activities. However, this approach does not correspond to the modern reality of companies adopting ESG standards. In a study by Eccles, Ioannou and Serafeim,¹⁰¹ researchers analysed data on companies adopting sustainable ESG practices. They found that ESG-focused companies perform better financially in the long run than those that do not adhere to these standards. The study also showed that sustainable companies are more able to attract investors and increase employee and customer satisfaction. The study concluded that companies that

⁹⁶ Joshua Margolis, Hillary Elfenbein and James Walsh, 'Does It Pay to Be Good...and Does It Matter? A Meta-Analysis of the Relationship between Corporate Social and Financial Performance' (2009) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1866371 accessed 10 September 2024.

⁹⁷ Campbell (n 95) 21.

⁹⁸ Adam Lindgreen and Valerie Swaen, 'Corporate Social Responsibility' (2010) 12(1) *International Journal of Management Reviews* 1.

⁹⁹ Olusegun Vincent, 'The Impact of Corporate Environmental Responsibility on Financial Performance: Perspective from the Multinational Extractive Sector' (Thesis, Brunel University 2012).

¹⁰⁰ Archie Carroll, 'The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders' (1991) 34(4) *Business Horizons* 39.

¹⁰¹ Robert Eccles, Ioannis Ioannou and George Serafeim, 'The Impact of Corporate Sustainability on Organizational Processes and Performance' (2014) 60(11) *Management Science* 2835.

adopt ESG are not only more profitable, but also contribute to enhancing transparency and social and environmental responsibility. The study stated that adherence to ESG standards enhances companies' ability to innovate and reduce long-term operational costs through more efficient resource and risk management.

The results of Eccles, Ioannou, and Serafeim's study support the idea that ESG is not just a tool for avoiding harm, or within the voluntary philanthropy previously undertaken by companies in their social responsibility efforts, but that ESG is a strategic framework that can drive companies towards improved overall performance and a tangible positive impact on society and the environment. ESG companies not only avoid harm, but they also seek to create positive value and maximise benefit for society and the environment. This shift reflects a significant evolution in companies' handling of sustainability issues, as withholding damage is no longer sufficient to ensure business sustainability.

Regarding the business shift to ESG, it sparks debate about whether to become the new CSR framework or stand as a separate concept. The literary debate shows that ESG can be seen as an expansion of the concept of social responsibility, especially in its environmental aspects and governance obligations. The shift from voluntary to mandatory disclosure of ESG is evidence of the growing importance of sustainability,¹⁰² noting that major companies listed on the exchanges are most affected by these shifts. These changes show how ESG is beginning to form an integral part of public companies' obligations, emphasizing the need to balance financial objectives with social and environmental responsibilities.

2.4. Summary

This section shows that the ESG framework is an important development in the field of CSR while emphasizing the importance of the environmental, social, and governance dimensions as an integral part of the company's strategy to achieve sustainable development. A deep analysis of the relationship between ESG and CSR provides a solid basis for understanding how companies can improve their strategies for market success while maintaining their commitments to the environment and society.

2.5. Benefits and Challenges of ESG

The development of business strategies and corporate governance requires understanding the ESG concept and its application within companies. Companies are confronted with multiple challenges and benefits when implementing these standards, as demonstrated by studies that use statistics and evaluate the performance of companies that comply with sustainability standards. This section will showcase the

¹⁰² Bastian Reber, Alexander Gold and Stefan Gold, 'ESG Disclosure and Idiosyncratic Risk in Initial Public Offerings' (2022) 179 *Journal of Business Ethics* 867.

advantages and disadvantages that companies may face, using studies and research that have been previously published in this field.

2.5.1 Benefits of ESG Practices in Risk Considerations and Mitigations

Companies that adopt ESG's sustainable behaviour can avoid legal and reputational risks. According to Nicholas,¹⁰³ environmental legislation has a significant impact on companies' behaviour, leading them to reduce reputational risk and legal obligations by adopting ESG standards. According to the González-Benito & González-Benito¹⁰⁴ study on the impact of legislative pressures in encouraging companies to make practical changes that benefit their environmental and social performance. Their findings found that companies often respond to legislative pressures by making changes in their operations to minimise negative impacts on the environment. This reflects the need to align legislation with companies' actual practices, helping to emphasise the importance of law enforcement in stimulating change towards sustainability and driving public companies to ESG practices.¹⁰⁵

Obviously, risks play a pivotal role in motivating companies to adhere to ESG standards. Companies that fail to meet stakeholders' aspirations or comply with environmental and social responsibility legislation face a range of compliance and reputational risks, including financial fines, administrative penalties, and even litigation from stakeholders or environmental and community groups. These risks are a powerful incentive for companies to improve their environmental and social practices and enhance their transparency and governance.

In terms of mitigating risk during crisis, regulatory flexibility is an integral part of ESG's performance, contributing to empowering companies to cope with crisis such as the COVID-19 pandemic effectively.¹⁰⁶ According to the Global Economy Forum,¹⁰⁷ companies that apply ESG standards rely on robust sustainability strategies that consider ESG impacts, giving them greater flexibility in dealing with unexpected changes.

Environmentally, the World Economic Forum¹⁰⁸ stresses that ESG standards have encouraged companies to invest in more sustainable and efficient supply chains,

¹⁰³ Andrew Nicholas, 'Government and Environmental Innovation in Europe and North America' (2002) 45 *American Behavioral Scientist* 1417.

¹⁰⁴ José González-Benito and Óscar González-Benito, 'A Review of Determinant Factors of Environmental Proactivity' (2006) 15 *Business Strategy and the Environment* 87.

¹⁰⁵ John Campbell, 'Why Would Corporations Behave in Socially Responsible Ways? An Institutional Theory of Corporate Social Responsibility' (2007) 32 *Academy of Management Review* 946.

¹⁰⁶ World Economic Forum, '3 Keys to a Resilient Post-Pandemic Recovery' (February 2022) <<https://www.weforum.org/agenda/2022/02/3-keys-to-a-resilient-post-pandemic-recovery/>> accessed 13 September 2024.

¹⁰⁷ *ibid.*

¹⁰⁸ World Economic Forum, 'How to Make Fragile Global Supply Chains Stronger and More Sustainable' (November 2021) <<https://www.weforum.org/agenda/2021/11/global-supply-chains-stronger-more-sustainable/>> accessed 13 September 2024.

contributing to reduced dependence on limited or at-risk resources. Traditional supply chains relied primarily on financial efficiency only without attention to cooperation and supply diversification.¹⁰⁹ The pandemic has highlighted the importance of finding local alternatives that allow companies to better cope with supply disruptions that may occur during crises such as the COVID-19 pandemic, which limits the impact of outages and contribute to maintaining business continuity.

Socially, according to the Global Asset Management Report,¹¹⁰ ESG standards focus on several aspects: protecting employees' rights and promoting a flexible and safe working environment, and societal impact. KPMG guide¹¹¹ states that during the coronavirus pandemic, companies that have adopted telework policies and protected their employees' rights by providing social support programs were better able to sustain productivity and minimise the impact of crises on the workforce. These companies not only protected their employees, but also maintained their reputation and financial performance.

In terms of governance, adopting flexible and uncomplicated governance standards and structures enhances the speed of decision-making and adaptation to changing situations. According to a study conducted by Chong et al,¹¹² companies applying flexible governance strategies were better able to adjust their policies quickly to meet unexpected conditions imposed by the pandemic, such as redirecting resources or modifying business plans in the short term. The team in crisis has proven to be at the heart of the structure through flexible organizational structures, enhancing speed and accuracy in decision-making and raising staff satisfaction. Chong et al¹¹³ believe that organizations should take this lesson into account continue to strengthen the hardest-hit task forces in times of crisis, and expand team working practices, which have proved effective in times of uncertainty¹¹⁴ making them an essential part of their culture and operations makes companies flexible enough to mitigate and overcome potential future risks with minimal losses.

From the above, it is clear that adopting ESG practices is a central element in mitigating potential risks during unforeseen crises. These practices enhance companies' resilience by enabling them to make decisions quickly and adapt to sudden changes. By

¹⁰⁹ *ibid.*

¹¹⁰ Global Asset Management, 'ESG in a Pandemic World Institutional, Executive Summary' (Oct 2021) <<https://institutional.rbcgam.com/en/us/research-insights/article/esg-in-a-pandemic-world/detail>> accessed 13 Sep 2024.

¹¹¹ KPMG, 'ESG: Environmental, Social, Governance – An Introductory Guide for Businesses' (July 2020) <<https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2020/08/esg-brochure.pdf>> accessed 13 September 2024.

¹¹² Elizabeth Chong and others, *Agile Resilience in the UK: Lessons from COVID-19 for the "Next Normal"* (McKinsey & Company 2020) <https://www.mckinsey.com/capabilities/people-and-organizational-performance/our-insights/agile-resilience-in-the-uk-lessons-from-covid-19-for-the-next-normal#> accessed 13 September 2024.

¹¹³ *ibid.*

¹¹⁴ *ibid.*

applying robust sustainability strategies, companies can channel resources effectively and overcome crises in the future.

2.5.1.1 Stakeholder Satisfaction Considerations

Eurosif report 2018¹¹⁵ shows that the increasing demand for responsible and ethical investment comes from changes in regulations and external pressures such as NGOs and the media by 16% exceeding legislative pressures of 13%. This underscores the importance of taking customer and stakeholder satisfaction into account ESG aspects as part of corporate responsibility. In addition, Puppim de Oliveira and Jabbour¹¹⁶ emphasise the importance of supply chain-based governance in driving companies towards sustainable environmental and social actions. This shows that changes in environmental management, which are often voluntary and driven by links between cluster-based companies and international buyers, have a significant impact on promoting sustainable corporate practices.¹¹⁷

In other words, companies, especially those that share global supply chains, find themselves driven towards adopting sustainable standards not only motivated by compliance with regulations, but also to ensure continued trade relations with international partners that may demand high levels of sustainability.¹¹⁸ This multifaceted impact leads to improvements in environmental practices across the entire productive chain, enhancing the overall environmental performance of the sectors concerned at an international level. Such voluntary shifts not only respond to external pressures of supply chains, but they can be the result of a shared perception of long-term benefits from sustainability.¹¹⁹ In addition, these transformations contribute to creating a competitive environment where sustainability becomes part of companies' standards of excellence and quality. This type of shift reflects the importance of companies using ESG disclosures to enhance their reputation and meet stakeholders' expectations, reflecting the role that listing can play in facilitating these requirements.

2.5.1.2 Impact on Performance and Operational Practices

Improving the company's performance after applying sustainable strategies is a critical criterion for assessing the success of these strategies. Research in this area

¹¹⁵ Eurosif, *Eurosif 2018 SRI Study* (19 November 2018) <<https://www.eurosif.org/news/eurosif-2018-sri-study-is-out/>> accessed 16 April 2024.

¹¹⁶ Jose de Oliveira and Charbel Jabbour, 'Environmental Management, Climate Change, CSR, and Governance in Clusters of Small Firms in Developing Countries' (2016) 56(130) *Business & Society* 130.

¹¹⁷ Peter Lund-Thomsen and Rajen Pillay, 'CSR in Industrial Clusters: An Overview of the Literature' (2012) 12 *Corporate Governance: The International Journal of Business in Society* 568.

¹¹⁸ Tim Hitchcock, 'Low Carbon and Green Supply Chains: The Legal Drivers and Commercial Pressures' (2012) 17(1) *Supply Chain Management: An International Journal* 98.

¹¹⁹ Bader Alareeni and Ahmad Hamdan, 'ESG Impact on Performance of US S&P 500-Listed Firms' (2020) 20 *Corporate Governance: The International Journal of Business in Society* 1409.

shows such as Hart;¹²⁰ Karagozoglu and Lindell;¹²¹ Majumdar and Marcus,¹²² there is a significant improvement in the financial and operational performance of companies that adopt more sustainable policies. Rather, companies can enhance their profitability and productivity through their environmental regulations and commitments to environmental problems. This section will demonstrate the impact of environmental disclosure regulations on companies' operating financial performance.

2.5.1.3 Impact of Environmental Regulation and Disclosure

Porter and Van der Linde¹²³ discuss how strict environmental legislation can lead to improvements in companies' operational and financial performance by stimulating them to adopt more efficient and sustainable practices. These studies support the idea that effective regulation can benefit businesses and society at large, reflecting the need for strong regulatory action to incentivize companies to disclose and continuously improve. They point out that legislative challenges associated with environmental disclosures may encourage companies to innovate technologies that increase efficiency and reduce costs, resulting in improved long-term revenues and a link to better financial and operational performance.

This idea put forward by Porter and Van der Linde is central to understanding how regulatory pressures and environmental disclosures can positively impact companies' performance. The prevailing belief that adherence to environmental legislation may be a financial and operational burden turns here into an opportunity for innovation and improvement. When companies face regulatory challenges such as environmental disclosure requirements, they are often forced to reassess and improve their operations. This compulsion is not only to comply with regulations, but also to promote efficiency through innovation in more sustainable techniques and practices. For example, companies may invest in more energy-efficient technology or develop raw materials that reduce environmental impact, reducing long-term costs and improving the company's financial and operational performance. Examples of these innovations were provided by Shrivastava¹²⁴ and Sarkis,¹²⁵ including designs that eliminate polluting and hazardous materials from products and products that can be easily disassembled, reuse, recycle and remanufacture to reduce resource consumption in production.

¹²⁰ Stuart Hart, 'A Natural-Resource-Based View of the Firm' (1995) 20(4) *Academy of Management Review* 986.

¹²¹ Nazmi Karagozoglu and Michael Lindell, 'Environmental Management: Testing the Win-Win Model' (2000) 43(6) *Journal of Environmental Planning and Management* 817.

¹²² Sumit Majumdar and Alfred Marcus, 'Rules Versus Discretion: The Productivity Consequences of Flexible Regulation' (2001) 44(1) *Academy of Management Journal* 170.

¹²³ Michael Porter and Claas van der Linde, 'Green and Competitive: Ending the Stalemate' (1995) 73(5) *Harvard Business Review*.

¹²⁴ Paul Shrivastava, *Environmental Technologies and Competitive Advantage* (1st edn, Business Ethics and Strategy 2007).

¹²⁵ Joseph Sarkis, 'Evaluating Environmentally Conscious Business Practices' (1998) 107(159) *European Journal of Operational Research* 159.

This perspective emphasises the significance of effective regulation and how thoughtful governance policies can be utilized to encourage innovation rather than hinder it, assisting in the transition to a more sustainable and transparent economy.

2.5.1.4 Influence on Market Value and Competition

Studies such as Dowell, Hart and Yeung,¹²⁶ and Saleh, Zulkifli and Muhamad,¹²⁷ have shown that good disclosure of environmental performance and corporate social responsibility can improve companies' market value. Effective disclosure of ESG practices attracts more attention from investors who are increasingly aware of the importance of sustainable investments, enhancing the value of companies in the market. In contrast, according to a study by Alareeni and Hamdan,¹²⁸ the disclosure of ESG to S&P 500 companies has had a negative impact on operational and financial performance in some cases, while showing a positive impact on market performance. This suggests that companies may face short-term financial challenges due to investing in sustainable practices, but acquire long-term value by improving their reputation and attracting more sustainable investments.

It is apparent through the analysis of researchers' opinions that ESG has a clear influence on companies' operational and financial performance, with different results depending on the ESG dimension being taken into account. Short-term financial challenges can be overcome with long-term benefits by enhancing reputation and efficiency. These results support the need to develop and implement strong regulatory policies that encourage companies to adopt more sustainable practices, helping to achieve the study's overall objectives and enhancing understanding of the role of listing in facilitating ESG disclosure requirements.

2.5.2. Challenges of Implementing ESG Principles in Business and Investment

According to Scatigna et al,¹²⁹ ESG reports and disclosures of corporate sustainability practices face multiple challenges that hinder the effectiveness of these efforts. These challenges include the inaccuracy of information, the absence of standard and mandatory global ratings, and political and global influences affecting the standardization of ESG ratings.

¹²⁶ Glen Dowell, Stuart Hart and Bernard Yeung, 'Do Corporate Global Environmental Standards Create or Destroy Market Value?' (2000) 46(8) Management Science 1059.

¹²⁷ Mustapha Saleh, Norhayah Zulkifli and Rusnah Muhamad, 'Looking for Evidence of the Relationship between Corporate Social Responsibility and Corporate Financial Performance in an Emerging Market' (2011) 3(2) Asia-Pacific Journal of Business Administration 165.

¹²⁸ Alareeni and Hamdan (n 119) 26.

¹²⁹ Michela Scatigna, Federico Xia, Aaron Zabai and Oscar Zulaica, 'Achievements and Challenges in ESG Markets' (BIS Quarterly Review, 20 December 2021) <https://ssrn.com/abstract=3989761> accessed 27 March 2025.

2.5.2.1 Inaccuracy of Information and Absence of Global Standards

The inaccuracy of information provided in ESG reports is a complex problem that reflects the challenges of transparency and credibility in the business environment. Companies that fail to provide accurate and reliable reports risk misleading financial markets and investors, which can lead to investment decisions based on misinformation¹³⁰. Furthermore, the lack of a global standard for ESG may make many global standards and frameworks conflicting within the same industry.¹³¹ This issue deepens fundamental challenges associated with market credibility and weakens confidence in financial disclosures, indicating the urgent need to strengthen verification and oversight mechanisms within companies and at the industry level. The accuracy of information is linked to the absence of ESG's standardised global standards, which can be documented by several pieces of evidence and indicators highlighting the disparity in the application of these standards across industries and countries.

2.5.2.2. Variety of Benchmarks and Reference Frameworks

Up to 600 global standards and frameworks are used to measure ESG performance according to World Economic Forum.¹³² As these standards vary according to industries and geographical regions, there is still no uniform global consensus. However, there are some of the most widely used frameworks and criteria:

1. Global Reporting Initiative (GRI)¹³³

The GRI standard is among the most widely used frameworks worldwide to disclose the ESG performance of companies. GRI provides guidance on preparing sustainability reports and measuring companies' social and environmental impact.

2. Sustainability Accounting Standards Board (SASB)¹³⁴

¹³⁰ Anna Dziadkowiec and Katarzyna Daszyńska-Żygadło, 'Disclosures of ESG Misconducts and Market Valuations: Evidence from DAX Companies' (2021) 32(2) *Inżynieria i Gospodarka Budowlana* 95.

¹³¹ Princewill Tamuno, 'Corporate Social Responsibility in the Niger Delta: Past, Present and Future Challenges' (2022) 66(3) *Journal of African Law* 391.

¹³² World Economic Forum, 'The Bright Spots in a Complicated ESG Framework' (July 2022) <<https://www.weforum.org/agenda/2022/07/still-reason-for-optimism-about-esg-investing/>> accessed 22 September 2024.

¹³³ "Global Reporting Initiative (GRI) engages with policymakers worldwide to adopt effective policies and regulatory frameworks promoting the alignment of private sector disclosures with sustainable development. We also support capacity-building efforts". See: Global Reporting Initiative, 'Public Policy: Legislation and Regulation' <<https://www.globalreporting.org/public-policy/legislation-and-regulation/>> accessed 19 April 2024.

¹³⁴ "SASB Standards help companies disclose relevant sustainability information to their investors. Available for 77 industries, the SASB Standards identify the sustainability-related risks and opportunities most likely to affect an entity's cash flows, access to finance and cost of capital over the short, medium or long term and the disclosure topics and metrics that are most likely to be useful to investors". Sustainability Accounting Standards Board, 'SASB Standards' <<https://sasb.ifrs.org/standards/>> accessed 17 September 2024.

SASB standards help organizations disclose industry sustainability risks and opportunities affecting cash flows, finance, and short-term or long-term capital costs. These standards were developed through evidence-based searches and broad participation of investors and companies, under the supervision of an independent board. International Financial Reporting Standards (IFRS)¹³⁵ recognizes SASB standards as essential to sustainability disclosure requirements, including IFRS S1 for public disclosure and IFRS S2 for climate disclosures.

3. UN Principles for Responsible Investment (UNPRI)¹³⁶

These principles provide guidance to investors on how to integrate ESG standards into their investment decisions. These principles represent a more ethical framework than benchmarks for measurement, but they are widely used to guide responsible investments.

4. Carbon Disclosure Project (CDP)¹³⁷

CDPs are used to assess climate change, water and forest disclosures. CDP collects data from companies to determine how environmental resources are managed and to measure environmental impacts.

5. ISO 26000¹³⁸

ISO 26000 provides guidance on social responsibility rather than requirements, and aims to help companies and organizations transform social responsibility principles into practical actions and share best practices globally, regardless of the type of activity, size or location. It was launched in 2010 after five years of negotiations between a variety of stakeholders from around the world, including governments, NGOs, and industry, making it an international consensus.

In summary, the diversity of frameworks and standards for measuring ESG performance provides great flexibility for companies and investors, Cort and Esty¹³⁹ argue that a single narrow framework of ESG data would not be able to meet all investors' needs adequately. This diversity allows companies to choose frameworks that are commensurate with their industry, geographical area, and stakeholder requirements.¹⁴⁰ The diversity of standards also provides an opportunity to cover a wide

¹³⁵ International Financial Reporting Standards (IFRS) Foundation, 'IFRS Sustainability Standards' <<https://www.ifrs.org/sustainability/tcfd/>> accessed 17 September 2024.

¹³⁶ United Nations Principles for Responsible Investment, 'About the PRI' <<https://www.unpri.org/about-us/about-the-pri>> accessed 19 April 2024.

¹³⁷ "Carbon Disclosure Project (CDP) is a not-for-profit charity that runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts. The world's economy looks to CDP as the gold standard of environmental reporting with the richest and most comprehensive dataset on corporate and city action", Carbon Disclosure Project (CDP), 'About Us' <<https://www.cdp.net/en>> accessed 19 April 2024.

¹³⁸ International Organization for Standardization (ISO), 'ISO 26000 Social Responsibility' <<https://www.iso.org/iso-26000-social-responsibility.html>> accessed 17 September 2024.

¹³⁹ Todd Cort and Daniel Esty, 'ESG Standards: Looming Challenges and Pathways Forward' (2020) 33(4) Organization & Environment 491.

¹⁴⁰ *ibid.*

range of ESG issues to meet the needs of different markets and industries. For example, standards such as GRI may be better suited to large, global-oriented companies, as they focus on providing comprehensive and transparent reporting on environmental and social impacts.¹⁴¹ This is appropriate for companies seeking to demonstrate their commitment to international sustainability and meet multi-stakeholder expectations. While SASB standards can be more appropriate for companies seeking to disclose financial risks related to sustainability,¹⁴² which makes it more suitable for companies seeking to provide accurate information to investors on how ESG issues affect their direct financial performance, such as companies listed in financial markets. This diversity of ESG disclosure standards can give companies the opportunity to innovate in disclosures and reports, as companies can improve their reporting according to their most appropriate framework.

One of the disadvantages of the multiplicity of ESG performance measurement standards is the apparent discrepancy between ratings issued by different rating providers. As Chatterji, et al¹⁴³ explained, this discrepancy is due to the absence of a common definition of social responsibility and the different standards adopted. According to the Berg et al¹⁴⁴ study, the discrepancy mainly appears in the range, measurement, and weights used. This discrepancy leads to inconsistency in valuations, making it difficult for investors and companies to compare performance accurately and effectively, and thus calls for the need to channel investments towards the United Nations' SDGs.

2.5.2.3. Legal and Regulatory Differences

Laws and regulations on ESG disclosures vary greatly between countries. For example, the EU has legislation such as the Corporate Sustainability Reporting Directive (CSRD)¹⁴⁵ that affects how ESG data is collected and shared, while in the UK, ESG disclosure laws and regulations are constantly evolving to enhance sustainability transparency and accountability. After the UK departed from the EU (Brexit), the UK continued to adopt similar EU standards in some respects but also began to develop its approach in others. To this end, amendments have been made to

¹⁴¹ Global Responsibility Initiative (GRI), <<https://www.globalreporting.org/public-policy/legislation-and-regulation/>> accessed 17 September 2024.

¹⁴² Sustainability Accounting Standards Board (SASB), <<https://sasb.ifrs.org/standards/>> accessed 17 September 2024.

¹⁴³ Abhijit Chatterji, Rodolphe Durand, David Levine and Samuel Touboul, 'Do Ratings of Firms Converge? Implications for Managers, Investors and Strategy Researchers' (2016) 37(8) *Strategic Management Journal* 1597.

¹⁴⁴ Florian Berg, Julian F Koelbel and Roberto Rigobon, 'Aggregate Confusion: The Divergence of ESG Ratings' (2019) *Review of Finance* (forthcoming) <<https://ssrn.com/abstract=3438533>> accessed 22 March 2025.

¹⁴⁵ Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (Text with EEA relevance) <<http://data.europa.eu/eli/dir/2022/2464/oj>> accessed 19 April 2024.

the Companies Act 2006,¹⁴⁶ making it mandatory for large companies to provide detailed information on ESG issues in their annual reports, which will be mentioned in Chapter 3. In contrast, other States may take less stringent or detailed measures in their requirements towards environmental protection and responsible investment.

2.5.2.4. Industry Reports and Studies

Many industrial reports and academic studies indicate that standards are not standardised. For example, a study by Long and Johnstone¹⁴⁷ examined how the inconsistency in ESG standards hinders investors from making accurate comparisons between companies' performance globally. Doyle¹⁴⁸ explains that differences and non-standardization are due to the fact that each rating agency has a dedicated registration method that assesses different non-financial metrics and varies in many parts of ESG standards. Identifying ESG themes to be assessed is not easy when compared with traditional financial measures. As a result, the disparity in ratings agency standards makes it difficult to compare companies' performance objectively and consistently.

Through the provision of this evidence, there is a need for increased efforts to improve global coordination and standardization. The lack of standardisation of ESG's global standards is a major obstacle to the effective implementation of these principles globally. ESG standards can be explained and applied differently between companies in different countries, leading to significant differences in the quality and effectiveness of disclosures. This problem highlights the need for a unified methodology that ensures fair comparison and transparency across industries and geographical boundaries, enhancing the effectiveness of global markets in assessing companies' real performance in sustainability areas. At the same time, however, this idea of standardization is met with another challenge, namely, different countries' social and cultural differences.

2.5.2.5. Social Complexities

Social challenges reflect the urgent need to take into account each community's unique cultural and social diversity when applying ESG standards.¹⁴⁹ Each society has values and beliefs that shape its perceptions and behaviours towards environmental and social responsibility, Shi and Veenstra¹⁵⁰ emphasised in their study that diverse cultural

¹⁴⁶ Companies Act 2006 <<https://www.legislation.gov.uk/ukpga/2006/46/contents>> accessed 19 April 2024.

¹⁴⁷ Florian Long and Simon Johnstone, 'Applying "Deep ESG" to Asian Private Equity' (2023) 13(2) *Journal of Sustainable Finance & Investment* 943.

¹⁴⁸ Mark Doyle, 'Ratings That Don't Rate – The Subjective View of ESG Rating Agencies' (2018) Technical Report, American Council for Capital Formation.

¹⁴⁹ Daron Acemoglu and Matthew Jackson, 'Social Norms and the Enforcement of Laws' (2017) 15(2) *Journal of the European Economic Association* 245.

¹⁵⁰ Wenting Shi and Koen Veenstra, 'The Moderating Effect of Cultural Values on the Relationship between Corporate Social Performance and Firm Performance' (2021) 174(1) *Journal of Business Ethics* 89.

systems lead to different responses to sustainability standards. For example, local values and social dynamics may directly affect the acceptance and effectiveness of these standards, as what is accepted in an environment may be rejected or deemed ineffective in another environment because of these differences.¹⁵¹ This requires a deep understanding by policymakers and companies of these cultural dynamics and their intelligent integration into sustainability strategies¹⁵². For example, developing countries struggling to meet the basic needs of their populations may find it difficult to apply strict environmental protection standards similar to those applied in developed countries.

Cultural and social differences between nations play a crucial role in determining the effectiveness of unified sustainability standards, and this reflects the urgent need to consider each society's cultural and social specificities, through a flexible standard adapted to most different cultural, social, and economic frameworks.

2.5.2.6. Economic Differences

Economic capabilities significantly affect the applicability of globally standardised sustainability standards. The Organization for Economic Cooperation and Development (OECD)¹⁵³ noted that developed countries have the capacity to finance investments in environmental technologies and social protection measures, thereby enhancing their ability to adapt to environmental challenges. In contrast, developing countries face significant difficulties in providing the resources and technology needed to support a sustainable economy. Hence, OECD¹⁵⁴ emphasises the need to support developing countries through additional financing and technology transfer, to enable them to meet environmental challenges and promote environmental innovation, thereby reducing the sustainability gap between States. This economic disparity among States weakens the chances of applying unified global standards that can address sustainability issues in a fair and comprehensive manner commensurate with all States' economic potential.

2.5.2.7. Global Variables

As ESG is interconnected with multiple facets of corporate existence and stakeholders, policymakers are confronted with the task of adapting ESG standards

¹⁵¹ Acemoglu and Jackson (n 149).

¹⁵² Patricia Ewick and Susan Silbey, *The Common Place of Law: Stories from Everyday Life* (University of Chicago Press 1998); Idit Kostiner, 'Evaluating Legality: Toward a Cultural Approach to the Study of Law and Social Change' (2003) 37(2) *Law & Society Review* 323.

¹⁵³ David Ockwell and others, 'Enhancing Developing Country Access to Eco-Innovation: The Case of Technology Transfer and Climate Change in a Post-2012 Policy Framework' (2010) OECD Environment Working Papers No 12.

¹⁵⁴ *ibid.*

flexibly enough to respond to changing global events.¹⁵⁵ The COVID-19 pandemic, for example, has revealed the importance of sustainable investment models and the growing resilience of ESG funds in the face of the challenges of the pandemic.¹⁵⁶ Some evidence also suggests that ESG risk management is important for investment performance at least during the lockdown and precautionary crisis constraints, as sustainable investment is expected to yield stronger returns than unsustainable investments.¹⁵⁷ At the same time, the COVID-19 pandemic has highlighted companies' unequal response to their social practices.¹⁵⁸ The Covid-19 crisis meant that companies were forced to retire a significant proportion of their workforce due to its financial impact. The global epidemic disrupted supply and food chains, leading businesses to suffer losses due to the required closures and the preventative measures taken against the virus.¹⁵⁹ Employers were compelled to balance their social responsibility towards their employees and the risk of financial ruin, which could negatively impact the local economy.

Furthermore, the impact of the global pandemic has been exacerbated by the conflict between Russia and Ukraine, further impeding sustainability initiatives and leading to an increased reliance on unclean energy sources such as oil, gas, and coal.¹⁶⁰ The war in Ukraine has confused many assumptions about ESG. For example, whether companies investing in defence and arms manufacturing are harmful if those weapons are for the defence of democracy.¹⁶¹ In this context, the Swedish bank SEB has previously adopted sustainability policies that prohibit its financial products from investing in the defence sector, but with Russia's invasion of Ukraine, the bank has relaxed the ban on certain funds, arguing the need to invest in the defence sector, for the freedom and human rights hob.¹⁶² Sweden's SEB position shows that in developing sustainable investment strategies, consideration should be given to being realistic and resilience enough to keep pace with global change. Tightening the transition to sustainability could be counterproductive in the event of inter-State crises, particularly with regard to supply chains, and economic exports and imports.

To sum up, sustainability practices may face significant challenges and may be partially or entirely disrupted during periods of crisis. Exceptional domestic or global

¹⁵⁵ Benoit Bastit and others, 'Key Events that Will Drive the ESG Agenda in 2022' <<https://www.spglobal.com/esg/insights/featured/special-editorial/key-esg-trends-in-2022>> accessed 16 March 2025.

¹⁵⁶ Jean-Jacques Barb  ris and Marie Bri  re, 'ESG Resilience During the Covid Crisis: Is Green the New Gold?' (2020) European Capital Markets Institute 67.

¹⁵⁷ Agnes Sipiczki, *A Critical Look at the ESG Market* (CEPS 2022).

¹⁵⁸ Michela Scatigna and others, 'Achievements and Challenges in ESG Markets' (BIS Quarterly Review, 20 December 2021).

¹⁵⁹ Congressional Research Service, 'Global Economic Effects of Covid-19' (10 November 2021) <<https://sgp.fas.org/crs/row/R46270.pdf>> accessed 20 August 2023.

¹⁶⁰ World Economic Forum, *The Global Risks Report 2023: 18th Edition* (2023) <https://www3.weforum.org/docs/WEF_Global_Risks_Report_2023.pdf> accessed 20 August 2023.

¹⁶¹ Sophie Simpson, Helen D'Ardenne and Liz Thomas, 'ESG in a Complex World: Immaturity Exposed' (Thomson Reuters Practical Law 2022) <<https://ca.practicallaw.thomsonreuters.com/w-035-5886>> accessed 27 March 2025.

¹⁶² *ibid.*

circumstances have a clear impact on companies' ability to continue implementing their environmental, social and governance initiatives with usual effectiveness. These changes underscore the importance of having flexible ESG strategies that can adapt to changing circumstances and ensure continuity of application of principles at all times, including crises.

2.5.3. Summary

After presenting those challenges, the issue of standardisation of sustainability raises important questions about the applicability of these standards on a global scale. While sustainability is a global concept that aims to balance economic growth, environmental protection and social justice, applying common standards in different cultural and economic contexts is a major challenge, and requires sufficient flexibility to ensure effectiveness and acceptance.

Researchers' views reinforce the understanding that standardised sustainability matters need a complex composition of balance between global guidance and local application. Implementation challenges are not only technical and financial but include a cultural and social dimension that must be taken into account to ensure effectiveness and acceptance through local communities. Unified sustainability standards can only be effective if adapted to global cultural and economic diversity, and flexible response to global variables; It allows for a genuine and sustainable commitment to ESG standards across geographical and cultural boundaries. Presenting these challenges will help to understand the challenges that the Saudi capital market regulator might face - and should be considered, as presented in Chapter 5.

2.6. ESG Rating

An important aspect of institutional change associated with CSR is the role of investors. While investors have traditionally been thought to focus solely on maximising profits, it has become clear that they can be effective drivers of institutional change towards enhancing corporate social responsibility.¹⁶³ Hockerts and Moir¹⁶⁴ believe that through socially responsible investment, investors can influence companies by using investment strategies that include positive and negative screens, where companies that do not adhere to social responsibility standards are penalized, and committed companies are rewarded. One manifestation of this institutional change is the emergence of ESG classification agencies that reinforce the importance of

¹⁶³ Bruce Hutton, Louis D'Antonio and Tommi Johnsen, 'Socially Responsible Investing: Growing Issues and New Opportunities' (1998) 37(3) *Business & Society* 281.

¹⁶⁴ Kai Hockerts and Lance Moir, 'Communicating Corporate Responsibility to Investors: The Changing Role of the Investor Relations Function' (2004) 52 *Journal of Business Ethics* 85.

adherence to sustainability standards according to Avetisyan and Ferrary.¹⁶⁵ ESG rating agencies provide investor- and company-requested rating services, corporate research, compliance, and advisory services similar to those provided by credit rating agencies - but with an emphasis on ESG standards.¹⁶⁶ ESG rating agencies is a way to provide reliable ratings and information that encourage capital to invest in companies that adhere to ESG standards, which is in accordance with the increasing demand from investors in recent years.

The wave of the trend towards sustainable investment aims to force investors to consider the factors of ESG in decision-making, but at the same time creates challenges for rating service providers associated with identifying the best standards for measuring sustainability risk. This has raised the question of the extent to which ESG rating agencies can contribute to a positive role in sustainable development by incorporating environmental, social, and governance sustainability principles into their assessment processes and practices.¹⁶⁷ The main hurdle regarding ESG disclosures is the flow of information from service providers, as investors seek high-quality information from third parties such as ESG rating agencies and credit rating agencies, and want the information to be as standardised as possible to provide the ability to compare performance across different industries and regions.¹⁶⁸ There have been many initiatives developed to meet these demands, but they have also run into major problems, in terms of identifying materially important issues.¹⁶⁹ This shows that, despite numerous initiatives to improve the process of providing uniform standards such as GRI and SASB, significant challenges remain, especially in identifying issues of material importance that vary across industries and regions, complicating the global performance appraisal process.

2.6.1. The Industry of ESG Rating Agencies

The ESG rating market has grown significantly in the past decade after the financial crisis of 2008,¹⁷⁰ as a result of a combination of several financial factors¹⁷¹ and the

¹⁶⁵ Elmira Avetisyan and Michel Ferrary, 'Dynamics of Stakeholders' Implications in the Institutionalization of the CSR Field in France and in the United States' (2013) 115 *Journal of Business Ethics* 115.

¹⁶⁶ Elmira Avetisyan and Kai Hockerts, 'The Consolidation of the ESG Rating Industry as an Enactment of Institutional Retrogression' (2016) 26(3) *Business Strategy and the Environment* 316.

¹⁶⁷ Elena Escrig-Olmedo, María Fernández-Izquierdo, Ignacio Ferrero-Ferrero, José Rivera-Lirio and María Muñoz-Torres, 'Rating the Raters: Evaluating How ESG Rating Agencies Integrate Sustainability Principles' (2019) 11(3) *Sustainability* 915.

¹⁶⁸ David Cash, 'Sustainability Rating Agencies Vs Credit Rating Agencies: The Battle to Serve the Mainstream Investor' (2021) *Palgrave Studies in Impact Finance* <https://doi.org/10.1007/978-3-030-71693-6>.

¹⁶⁹ *ibid.*

¹⁷⁰ Kerstin Lopatta and Thomas Kaspereit, 'The World Capital Markets' Perception of Sustainability and the Impact of the Financial Crisis' (2014) 122 *Journal of Business Ethics* 475.

¹⁷¹ Avetisyan and Hockerts (n 166) 36.

increasing attention from financial markets to this issue.¹⁷² This called for attention to the study of ESG classification agencies not only as economic actors but also as social actors, with influence on the behaviour of investors and stakeholders in society.¹⁷³ According to Elbasha and Avetisyan's,¹⁷⁴ definition, the work of classification agencies is based on examining the business and evaluating the sustainability performance of companies using their own research methodologies, which distinguishes a rating agency from another. They add that the accumulation of experience and knowledge in sustainability classifications has made ESG rating agencies a key reference for companies, financial markets, and academia in relation to sustainability assessments. As Scalet and Kelly¹⁷⁵ explain, ESG rating agencies work that they assess corporate sustainability performance for a large number of companies, and some agencies limit their ratings to financial information only, while others combine financial statements with additional financial statements to assess value and long-term sustainability.

This role of ESG rating agencies is to gather financial information raises the question of the need for ESG reports to be separate from companies' financial and annual reports. Companies are supposed to disclose any financial statements affecting their financial, operational or administrative performance to the general investors and stakeholders. For example, article 414A of the Companies Act 2006¹⁷⁶ stipulates that companies' annual reports must contain sufficient information about their financial and administrative situation. This disclosure aims to provide the necessary information to investors and stakeholders to understand the company's overall performance and make informed investment decisions based on that information. Therefore, the usefulness of making sustainability reports separate from financial corporate reports deserves to be measured in practice to provide considerable feasibility opinions. Any corporate report requires a budget to prepare and verify the data in it before it is made available to the public, as part of the compliance costs.¹⁷⁷ In Consequently, the cost to companies will increase if ESG reports are prepared independently of financial reports. However, it can be borne in mind that issuing separate ESG reports provides more transparency and inclusiveness in disclosing the company's sustainable performance, which can enhance investor confidence, stimulate investments in the company, and make it more attractive.

¹⁷² Sarah Windolph, 'Assessing Corporate Sustainability through Ratings: Challenges and Their Causes' (2011) 1(1) *Journal of Environmental Sustainability* 5.

¹⁷³ Tamim Elbasha and Emma Avetisyan, 'A Framework to Study Strategizing Activities at the Field Level: The Example of CSR Rating Agencies' (2018) 36(1) *European Management Journal* 38.

¹⁷⁴ *ibid.*

¹⁷⁵ Steven Scalet and Thomas Kelly, 'CSR Rating Agencies: What Is Their Global Impact?' (2010) 94(1) *Journal of Business Ethics* 69.

¹⁷⁶ Companies Act 2006, s 414A.

¹⁷⁷ Keith Maskus, Tsunehiro Otsuki and John Wilson, *The Cost of Compliance with Product Standards for Firms in Developing Countries: An Econometric Study* (World Bank Publications 2005) 3590.

2.6.2. The Difference between Credit Rating Agencies and ESG

Rating Agencies

As it is aforementioned, the role of ESG classification agencies is to present their opinion and assessment of companies' activities on financial issues related to the environment, social role and corporate governance. The role of credit rating agencies (CRAs) is to provide views on the creditworthiness and financial obligations of entities, to determine their financial suitability and ability to meet their debts.¹⁷⁸ White¹⁷⁹ explains the importance of credit rating agencies and their providers to investors, when there is a potential or actual lending/borrowing relationship between two parties, the lender will obviously question whether to recover from the borrower. In other words, whether the borrower's solvency is capable of meeting its debts by considering the borrower's current financial position; financial prospects, track record with respect to prior financial obligations. To answer these questions, the lender will need - among other things - to gather information about the borrower, whether the borrower is companies, individuals or government institutions. Beyond that, the role of credit rating agencies does not end once the loan is made, because the lender will want to monitor the borrower, so as to be assured that the borrower's financial situation has not deteriorated, to discover it as soon as possible, so that it can intervene earlier while some or all of the amount owed can still be saved.¹⁸⁰ All of this invites financial institutions to collect and analyse their own information about certain types of loans, and they are likely to turn to third parties - credit rating agencies - that collect and analyse relevant information on loans and bonds to financial service providers. By assuming this role, credit rating agencies are regarded as White¹⁸¹ calls "creditworthiness advisory services".

Based on the above explanation, it should be considered that the work of credit rating agencies differs from that of ESG rating agencies in the quality of the information analysed, they are purely financial on the credit rating side to see how much they can meet their financial obligations. ESG classification agencies focus on evaluating institutions' sustainability practices, and whether they achieve environmental and social performance and have a high or low level of governance. This is the origin, but in practice, even current legislation in the United Kingdom, for example, requires disclosures on climate "financial matters". Here the same question back again, about the feasibility of separating ESG valuations from solvency valuations as long as both will investigate the financial matters related to the company whatever the origin of its subject matter, whether it is related to the company's budget and expenses, or issues of sustainability and social responsibility.

¹⁷⁸ Carol Frost, 'Credit Rating Agencies in Capital Markets: A Review of Research Evidence on Selected Criticisms of the Agencies' (2007) 22(3) *Journal of Accounting, Auditing & Finance* 469.

¹⁷⁹ Lawrence White, 'Credit Rating Agencies: An Overview' (2013) 5 *Annual Review of Financial Economics* 93 [94].

¹⁸⁰ *ibid.*

¹⁸¹ *ibid.*

Logically, it may be futile to separate ESG ratings and solvency from each other, given the overlap of these factors and their impact on the company's overall performance. The abundance of corporate ratings and reports can make assessing the company's overall performance complicated, especially for ordinary non-specialist investors. These investors may find it difficult to analyse multiple and different information, unlike institutional investors who have the expertise and resources to understand this data more clearly and make investment decisions based on comprehensive analysis.

In this relation, many credit rating agencies and big data providers have expanded their services as ESG information providers to institutional investors by acquiring or merging with other entities. The clearest example of this expansion is illustrated by Escrig-Olmedo et al,¹⁸² the case of Morgan Stanley Capital International (MSCI). MSCI is currently one of the ESG rating agencies, analysing the environmental, social and governance business practices of thousands of companies around the world.¹⁸³ In 2010, MSCI acquired RiskMetrics Group, one of the companies providing risk management and governance products and services. RiskMetrics previously purchased ISS (Institutional Shareholder Services) in 2007, Innovest Strategic Value Advisors in February 2009 and Kinder Lydenberg Domini (KLD) Research & Analytics (KLD) in November 2009. The latter two are now known as MSCI ESG Research.¹⁸⁴ MSCI's acquisition of RiskMetrics Group means the transfer of all the technical, managerial and technical expertise of the companies acquired by the latter to Morgan Stanley. In addition, in July 2010, MSCI acquired MeasureRisk, which provides transparency and risk measurement tools for hedge fund investors. Then, in January 2013, it bought InvestorForce, a performance reporting tool provider for the corporate investment community in the United States. In 2014, MSCI acquired Governance Holdings Co. (GMI Ratings), a company that provides corporate governance research and classifications.¹⁸⁵

Bearing in mind that sustainability is a multidimensional concept, this focus process has allowed ESG rating agencies to develop more comprehensive and integrated corporate sustainability assessments. Environmental, community and governance classification agencies have also integrated specialised actors in corporate governance, data management, risk or communications into their systems. In addition, this market change has led to the emergence of more professional, multidisciplinary and multicultural task forces and the expansion of geographical and sectoral scope.¹⁸⁶

¹⁸² Escrig-Olmedo and others (n 167) 36.

¹⁸³ Jinwook Kim, Sunggon Chung and Cheongkyu Park, 'Corporate Social Responsibility and Financial Performance: The Impact of the MSCI ESG Ratings on Korean Firms' (2013) 14(11) *Journal of the Korea Academia-Industrial Cooperation Society* 5586; Elroy Dimson, Paul Marsh and Mike Staunton, 'Divergent ESG Ratings' (2020).

¹⁸⁴ Escrig-Olmedo and others (n 167) 36.

¹⁸⁵ *ibid.*

¹⁸⁶ *ibid.*

In contrast, there are several negative aspects to the industry's consolidation and integration into major financial entities. In a study by Avetisyan and Hockerts¹⁸⁷ on the main drivers of standardization or merger and their effects on the ESG classification industry, these mergers were found to have largely fragmented the industry and made entering this market difficult. It is because large entities such as MSCI have become dominant in this area and it is increasingly difficult for new market entrants to adopt ratings at a lower cost than current players do.

Further, a number of participants in the study sample indicated that the merger caused weak investor confidence, as there are doubts whether values will remain the same when ESG agencies are an integral part of a larger enterprise. Maintaining the independence of the ratings agency is important to safeguard its credibility and ensure that the objectivity of its provisions is not adversely affected by any conflict of interest. Finally, some investors would prefer to see a competitive landscape for the ESG rating industry, where they do not have to rely on a few “big players”,¹⁸⁸ so that merging into a limited number of major financial entities will weaken competition and multiple options.

2.6.3. Challenges for ESG Rating Agencies

The expansion of ESG rating agencies and the diversity of their appraisal methodologies have given rise to many challenges that must be taken into account and addressed. In studies published by Escrig-Olmedo et al ;¹⁸⁹ and Lindsey,¹⁹⁰ on environmentally sound management agencies, there are many challenges faced by these agencies, including lack of transparency and inconsistency in evaluations. These agencies often do not provide enough information about the criteria they use to measure sustainability performance, making it difficult for investors and users to understand the details of what is being evaluated and make accurate comparisons between different agencies. In addition, measurement of the same concept varies between agencies due to the multiplicity of aspects assessed in sustainability. This disparity sometimes leads to a conflict between standards and the reality of sustainable corporate practices, affecting the expected benefits of CSR. A form of standardisation in the preparation of environmental, social and institutional governance reports is crucial to the development of the classification agencies' work, in order to provide objectivity and extract meaningful and comparable data. Without standard ESG standards, companies can

¹⁸⁷ Avetisyan and Hockerts (n 166) 36.

¹⁸⁸ *ibid.*

¹⁸⁹ Escrig-Olmedo and others (n 167) 36; Eva Escrig-Olmedo and others, ‘Measuring Corporate Environmental Performance: A Methodology for Sustainable Development’ (2017) 26 *Business Strategy and the Environment* 142.

¹⁹⁰ Timothy Lindsey, ‘Sustainable Principles: Common Values for Achieving Sustainability’ (2011) 19(5) *Journal of Cleaner Production* 561.

select the data they most fit for disclosure, as a result of which they may increase environmental laundering, either intentionally or unintentionally.¹⁹¹

In addition to difficulties, the challenge of differentiation between standards is a way of trading-off between standards, where classification methodologies sometimes rely on compensating for poor performance in one area (e.g. governance) for poor performance in another (e.g. environment). Instead of providing a comprehensive and balanced picture of the company's performance, the company's final results may appear to be generally good despite significant weaknesses in other important aspects. This classification method makes it difficult to assess the company's actual performance in achieving sustainability, as it blurs potential flaws that may be critical for stakeholders. In addition, most rating agencies fail to provide an overall score of the company's performance in all areas, but rather separate assessments of all ESG aspects, limiting the ability to assess the company's overall sustainability performance. Different stakeholders' preferences are not adequately taken into account, as agencies work in isolation from their expectations and concerns, affecting the acceptance of evaluations. Furthermore, there is a lack of integration of business life cycle thinking and supply chains into sustainability assessments. Although some agencies seek to develop supply chain analysis,¹⁹² the lack of reliance on life-cycle-specific assessment methodologies makes these assessments insufficient to achieve sustainable goals.

Overall, these issues need to be addressed to offer accurate and comparable information for investors and stakeholders.¹⁹³ ESG rating agencies should cope with these problems to maintain their legitimacy and relevance as evaluators of sustainability performance. Their judgements have a considerable impact on the behaviour of investors and stakeholders in society, and the absence of openness and consistency can lead to mistrust and uncertainty.¹⁹⁴ Also, addressing these challenges can assist in improving the overall quality of ESG ratings and guarantee that they appropriately reflect the sustainability performance of companies. This can ultimately lead to better informed investment decisions and enhance sustainable growth.

The expansion of the ESG rating industry is a reflection of the financial markets' growing need for sustainability evaluations¹⁹⁵. Yet, the difficulties in determining the most effective metrics for assessing sustainability risk make it difficult for rating agencies to contribute to sustainable development. In evaluating corporate sustainability performance, the involvement of ESG rating agencies is crucial, and their

¹⁹¹ Tom Venables, Simon Boyle, James Bee and Robert Lee, 'ESG Data and Ratings Providers: Introduction' *Practice Notes* <<https://uk.practicallaw.thomsonreuters.com/w-037-7446>> accessed 3 March 2023.

¹⁹² María Muñoz-Torres and others, 'An Assessment Tool to Integrate Sustainability Principles into the Global Supply Chain' (2018) 10(2) *Sustainability* 535.

¹⁹³ Florian Berg, Julian Kölbel and Roberto Rigobon, 'Aggregate Confusion: The Divergence of ESG Ratings' (2022) 26(6) *Review of Finance* 1315.

¹⁹⁴ Aaron Chatterji, Rodolphe Durand, David Levine and Samuel Touboul, 'Do Ratings of Firms Converge? Implications for Managers, Investors and Strategy Researchers' (2016) 37(8) *Strategic Management Journal* 1597.

¹⁹⁵ *ibid.*

reports offer transparency and inclusivity in exposing a company's sustainable performance. Although more research is needed to determine the value of keeping sustainability reports distinct from financial reports, the advantages of boosting investor trust and encouraging investments in the company make it an appealing choice.

2.7. Conclusion

This chapter concludes with a comprehensive analysis of the fundamental differences between the features and nature of the traditional corporate governance disclosure and ESG, highlighting the challenges public companies face in achieving compliance and transparency. By reviewing the historical evolution of financial and non-financial disclosures, the shift towards integrating environmental and social dimensions into corporate reporting has shown that regulatory gaps vary depending on different legal frameworks between states and financial markets. The chapter also discussed how these changes may constitute obstacles for companies, especially in environments where ESG standards remain unclear or non-binding, which may lead to varying compliance between listed companies. This review contributed to an integrated vision of the research question of the extent to which the difference between the nature of traditional disclosures and ESG requirements affects public companies and whether these differences pose particular regulatory challenges with regard to environmental and social issues of a changing nature from country to country. This analysis sets the stage for future chapters, which will address the role of different regulatory frameworks, such as the British model and practices in the Saudi market, in shaping the effectiveness of environmental, social and governance disclosures, and their impact on improving compliance and sustainability of public companies listed in both countries' capital markets.

Chapter 3: The Role of the Corporate Governance Framework in ESG Disclosures

3.1. Introduction

After reviewing ESG disclosure requirements and challenges associated with compliance and transparency in the previous chapter, this chapter explores the relationship between corporate governance and the effectiveness of ESG disclosures, with a focus on the UK's principle-based governance model. This model is flexible through a “comply or explain” approach, which allows companies to adjust their disclosures to changing regulatory and economic conditions, making it more consistent with the “dynamic materiality” concept, which acknowledges that the importance of disclosures may change over time in response to market and policy variables. This chapter aims to answer the research question on the extent to which the corporate governance framework contributes to enhancing the effectiveness of ESG disclosures, focusing on the UK's principle-based governance model, and adopting the concept of dynamic materiality in determining the scope of these disclosures.

The chapter focuses on several main themes; First, identify the linkages between the corporate governance framework and the effectiveness of disclosures from listed public companies. The chapter also discusses the role of institutional stakeholders and investors in promoting transparency and effective corporate oversight to ensure accurate disclosures and avoid greenwashing. In addition, the chapter reviews legislative frameworks governing companies' inclusion in the UK capital market, including listing rules, mandatory reporting requirements, and disclosure obligations in accordance with FCA regulations. The chapter also addresses mechanisms for applying dynamic materiality, comparing them with traditional concepts such as financial materiality and dual materiality, while highlighting the UK's position on these concepts. Through this analysis, the chapter aims to assess the extent to which the principles-based governance model contributes to the promotion of environmental, social and governance disclosures, and to explore the possibility of using this approach to develop more flexible regulatory frameworks commensurate with different market environments.

3.2. Identifying Linkages between Corporate Governance and the Effectiveness of ESG Disclosure

In recent years, corporate governance has become a key indicator of corporate success globally, reflecting the ability of companies, equity markets, and regulators to

adapt to contemporary market pressures,¹⁹⁶ and protect shareholders.¹⁹⁷ Center for International Private Enterprise (CIPE) emphasises that corporate governance structure can enhance fairness and fair treatment of employees and various stakeholders. These definitions also incorporate elements of social responsibility and ethical values, which reflect the growing connections between governance and issues like corporate social disclosure and sustainability reporting within ESG standards. According to Shleifer and Vishny,¹⁹⁸ “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. How do the suppliers of finance get managers to return some of the profits to them? How do they make sure that managers do not steal the capital they supply or invest it in bad projects? How do suppliers of finance control managers?”. This definition explains the role of effective control by financial suppliers over managers to ensure that their decisions are in the interest of investors and that resources are not directed towards unprofitable or high-risk enterprises, thereby enhancing the role of governance in protecting capital and achieving corporate financial sustainability.

Fawzy¹⁹⁹ believes that corporate governance is divided into two main perspectives: the first is from the company's point of view, where governance focuses on maximising value while adhering to financial, legal, and contractual responsibilities, which contributes to increasing the company's profits and improving its financial performance. The second perspective comes in terms of public policies, where governance aims to protect enterprises, ensure accountability in the use of power, and provide incentives for companies to reduce the gap between private and social returns, thereby enhancing companies' commitment to stakeholder interests. This comprehensive definition of corporate governance reflects the importance of finding a balance between shareholders' interests and other stakeholders such as employees, customers, and suppliers. The importance of corporate governance as stated by Sir Adrian Cadbury,²⁰⁰ is also linked to the economic impact of companies through their role in enhancing operational efficiency, improving risk management, and attracting investments. Good corporate governance increases access to capital and contributes to improved financial market stability, enhancing companies' impact on the overall economy.²⁰¹ Fawzy's definition of governance also points to the importance of adherence to regulations to protect the interests of broader stakeholders, creating long-term sustainable value for companies that adopt good governance practices.

¹⁹⁶ Joshua Davis, ‘Law without Mind: AI, Ethics, and Jurisprudence’ (2018) 55(1) California Western Law Review 165.

¹⁹⁷ Gerald Grant, ‘The Evolution of Corporate Governance and Its Impact on Modern Corporate America’ (2003) 41(9) Management Decision 923.

¹⁹⁸ Andrei Shleifer and Robert Vishny, ‘A Survey of Corporate Governance’ (1997) 52(2) The Journal of Finance 737.

¹⁹⁹ Samia Fawzy, ‘Globalization and Firm Competitiveness in the Middle East and South Africa Region’ (2002) Mediterranean Development Forum 3, The International Bank for Reconstruction and Development / The World Bank.

²⁰⁰ Sir Adrian Cadbury, ‘The Corporate Governance Agenda’ (2000) 8(1) Corporate Governance: An International Review 7.

²⁰¹ *ibid.*

According to Aras & Crowther, corporate governance term represents “an environment of trust, ethics, and ethical values, as a participatory effort encompassing all components of society including the Government, the public, service providers, employees, and companies”.²⁰² The Center for International Private Enterprise CIPE²⁰³ has stated that the objective of corporate governance structure is to enhance equity between employees and stakeholders. From here, it becomes clear that good governance is not only a guarantee of legal compliance, but also a key tool for achieving sustainable corporate growth, which is ultimately reflected in the economy as a whole. In fact, these definitions illustrate the growing relationship between corporate governance, social responsibility, and ethical values, reflecting the current trend in the business world to link governance with social disclosure issues and sustainability reporting according to ESG standards.

Studies suggest a positive correlation between the characteristics of governance and the level of corporate social responsibility, reflecting the impact of the governance framework on facilitating environmental and social disclosures. For example, a study by Harjoto and Jo²⁰⁴ emphasises the importance of a strong corporate governance framework in promoting corporate community and environmental activities. The study of a wide variety of companies in the Russell 2000, S&P 500, and Domini 400 indices during 1993-2004 found a positive correlation between the level of corporate social responsibility and governance characteristics such as board independence and corporate ownership.²⁰⁵ Through both studies, it can be understood that there is a close correlation between the quality of governance practices and the level of corporate social responsibility. A strong corporate governance framework, such as board independence and corporate ownership, contributes to enhancing corporate social responsibility and environmental activities. This reflects the role of effective governance in facilitating environmental and social data disclosures, as it is clear that companies with better governance are more willing to assume social and environmental responsibilities and provide transparent disclosures.

This relationship shows an important overlap between corporate governance and ESG standards, especially regarding the governance part of ESG standards. This overlap poses an important question as to whether ESG practices and disclosures are part of the traditional framework of corporate governance. To determine if the traditional corporate governance framework is the primary framework for ESG disclosures or vice versa, it is necessary to distinguish between the types of disclosures

²⁰² Güler Aras and David Crowther, ‘Governance and Sustainability: An Investigation into the Relationship between Corporate Governance and Corporate Sustainability’ (2008) 46(3) *Management Decision* 433.

²⁰³ Center for International Private Enterprise (CIPE), ‘Strengthening Ethical Conduct & Business Integrity: A Guide for Companies in Emerging Markets’ (2020) <<https://www.cipe.org/resources/strengthening-ethical-conduct-business-integrity-a-guide-for-companies-in-emerging-markets/>> accessed 27 April 2024.

²⁰⁴ Maretno Harjoto and Hoje Jo, ‘Corporate Governance and CSR Nexus’ (2011) 100 *Journal of Business Ethics* 45.

²⁰⁵ *ibid.*

in both concepts and identify their beneficiaries. In the following paragraphs, the relationship between the concept of corporate governance and the concept of ESG will be reviewed in terms of the quality of the disclosures made and their beneficiaries. Emphasis will be placed on comparing financial disclosures and disclosures on sustainability and ESG to determine whether corporate governance is the basis of ESG, or whether ESG depends on an independent disclosure framework.

3.3. Type of Beneficiaries of CG and ESG Disclosures

A distinction can be made between corporate governance and environmentally sound management disclosures by understanding which categories benefit from each type of disclosure. Different stakeholder groups and expectations from the company can be understood through the company's multiple levels of liability identified by Sir Adrian Cadbury.²⁰⁶ Cadbury believes that in practice, there are three levels of corporate responsibility. The primary level is the company's responsibilities to meet its material obligations to shareholders, employees, customers, suppliers and creditors, pay its taxes and fulfil its legal obligations. Competition and law provide for sanctions that do not correspond to those responsibilities that are relatively easy to identify and measure, as reflected in traditional commitments to governance disclosures. The second level of responsibility is concerned with the direct consequences of corporate actions in carrying out their core function and involves maximizing the community's human resources and avoiding damage to the environment. The third level of responsibility is much less specific, including the relationship between business and the wider community. Monks and Minow²⁰⁷ refer to the second level's responsibilities as external factors of corporate. The extent to which business is responsible for maintaining the framework of the society in which it operates and to what extent business should reflect rather than business priorities of society.

From Cadbury's division of corporate liability levels, the first level represents traditional corporate governance disclosures that are based on providing information that has a direct and substantial financial impact, which is of primary interest to shareholders, suppliers, scientists, employees and all those who have a direct contractual relationship with the company and its business. The second and third level of responsibility includes environmental and social management disclosures, which target a broader base of beneficiaries of such disclosures, including the environment, the local economy, and wider society.

ESG disclosures may involve reporting information that does not have a direct material impact on the company, but is necessary for stakeholders wishing to know the extent of companies' commitment to ethics and their responsibility to the environment

²⁰⁶ Sir Adrian Cadbury, *The Company Chairman* (Fitzwilliam Publishing 1990).

²⁰⁷ Robert Monks and Nell Minow, *Corporate Governance* (5th edn, Blackwell Publishing 2011) ISBN 978-0-470-97259-5.

and society²⁰⁸. Since the traditional framework of corporate governance in capital markets has been stable and clear for decades, the introduction of a new type of unusual environmental and social disclosures faces legislative challenges to enable legislative and supervisory bodies to enforce such disclosures.

3.4. Stakeholder Role in Moving Toward ESG Disclosures

In light of concerns about the materiality importance of ESG disclosures, Katz and McIntosh²⁰⁹ argue that the current debate should consider distinguishing between two key issues: first, the importance of stakeholder management and environmental, social and cultural governance on the one hand, and second, the issue of redefining the criterion of ESG materiality from the perspective of securities law and the market on the other. Stakeholder management and sound environmental management are investing institutions' major focus and concerns.

Haley, Shaffer and Sloan²¹⁰ study outcomes noticed that stock price volatility changes slightly around the time sustainability reports are issued, increasing by only 8% from normal. In contrast, stock price volatility increases markedly when profits are declared, rising more than 200% from normal, which means ESG reports do not provide investors with a great deal of useful information for decision-making compared to profit announcements. From the results of these studies, it can be concluded that sustainability reports may not affect stock prices as do profit announcements, suggesting that investors may not consider these reports as important when making their investment decisions. Thus, Haley et al,²¹¹ believe that sustainability reports aim to report important environmental and social impacts of companies regardless of their financial impact. As stressed by Helisek,²¹² the concept of materiality is intended to mean that the company's sustainability strategy and reports should focus on issues that significantly affect stakeholders' decisions, whether through their profound impact on the health of the company and industry, or through the company's ability to significantly influence society. This interpretation is consistent with the primary objective of sustainability reports targeting a wide range of stakeholders interested in environmental and social impacts, suggesting that companies' objectives extend beyond providing financial information to investors. This shows that sustainability reports serve a broader

²⁰⁸ Astoneia Moss, 'Climate, Clarity, Controversy: A Constitutional, Statutory, and Policy Analysis of the SEC's Proposed Climate Disclosure Rules' (2024) 11(1) Emory Corporate Governance and Accountability Review 47.

²⁰⁹ David Katz and Laura McIntosh, "'Materiality' in America and Abroad' (April 2021) New York Law Journal 1.

²¹⁰ Suzanne Haley, Matthew Shaffer and Richard G Sloan, 'Do Sustainability Reports Contain Financially Material Information?' (2025) USC Marshall School of Business Research Paper sponsored by iORB.

²¹¹ *ibid.*

²¹² Andrea Helisek, 'The Symbiotic Rise of ESG and Materiality' (Edelman, 2 May 2019) <<https://www.edelman.com/insights/symbiotic-rise-esg-and-materiality>> accessed 2 June 2024.

purpose involving a variety of stakeholders, making them an important tool for managing companies sustainably and responsibly.

As a consequence, it can be argued that broader stakeholders - such as institutional shareholders, the state, the economy, and local communities - have played a crucial role in expanding the concept of financial materiality to include environmental and social impacts. Increased pressure by stakeholders to be more transparent and accountable about the non-financial impacts of responsible corporate performance has led to the modification of sustainability reports to include information of interest to a wide range of stakeholders, not just financial investors. This was confirmed by a study of Rudyanto, and Siregar²¹³ that companies often provide higher quality sustainability reports when faced with pressure from various stakeholders, such as employees and consumers. This pressure helps to improve companies' non-financial disclosures, especially on environmental and social issues. Understanding stakeholders' role and new aspirations about corporate performance in ESG cases paves the way for accommodating the difference between traditional and environmental and social governance disclosures, as explained in the following paragraph.

3.5. Distinction between Disclosure Types of Corporate Governance and ESG

The distinction between governance disclosures and ESG requires a careful understanding of the motivations behind each type of disclosure and its importance to different stakeholders. According to Sheng,²¹⁴ disclosure is a vital means for investors to obtain high quality information that enhances the level of confidence in the quality of due diligence and financial market ethics. It also indicates that disclosure becomes fruitful when disclosed information meets several characteristics such as reliability, commitment to economic reality, clarity, provision of accurate information about risk management, and alignment with generally accepted accounting practices.²¹⁵ Corporate governance laws and regulations such as those in the UK for 2024²¹⁶ and the Saudi CMA's Corporate Governance Regulations for 2023²¹⁷ do not include a specific definition of disclosure covering these aspects, but provide guidance on the considerations companies must take into account to ensure effective and reliable disclosure. For example, article 89 of the Saudi CMA's Corporate Governance Regulations²¹⁸ indicates that registered public companies must establish written

²¹³ Agus Rudyanto and Sylvia Siregar, 'The Effect of Stakeholder Pressure and Corporate Governance on the Sustainability Report Quality' (2018) 34(2) International Journal of Ethics and Systems.

²¹⁴ Andrew Sheng, 'Disclosure Regulation: The Role of Intermediaries' (2004) speech at Asia Pacific In-House Counsel Summit, International Organization of Securities Commissions.

²¹⁵ *ibid.*

²¹⁶ UK Corporate Governance Code 2024 <<https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/>> accessed 30 September 2024.

²¹⁷ Saudi Capital Market, Corporate Governance Regulation 2023 <<https://cma.org.sa/en/RulesRegulations/Regulations/Documents/CorporateGovernanceRegulations1.pdf>> accessed 30 September 2024.

²¹⁸ *ibid.*

disclosure policies that ensure appropriate methods to enable shareholders and stakeholders to access financial and non-financial information about the company. Such policies must be understandable, and clear, and must be presented systematically and accurately to enable all parties concerned to fully exercise their rights. Corporate governance disclosures included in the Saudi capital market regulations are the traditional type that focuses on the company's material and financial aspects, which are of primary interest to shareholders.

In contrast, ESG disclosure encompasses issues that may be non-financial but that are of great importance to stakeholders and society as a whole, which made the broad debate on how to regulate mandatory disclosures of environmental and social activities.²¹⁹ In the context of distinguishing between the nature of traditional corporate governance disclosures and ESG disclosures, the challenge is to understand the material significance that is at the core of each type of disclosure. As Katz and McIntosh²²⁰ explain corporate governance disclosures traditionally focus on financial statements and information of direct interest to shareholders. These statements are essential for assessing a company's financial performance and material stability. Such disclosures demonstrate companies' commitment to ethical standards and environmental and social sustainability, and concern individuals and groups concerned with the broader impacts of the company on the environment and society. The following section will focus on clarifying the difference between the financial materiality as traditional disclosures, and the dual/dynamic materiality of disclosures.

3.5.1. Nature of ESG's Financially Immaterial Disclosures

In the early 2000s, determining the materiality of ESG issues became a major goal of sustainable ethical investment.²²¹ According to the Sustainability Disclosure Standards Board (SASB), material information²²² is defined as information that if its absence, distortion, or withholding is reasonably expected to affect the decisions of investors or lenders. Similarly, other organizations such as the Task-Force on Climate Financial Disclosures and the International Board of Disclosure Standards (ISSB) provide sustainability disclosure guidance that includes the importance of impact. For example, the Global Reporting Initiative (GRI)²²³ defines material topics as representing the organisation's most important reporting effects on the economy, the environment, and people, including human rights. In other words, the materiality of

²¹⁹ Moss (n 208) 47.

²²⁰ Katz and McIntosh (n 209) 47.

²²¹ Thomas Kuh, Andre Shepley, Greg Bala and Michael Flowers, 'Dynamic Materiality: Measuring What Matters' (2020) SSRN 3521035.

²²² Sustainability Accounting Standards Board, 'Proposed Changes to the SASB Conceptual Framework & Rules of Procedure: Bases for Conclusions & Invitation to Comment on Exposure Drafts' (2020) Technical Report.

²²³ Global Reporting Initiative, 'GRI 1: Foundation 2021' (2022) Technical Report, January.

ESG disclosures can be defined as information whose deletion or misrepresentation can reasonably affect investment or lending decisions.

Standards-setters, regulators, practitioners, and academics have extensively discussed guidelines for recognising ESG topics material to companies.²²⁴ This section discusses the nature of ESG issues materiality, focusing on the different definitions and concepts that frame this type of disclosure. It addresses the two main opinions on the obligation of registered public companies to disclose ESG: the first represents the traditional opinion adopted by the United States, which opposes such mandatory disclosures on the grounds that they are not financially material, and the second represents the UK dynamic view that supports the definition of ESG disclosure as non-traditional material. Adding an American view - although it is not the primary focus of the study- puts the debate in a broader historical and academic context which contributes to understanding the different perspectives on the concept of materiality in disclosures. It is expected that it will aid in identifying the most suitable method for interpreting modern environmental and social governance disclosures in public company literature, which will be used later in proposing legislative amendments appropriate to the Saudi perspective in Chapter 5.

3.5.1.1. Traditional View of Financial Materiality and ESG Disclosures

The traditional view of financial material in the context of financial disclosures is based on a strict definition of material information, where information is considered material if its deletion or misrepresentation is reasonably expected to affect investment or lending decisions, according to Sustainability Accounting Standards Board (SASB).²²⁵ This definition states that financial information that is disclosed has to have a direct and noticeable impact on the economic decisions of investors. The goal of this concept is to safeguard investors and ensure transparency in financial markets,²²⁶ which is one of the main capital markets authorities objectives.

The U.S. view of its definition of material information in the context of Securities Exchange Act of 1934²²⁷ was based on the ‘reasonable person’ criterion of Tort Law, creating a stable concept that has withstood time changes and global events since the

²²⁴ Charles Dodsworth, Edmund Bourne, Billie-Louise Schlich and Jaakko Kooroshy, ‘Financial, Double, or Dynamic? Theories of ESG materiality and practitioner approaches’ (2023) 4(2) *Journal of Impact & ESG Investing* 109.

²²⁵ Sustainability Accounting Standards Board, ‘Proposed Changes to the SASB Conceptual Framework & Rules of Procedure: Bases for Conclusions & Invitation to Comment on Exposure Drafts’ (2020) Technical Report.

²²⁶ Ruth Jebe, ‘The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream’ (2019) 56(3) *American Business Law Journal* 645.

²²⁷ Securities Exchange Act of 1934, 17 CFR § 240.10b-5 (1934) (“The Reasonable Investor”).

1940s.²²⁸ The Securities and Exchange Commission (SEC)²²⁹ decided that ‘material information’ in the context of the financial statements was “those matters that the ordinary investor must have reasonable caution to report prior to the purchase of the listed security”. This language was slightly amended in 1982 with the adoption of the modern version of rule 405 of the Securities Act, but the Securities and Exchange Commission has adhered to the essence of the definition for decades, stating in 1999 that “the issue is essential” if there is a reasonable prospect that a reasonable person would consider it important. The SEC's commitment to the traditional definition of materiality emphasise its priority on investor protection in the U.S. Securities Act, and clearly limits companies' compliance with their legal duty to provide information to investors.²³⁰

Notably in the traditional context of material information, financial disclosures follow a strict traditional definition of the financial materiality aspect. This definition limits disclosures to information that is expected to affect investors' investment decisions directly. Because of this, many companies may refrain from providing highly transparent information about their ESG practices if they do not consider this information to have a direct financial impact. These practices limit the quantity and quality of information available to stakeholders and investors who may be interested in these non-financial aspects, as noted by Haley et al ²³¹ study. At the same time, with global trends towards enhancing transparency around ESG practices, companies may have to reconsider the issue of disclosure about their environmental and social practices if they face pressure from stakeholders and investors to meet their expectations on those issues.

Opponents of mandatory sustainability disclosures fear that they will affect the fundamental feature of U.S. securities law, the concept of “materiality”. Katz and McIntosh said: “The working definition of material in the United States, which has served corporate well for nearly nine decades, now finds itself facing significant pressures from a variety of sources”,²³² expressing concern about the sustainability disclosures of this institution. Economists, other stakeholders, and ESG-oriented organisations are currently calling for the expansion and development of expanded comparative materiality concepts,²³³ which, in fact, are not commensurate with the traditional approach, and threaten to undermine the utility of materiality as a guideline for detection.

Indeed, the stability of basic concepts such as fiscal information that companies are required to disclose is essential to the stability of business environments, which has

²²⁸ Amanda Rose, ‘The Reasonable Investor of Federal Securities Law: Insights from Tort Law’s Reasonable Person & Suggested Reforms’ (2017) 43 *Journal of Corporate Law* 77.

²²⁹ Securities and Exchange Commission, ‘Employment of Manipulative and Deceptive Devices’ 17 CFR § 240.10b-5 (1934).

²³⁰ Katz and McIntosh (n 209) 47.

²³¹ Haley and others (n 210) 47.

²³² Katz and McIntosh (n 209) 47 [1].

²³³ *ibid.*

been widely discussed in the United States since 2021.²³⁴ At the same time, it can be argued that extending this concept to non-financial information that has no direct financial impact should not be seen as a violation of the traditional concept of material significance. This expansion has become necessary, not only to serve modern shareholder trends, but also to enhance companies' ability to adapt to the changing regulatory and social environment. Providing a clear concept adopted by the Securities Commission that encompasses recent changes in governance and disclosures will contribute to achieving this goal.

3.5.1.2. “Dynamic Materiality” and ESG Disclosures: The UK View

This approach is at odds with the traditional view of refusing to disclose non-financial issues to sustainability, as the UK's approach tends to embrace the concept of “double materiality” and “dynamic materiality” in disclosures, as will be discussed during this section. This approach emphasises the importance of incorporating material and non-material information that supports the protection of the environment, society and the economy.²³⁵ In this section, the concepts of ‘dual materiality’ and ‘dynamic materiality’ will be reviewed to understand how they affect sustainability-related disclosures, and the UK position will therefore be analysed to see which of the two approaches -dual or dynamic- are closest to the UK's vision to disclose material and non-material issues.

3.5.1.3. The Concept of “Double Materiality”

The term ‘double materiality’ dates back to 2019, when it was introduced by the European Commission providing detailed guidance on climate-related reporting in its 2019 guidelines,²³⁶ as a concept based on the idea that materiality has two fundamental aspects: the first is financial materiality, and the second is social and environmental materiality. The European Union's Non-Financial Disclosure Directive (NFRD) requires companies to disclose information on environmental, social, personnel, human rights, anti-corruption and bribery issues. Furthermore, according to the European Commission,²³⁷ companies must disclose not only how sustainability issues affect the company, but also how the company affects society and the environment, a so-called “double materiality” perspective. The philosophy behind double materiality, which

²³⁴ Bingham and others, ‘ESG Regulations: US SEC Proposes Major New Climate disclosure Requirements’ (2021) GS Sustain <<https://www.goldmansachs.com/insights/pages/gs-sustain-esg-regulations-us-sec-proposes-major-new-climate-disclosure.html>> accessed 26 July 2022.

²³⁵ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L330/1 <<http://data.europa.eu/eli/dir/2014/95/oj>> accessed 29 Oct 2024.

²³⁶ European Commission, ‘Guidelines on non-financial reporting: supplement on reporting climate-related information’ [2019] OJ C209/1.

²³⁷ European Commission Directorate-General for Financial Stability, Financial Services and Capital Markets Union, ‘Consultation document review of the Non-Financial Reporting Directive’ (8 June 2020).

supports the EU's guidance on non-financial reporting, is that “these risk perspectives are already overlapping in some cases and are increasingly likely to do so in the future”. Dodsworth et al,²³⁸ commenting on the reliance of double materiality, comments that the debate on determining materiality in sustainability issues whether the materiality in terms of the potential financial effects of corporate practices (financial materiality) should be defined or whether it should include the impact of a company's practices on the economy, environment and people (material impact). Financial significance and material influence were combined under a single theoretical umbrella of double materiality,²³⁹ thereby expanding the concept of materiality so that a large number of information and matters could be considered material depending on either perspective.

3.5.1.4. The Concept of “Dynamic Materiality”

The other aspect of materiality is the concept of ‘dynamic materiality’, described by the World Economic Forum in a 2020 white paper.²⁴⁰ This concept suggests that issues that may be financially immaterial today could become intrinsic tomorrow, a process known as “dynamic incarnation”. The World Economic Forum²⁴¹ encourages the widespread adoption of these standards and their inclusion in periodic reports, with companies able to apply their own perspective to report on their disclosures and explanations.

The issue of material information to be disclosed in annual reports varies according to regional regulations and projections. The World Economic Forum notes that the recommended metrics not only reflect financial implications, but also include ‘pre-financial’ information that may not be entirely material in the short term, but material to society and the planet, and therefore may become material for financial performance in the medium or long term. Materiality is a dynamic concept, where only matters considered relevant to social value can quickly become financial material. In this sense, the creation of sustainable value lies in the intersection of social and corporate value.

The Global Reporting Initiative (GRI)²⁴² supported the double materiality concept on sustainability reporting. As a result, GRI revised its definition of material information to include double comparative materiality. Its view is based on the external impacts of the corporations' sustainable practices, explaining that such impacts can have negative or positive consequences for the corporation itself (operationally or in terms of reputations and, in many cases, financially).²⁴³ For example, the corporation's high

²³⁸ Dodsworth and others (n 224) 50.

²³⁹ Tiziana De Cristofaro and Carmela Gulluscio, ‘In Search of Double Materiality in Non-Financial Reports: First Empirical Evidence’ (2023) 15(2) Sustainability 924.

²⁴⁰ World Economic Forum, *Embracing the New Age of Materiality: Harnessing the Pace of Change in ESG* (White Paper, March 2020).

²⁴¹ World Economic Forum, *Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation* (White Paper, September 2020).

²⁴² Global Reporting Initiative, ‘GRI Universal Standards: GRI 101, GRI 102, and GRI 103 – Exposure Draft’ (June 2020) Global Sustainability Standards Board.

²⁴³ *ibid.*

use of non-renewable sources of energy could increase operating costs because of legislation seeking to transform energy use into renewable sources.

3.5.1.5. The UK View on Materiality

Financial Reporting Council (FRC) adopts the definition of information materiality issued by the International Financial Reporting Standards Foundation (IFRS)²⁴⁴ “Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity’s financial report”.²⁴⁵ FRC²⁴⁶ comments on this definition that material information means considering beyond the relevance of information to business, but rather taking into account the information investors need for decision-making. While investors and their aspirations are not uniform, they agree on a similar goal, namely, to achieve returns on their investments.

The UK's approach stems from the realisation that environmental and social issues can have long-term effects on companies beyond direct financial impact. FRC²⁴⁷ emphasised that investors appreciate future corporate plans that take into account business strategy, financial performance and sustainability in an integrated and coherent manner; Sustainability factors are not separate from businesses' operations and finances. These expectations may be motivated by companies expanding sustainability disclosures, helping to achieve transparency and accountability, and coinciding with investors' and other stakeholders' expectations. According to the findings of Haley et al²⁴⁸ place to achieve more comprehensive and transparent reporting, which can enhance the company's reputation and fulfill investors' aspirations. However, there are some challenges that companies may face in implementing these disclosures, including the increased costs and efforts required to collect and analyse data, and the need to adapt to new and complex disclosure standards.²⁴⁹ Therefore, companies need to prepare to

²⁴⁴ Financial Reporting Council, ‘Materiality: Think about Investor Needs and Decision-Making’ (October 2023) <<https://www.frc.org.uk/library/research-and-insights/materiality/think-about-investor-needs-and-decision-making/>> accessed 29 October 2024.

²⁴⁵ International Financial Reporting Standards, ‘Practice Statement 2: Making Materiality Judgements’ (14 September 2017) <<https://www.ifrs.org/projects/completed-projects/2017/materiality-practice-statement/#published-documents>> accessed 29 October 2024.

²⁴⁶ Financial Reporting Council, ‘Materiality: Think about investor needs and decision-making’ (October 2023) <<https://www.frc.org.uk/library/research-and-insights/materiality/think-about-investor-needs-and-decision-making/>> accessed 29 October 2024.

²⁴⁷ *ibid.*

²⁴⁸ Haley and others (n 210) 47.

²⁴⁹ Financial Reporting Council, ‘Materiality: Think about Investor Needs and Decision-Making’ (October 2023) <<https://www.frc.org.uk/library/research-and-insights/materiality/think-about-investor-needs-and-decision-making/>> accessed 29 October 2024.

deal with the challenges that this approach to ensure its effective and sustainable implementation.²⁵⁰

The UK's approach adopts dynamic materiality, taking into account that what may seem immaterial today may become necessary in the future as circumstances change. This is confirmed by Practice Statement 2 of IFRS, which states that material information judgements should be re-evaluated at each date of preparation of a report based on changes in the circumstances of the entity.²⁵¹ This indicates that IFRS require companies to adapt their assessment of material information to evolving circumstances. Furthermore, IFRS stressed that the entity, when making judgments about material information, should consider the potential impact of information on all essential users, including current and potential investors, lenders, and creditors, with no exclusive focus on a particular category.²⁵² This guidance shows that companies should not narrow the scope of disclosures based solely on the needs of a particular group, as priorities may change in the future according to changing economic and operational conditions. Thus, it is clear that the UK's approach to the concept of materiality embraces such flexibility, noting that issues of materiality may change over time, thereby supporting the judgements of disclosures in a manner consistent with stakeholders' long-term expectations.

The dynamic materiality approach solves the challenge of criticizing the traditional view of materiality that it may focus too much on financial information and not adequately consider other types of information that may be essential to investors, such as sustainability or ESG issues.²⁵³ This may lead to a lack of transparency and accountability in these areas, which may not be in the interest of investors or the general public, particularly with increased attention to sustainability issues by institutional investors and rating agencies.

On the contrary, the UK approach, which includes the concepts of “double materiality” and “dynamic materiality”, may be seen as too broad or subjective, making it difficult for companies to identify material information and what is not. This can increase compliance burdens, and it can be difficult to provide a clear and adequate standard for companies to follow. This can be avoided by setting precise targets and indicators on sustainability issues that take into account different companies' activities, and establishing applicable and measurable standards in practice. In November 2023, the UK CFA published Policy Statement (PS23/16) Sustainability Disclosure Requirements (SDR) and investment labels.²⁵⁴ PS23/16 introduced mandatory rules on the requirements for disclosure of sustainability information that financial companies

²⁵⁰ Haley and others (n 210) 47.

²⁵¹ International Financial Reporting Standards, ‘Practice Statement 2: Making Materiality Judgements’ (14 September 2017) <<https://www.ifrs.org/projects/completed-projects/2017/materiality-practice-statement/#published-documents>> accessed 29 October 2024.

²⁵² *ibid.*

²⁵³ Katz and McIntosh (n 209) 47.

²⁵⁴ Financial Conduct Authority, ‘PS23/16: Sustainability Disclosure Requirements (SDR) and Investment Labels’ (November 2023) <<https://www.fca.org.uk/publications/policy-statements/ps23-16-sustainability-disclosure-requirements-investment-labels>> accessed 1 November 2024.

must adhere to, which help overcome information disparity, and aims to anti-greenwashing to all FCA-authorised firms, which leads to improve the transparency to the favour of investors. Standardised standards are a means that may limit the interpretation of sustainability issues related to environmental, social and cultural management to be a technical and financial burden on companies.

It should be noted in this context, the difficulty in achieving the objective of standardisation and developing measurable indicators for ESG issues, as discussed in chapter 2, given the diversity of sectors and the different local values and type of economy of each country. Therefore, the British model of climate disclosures tended to focus primarily in corporate law on financial climate disclosures, i.e. with a financial impact on a company's performance, as discussed in Chapter 3.²⁵⁵ This customisation makes it easier to determine the quality of environmental data that companies must disclose.

The tendency to assess material information from a perspective that is not limited to financial aspects, but also encompasses environmental and social aspects, is a necessary development with increased awareness of corporate social and environmental responsibility. This shift responds to stakeholders' demands that focus on the importance of transparency in environmental and social reporting along with financial reporting, reflecting the growing trend towards integrating ESG disclosures into the overall corporate governance framework. The discussion in this section will form the basis for discussing the materiality from a Saudi perspective in Chapter 5, which will include an analysis of the importance of disclosures requested from public companies, thus helping to propose the best appropriate legislation for this type of disclosure in the Saudi stock market.

3.5.2. Summary

In short, the distinction between corporate governance disclosures (CG) and environmentally and socially sound management disclosures (ESG) highlights differences in the type of beneficiaries: CG disclosures focus mainly on investors and shareholders with information of direct financial importance, while ESG disclosures target a broader base of beneficiaries, including the environment and society at large. This expansion enhances transparency and social and environmental accountability and requires the development of new criteria for evaluating and disaggregating disclosed information. Therefore, corporate governance (CG) can be said to provide the underlying framework for ESG disclosures. Corporate governance is the infrastructure that enables companies to harmoniously regulate and integrate ESG standards within a company's strategies and processes. By applying good governance practices, companies are better placed to effectively address ESG standards, which include attention to environmental, and social issues and the application of strict governance standards.

²⁵⁵ See section 3.4. Stakeholder Role in Moving Toward ESG Disclosures 47-48.

3.6. ESG-Related Corporate Governance Theories

3.6.1. Introduction

Discussions on the role of shareholders in corporate governance included continue to generate widespread interest in legal literature. The assumption that shareholders, as owners of the company, have the right to determine their own destiny is recognized in the present debate. Abugu²⁵⁶ points out that this idea has already been well established since the 18th century, as shareholders have never doubted their ownership of the shares that make up the company's capital. This traditional approach focuses mainly on shareholders as the main beneficiaries of the company, and the ultimate goal of the company is to make profits for them. This philosophy is clearly reflected in the words of Sir Robert Lowe, Vice-Chairman of the English Trade Council, who, in his famous speech when introducing the 1856 the law of Partnership and joint-stock Companies in the House of Commons,²⁵⁷ stressed that companies must be liable solely to their shareholders even if their actions might conflict with broader social interests. However, contemporary corporate governance theories challenging this traditional vision have emerged, calling for a more inclusive corporate role. These theories emphasize that corporate responsibilities must extend to all stakeholders, including employees, suppliers, society, and the environment. This is done by providing the agency's theory as a basis for understanding relationships within shareholders and highlighting the constraints that this theory may face. In addition, shareholder theory, embraced by both Saudi and UK financial markets, will be discussed to illustrate differences and similarities between the two models in listed corporate governance.

This part of the Chapter aims to deepen understanding about how these theories affect the structure of corporate governance and how they can contribute to the development of more inclusive and responsible governance practices. In addition, it aims to explore the theoretical framework for environmental and social governance disclosures and how these concepts integrate with traditional corporate governance frameworks. Through this analysis, it is sought to better understand how core principles of corporate governance affect environmental and social disclosure obligations, and how these theories can support a balance between shareholders' and other stakeholders' interests.

3.6.2. Agency Theory

The agency's theory highlights an interactive relationship governed by certain principles and behaviours between two parties; Principal and agent. As Miramón-

²⁵⁶ Joseph Abugu, 'Primacy of Shareholders' Interests and the Relevance of Stakeholder Economic Theories' (2013) 34(7) *Company Lawyer* 201.

²⁵⁷ Hansard 1803–2005, 'Mr Robert Lowe 1811–1892, 3 Speeches — Law of Partnership and Joint-Stock Companies' (Commons, 1 February 1856) <<https://api.parliament.uk/historic-hansard/people/mr-robert-low/1856>> accessed 3 March 2025.

Botero²⁵⁸ points out, this relationship arises when the principal's interests depend on the actions of the agent, who has the authority to act on his behalf. Bendickson et al²⁵⁹ agency's theory as that mechanism used to explain and analyse problems arising from differing interests between managers and shareholders in the business environment. In this relationship, shareholders (principal) and executive directors (agents) are the parties concerned, with challenges particularly reflected in conflicting priorities between these parties.²⁶⁰

Major agent problems arise when managers manage profits for their personal interests rather than shareholders' interests, which may harm the company's long-term value. This discrepancy can manifest itself in two forms: moral risk, where managers exploit their internal knowledge to obtain personal benefits, and negative choice, which occurs when managers have unequal access to information that may affect investors' decisions.²⁶¹ These problems are widespread in organisations and are a major focus of the literature on finance and the economy.²⁶² Compliance with corporate governance standards can also help alleviate these challenges by restricting managerial behaviour by preventing managers from exploiting wealth and manipulating investments.²⁶³ The greatest challenge in corporate governance is to assess how contractual processes depart from effective and ethical standards.²⁶⁴ Jensen and Meckling,²⁶⁵ in 1976 presented an early vision of the Agency's problems, highlighting how managers (agents) and shareholders (heads) interact in the corporate context. The key point is that Jensen and Meckling's view reveals problems arising from conflicts of interest between agents and presidents, leading to risks such as “moral risk” and “negative choice” which explain the modern trend of governance towards social and ethical responsibility of public companies.

Jensen and Meckling's outlook can be used to develop and implement corporate practices that not only focus on profit-making but also include transparency and responsibility in the areas of environmental and social governance. This means that companies can use principles learned from the agency's theory to ensure a balance between maximizing profits and taking into account the interests of other stakeholders, such as society and the environment, within a framework of responsible governance.

²⁵⁸ Santiago Miramón-Botero, 'The Corporate Governance Role of Lenders: Minority Shareholders Champions' (2017) 135 *Vniversitas* 219.

²⁵⁹ Josh Bendickson, Jeff Muldoon, Eric Liguori and Phillip Davis, 'Agency Theory: Background and Epistemology' (2016) 22(4) *Journal of Management History* 437.

²⁶⁰ Mahmoud El Diri, Christos Lambrinoudakis and Mazen Alhadab, 'Corporate Governance and Earnings Management in Concentrated Markets' (2020) 108 *Journal of Business Research* 291.

²⁶¹ *ibid.*

²⁶² Brahmadev Panda and Nabaghan Leepsa, 'Agency Theory: Review of Theory and Evidence on Problems and Perspectives' (2017) 10(1) *Indian Journal of Corporate Governance* 74.

²⁶³ Javed Khan and Shafiq Ur Rehman, 'Impact of Corporate Governance Compliance and Board Attributes on Operating Liquidity in Pre- and Post-Corporate Governance Reforms' (2020) 20(7) *Corporate Governance* 1329.

²⁶⁴ Marco Becht, Patrick Bolton and Ailsa Röell, 'Corporate Governance and Control' (ECGI Finance Working Paper No 02/2002, 2005) <http://ssrn.com/abstract_id=343461> accessed 3 March 2025.

²⁶⁵ Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' in *Corporate Governance* (1st edn, Gower 2000) 56.

3.6.3. Agency's Problems and Implications for Corporate Governance

The agency's approach is to analyse the relationship between shareholders (principals) and executives (agents) in shareholding companies. Despite its reasonableness in interpreting challenges within these relationships, the Agency's theory highlights problems of control and conflict of interest, as well as the costs of control faced by shareholders in trying to control management's actions.

Eisenhardt²⁶⁶ highlights the two main problems in the agency's theory. The first concerns the potential conflict between wishes or objectives between the principal and the agent, where conflicting interests can cause high challenges and expenses for small shareholders trying to verify the agent's actual business. The second deals with risk sharing that emerges between the manager and the agent and is characterized by different risk preferences, which can lead to decisions that may be detrimental to shareholders' long-term interests. Gottschalk²⁶⁷ emphasises three assumptions that affect relationships within agency contracts: self-interest, limited rationality, and risk aversion. These factors make balance within shareholders complex and require strenuous efforts to align shareholder and management goals. In addition, research shows that conflicts of interest between management and shareholders can lead to “agency problems”, which cause higher costs known as agency costs, as explained by Fontrodona and Sison.²⁶⁸ These costs arise from efforts to monitor agents and ensure that they follow the company's objectives, often translated into measures to ensure that management adheres to ESG standards.

It also adds to the challenges of the agency's theory of the relationship between shareholders and corporate governance, where control dilemmas and conflicts of interest arise. According to Eisenhardt,²⁶⁹ two main problems evolve in this dynamic: first, the conflict between shareholders' and managers' aspirations leads to high complexities and costs in taking management into account; Secondly, the differing preferences between them about risk, causing difficulties in sharing them. Gottschalk²⁷⁰ identifies three assumptions that affect this relationship: self-interest, limited rationality, and risk avoidance, revealing conflicts of goals within companies and difficulty in managing information. This discrepancy leads to problems such as profit manipulation and exploitation of internal information in the interest of management at the expense of shareholders, which is called a moral risk and a negative choice. The result is an increase in agency costs, as shareholders find it difficult to ensure that

²⁶⁶ Kathleen Eisenhardt, ‘Control: Organizational and Economic Approaches’ (1985) 31(2) *Management Science* 134.

²⁶⁷ Petter Gottschalk, ‘How Criminal Organisations Work: Some Theoretical Perspectives’ (2008) 81(1) *Police Journal* 46.

²⁶⁸ Joan Fontrodona and Alejo José Sison, ‘The Nature of the Firm, Agency Theory and Shareholder Theory: A Critique from Philosophical Anthropology’ (2006) 66(33) *Journal of Business Ethics* 33.

²⁶⁹ Eisenhardt (n 266).

²⁷⁰ Gottschalk (n 267).

management works to maximise the company's value as stated by Fontrodona and Sison.²⁷¹ Gillan and Starks²⁷² also highlighted the problem that the prevalence of ownership among many shareholders reduces control incentives for any individual shareholder, because oversight costs will fall on the active investor, while benefits reach everyone, creating a “free-rider problem”. Therefore, Shleifer and Vishny²⁷³ suggest that shareholders with controlling stakes will be more willing to bear control costs because they will directly benefit from improved management, given their share size.

It is evident from this presentation of perspectives on the problems of the agencies that the impact of individual shareholder activity on oversight in the areas of ESG presents complex challenges. The effectiveness of oversight is significantly affected by the structure of corporate ownership of the dispersed ownership structure. As studies by Shleifer and Vishny have shown, shareholders with controlling stakes tend to invest more resources in oversight because they directly benefit from improved management, including enhanced ESG practices. However, censorship becomes weaker when ownership is distributed among many small shareholders; as small shareholders are not motivated to take effective oversight roles because control costs are too expensive compared to their personal benefits. Thus, these shareholders may be reluctant to invest in effective control over environmental and social matters because the benefits of improving these practices are for society as a whole or long-term investors and not necessarily directly for small investors.

In this context, small shareholders can benefit from strategies such as the formation of alliances between small shareholders or the use of tools such as mutual funds that represent large groups of shareholders and oversee on their behalf, a model currently adopted by the United Kingdom through the Stewardship Code 2026.²⁷⁴ In addition, regulations and laws that impose specific disclosure standards in the areas of environmental and social governance can support these efforts and incentivize companies to comply, to compensate for weak shareholder control of fragmented ownership systems. Given the constraints associated with the agency's theory, new theories and governance models have emerged aimed at addressing contemporary challenges facing shareholders. These theories seek to reorient the focus of companies to include not only making profits, but also taking into account the broad interests of various stakeholders including the environment and society.

²⁷¹ Fontrodona and Sison (n 268) 59.

²⁷² Stuart Gillan and Laura Starks, ‘Corporate Governance, Corporate Ownership, and the Role of Institutional Investors: A Global Perspective’ (August 2003) Weinberg Center for Corporate Governance Working Paper No 2003-01 <<https://ssrn.com/abstract=439500>> accessed 10 August 2025.

²⁷³ Andrei Shleifer and Robert Vishny, ‘Large Shareholder and Corporate Control’ (1986) 94(3) *Journal of Political Economy* 461.

²⁷⁴ Financial Reporting Council, The UK Stewardship Code 2026 <<https://www.frc.org.uk/library/standards-codes-policy/stewardship/uk-stewardship-code/>> accessed 9 June 2025.

3.6.4. Stakeholders Theory

Stakeholder theory criticizes an agency theory approach that prioritizes shareholder interests only. This approach, according to Yan,²⁷⁵ places excessive emphasis on the rights of a specific group of stakeholders, namely shareholders, which may lead to disregard or even violation of the rights of other groups affected by the company's activities. Yan emphasizes that shareholders are part of a wider range of stakeholders, and their interests should not be treated as an absolute priority at the expense of others. Instead, corporate managers must take into account the interests of all parties involved, even if it means negatively affecting shareholder benefits. Samanta²⁷⁶ points out that supporters of stakeholder theory often call for a greater role for government intervention in the economy, contrary to the perspective promoted by new classical economists, who prefer free markets and minimal government intervention. This approach reflects the philosophy that companies must act not only for shareholders but for the well-being of all stakeholders, a fundamental shift from narrow consideration of traditional corporate governance functions.

Many scientists provided many perspectives to understand the concept of 'stakeholders' more deeply. Freeman²⁷⁷ defines stakeholders as "a wide range of groups who can affect or are affected by the corporation". Sternberg²⁷⁸ clarifies this concept by stating that the term "stakeholders" was originally used to refer to individuals and groups necessary for the company's survival; These are not only shareholders but also any individual or group with an interest in the company. Letza et al²⁷⁹ this debate by asserting that stakeholders are those persons or entities that have an interest or concern for the company, whether that interest is financial or not. The CMA Corporate Governance Regulation 2023²⁸⁰ refers to shareholders as "anyone with an interest in the company, including employees, creditors, customers, suppliers, and the community".

Stakeholder theory represents a shift in how organizations' role within society is understood. According to Zou,²⁸¹ this theory is regarded as a group of diverse stakeholders, emphasizing the importance of managing and meeting the interests, needs

²⁷⁵ Min Yan, 'Why Not Stakeholder Theory?' (2013) 34(5) *Company Lawyer* 148.

²⁷⁶ Navajyoti Samanta, 'Convergence to Shareholder Primacy Corporate-Governance: Evidence from a Lexi-Metric Analysis of the Evolution of Corporate-Governance Regulations in 21 Countries, 1995–2014' (2019) 19(5) *Corporate Governance: The International Journal of Business in Society* 849.

²⁷⁷ Edward Freeman, *Strategic Management: A Stakeholder Approach* (Cambridge University Press 2010) ISBN 978-0-521-15174-0.

²⁷⁸ Elaine Sternberg, *Corporate Governance: Accountability in the Marketplace* (2nd edn, The Institute of Economic Affairs 2004) SSRN 4350610.

²⁷⁹ Stephen Letza, James Kirkbride, Xiuping Sun and Clive Smallman, 'Corporate Governance Theorising: Limits, Critics and Alternatives' (2008) 50(1) *International Journal of Law and Management* 17.

²⁸⁰ Capital Market Authority, *The Saudi Corporate Governance Regulation for the Listed Companies* (August 2023) <<https://cma.org.sa/en/RulesRegulations/Regulations/Documents/CorporateGovernanceRegulations1.pdf>> accessed 7 May 2024.

²⁸¹ Weikang Zou, 'Corporate Governance in Banking Organization in China' (2013) PhD thesis, University of York, Department of Politics.

and expectations of these individuals and groups. Budi²⁸² reinforces this understanding by explaining that stakeholder theory is used to explain why companies participate in social and environmental initiatives. The theory shows that companies are not only accountable to shareholders, but also to a wide range of parties affected by their activities, reflecting the vision that companies must act responsibly towards the whole community.

To deepen understanding of the stakeholders' theory, Friedman and Miles²⁸³ develop this theory based on two basic principles: first, the principle of corporate legitimacy, which emphasizes the need to manage the company in a way that ensures that the interests and rights of stakeholders, such as customers, suppliers, owners, employees, and society are taken into account. The company should involve these groups in decisions that have a significant impact on their well-being. Secondly, the principle of credit stakeholders, which portrays management as agents of stakeholders, requires them to work for them and ensure the long-term continuity and success of the company, protecting the main interests of each interest group.

3.6.5. Criticisms of Stakeholders' Theory

Criticisms of stakeholder theory focus on the challenges companies face in balancing multiple and competing interests. Scherer and Voegtlin²⁸⁴ suggest that companies may tend to prioritize the demands of stakeholders with the greatest authority or who can exert significant pressure, leaving less influential stakeholders without sufficient attention. This means that environmental and social considerations may not always receive proper priority if the stakeholders involved do not have enough power to pressure the company. Moreover, these researchers demonstrate that the great diversity of social values and norms among different cultures makes it difficult for global companies to meet ethical expectations consistently. These differences may lead to conflicts in environmental and social governance directives, making theory less effective in multicultural environments. On the other hand, Kiarie²⁸⁵ criticizes the idea of stakeholder theory by emphasizing that there is not necessarily a permanent conflict between shareholders' interests and other stakeholders. Kiarie believes that, motivated by maximizing profits, shareholders are often motivated to support the interests of the wider community, because the company's success is directly linked to the environment and the society in which it operates. A company's failure to make profits can deteriorate

²⁸² Ichsan Budi, 'Islamic Corporate Social Responsibility (ICSR) Disclosure and Islamic Banks (IBs) Performance: The Application of Stakeholder Theory from Islamic Perspective' (2021) 25 Jurnal Akuntansi dan Auditing Indonesia 76.

²⁸³ Andrew Friedman and Samantha Miles, *Stakeholders: Theory and Practice* (Oxford University Press 2006).

²⁸⁴ Andreas Scherer and Christian Voegtlin, 'Corporate Governance for Responsible Innovation: Approaches to Corporate Governance and Implications for Sustainable Development' (2020) 34(2) Academy of Management Perspectives 182.

²⁸⁵ Sarah Kiarie, 'At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?' (2006) 17(11) International Company and Commercial Law Review 329.

environmental and social governance, negatively affecting the interests of all stakeholders. Based on Kiarie's view, it is clear that applying stakeholder theory requires an accurate and balanced determination of forces between different stakeholders, as well as strong and sustainable guidance for environmental and social governance that ensures the interests of all.

In brief, stakeholders' theory is crucial to understanding corporate governance challenges, especially in the context of ESG. This theory is centred on recognizing that companies not only serve shareholders' interests, they must also take into account the interests of other stakeholders, such as employees, customers, suppliers, the community and the environment. The challenge arising from applying stakeholder theory is how to balance the competing demands of these diverse stakeholder groups. Scherer and Voegtlin's criticism suggests that companies may favour stakeholders with greater or more influential power - such as controlling shareholders, potentially marginalizing other parties that may have legitimate claims but without sufficient force to impose their interests. This dynamic is more complex in the context of ESG, where environmental or community interests may conflict with the short-term objectives of shareholders seeking rapid profit. Here, systemic restrictions and legislation can play a vital role in providing protection to stakeholders by defining the limits and standards companies must follow to ensure that sustainable and responsible practices are maintained.

3.6.6. Contractual Theory

Contract theory is based on the understanding that relationships within companies, especially between shareholders and management, constitute foundational and regulatory contracts.²⁸⁶ The exchange of simple goods and trade-offs were the basis of trade and investment until the 1940s and 1950s. However, with the evolution of the economy and the emergence of long-term investment and futures contracts, theories have emerged that explain these complex relationships. Bolton and Dewatripont²⁸⁷ point out that intellectual developments about property rights and control in long-term contracts began to take shape in the 1980s and 1990s. According to Klausner,²⁸⁸ contracts in companies consist of the company's charter and internal regulations, which are amended in accordance with corporate law to serve to improve the performance and value of the company.

In the legal and economic context, as Hart²⁸⁹ explains, the company is conceived as a set of contracts between different parties, and shareholders as owners of the company are entitled to determine its purposes. One dilemma is the contracts of accession defined

²⁸⁶ Stephen Smith, *Contract Theory* (Oxford University Press 2004).

²⁸⁷ Patrick Bolton and Mathias Dewatripont, *Contract Theory* (The Massachusetts Institute of Technology Press 2005).

²⁸⁸ Michael Klausner, 'The Contractarian Theory of Corporate Law: A Generation Late' (2005) 31 *The Journal of Corporation Law* 779.

²⁸⁹ Oliver Hart, 'An Economist's Perspective on the Theory of the Firm' (1989) 89 *Columbia Law Review* 1757.

as "take it or leave it", where the less influential party has only the option of accepting or refusing without bargaining, as described by Bolton and Dewatripont.²⁹⁰ Easterbrook and Fischel²⁹¹ present the challenges of state interference in the founding contracts of shareholders, pointing out the need to establish restrictive controls on directors' authority and set minimum voting rates to ensure transparency and disclosure.

As a solution to these problems, contractual theory also emphasises the need to protect stakeholders' rights through contracts guaranteeing their rights under the law, as Salacuse²⁹² discusses. From this point of view, corporate law is essential to protecting shareholders, while other laws protect other stakeholders. Dean²⁹³ argues that companies, as independent legal entities, must act responsibly and take into account the interests of all stakeholders affected by their existence. Thus, the company is seen not only as a shareholder agent but as an enterprise obliged to engage responsibly with its wider community. This understanding reflects how contract theory provides a framework for the analysis and interpretation of companies' internal and external relationships. This includes how to deal with ESG issues in general, where a contractual approach requires companies not only to focus on shareholders but also to pay attention to the communities and environments within which they operate.

3.6.7. Contractual Theory and ESG Issues

Contractual theory provides a comprehensive interpretation of relationships within companies, especially shareholders, by emphasizing the importance of corporate contracts as the basis for those relationships. The UK Companies Act 2006²⁹⁴ and the Saudi Companies Law 2022²⁹⁵ for example, clearly define the importance of the Foundation Memorandum clarifying the company's purpose, capital and management structure to regulate the company's long-term work and ensure compliance with legal standards.

According to this theory, states usually interfere with corporate regulation to ensure a balance between the interests of all parties affected by the company's operations, including maintaining stability of the economy and stimulating foreign investment. This intervention includes regulations governing governance, and capital market laws to reduce legal and economic risks. However, this intervention is seen by some as insufficient on its own to ensure that companies act with social and moral responsibility, especially in terms of increasing returns at the expense of social and environmental

²⁹⁰ Bolton and Dewatripont (n 288) 64.

²⁹¹ Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996).

²⁹² Jeswald Salacuse, 'Corporate Governance in the New Century' (2004) 25(3) *Company Lawyer* 69.

²⁹³ Janice Dean, 'Stakeholding and Company Law' (2001) 22(3) *Company Lawyer* 66.

²⁹⁴ Companies Act 2006.

²⁹⁵ The Saudi Companies Law 2022, issued by Royal Decree No. (M/132) of 1443/12/1 AH, Corresponding to 30/06/2022.

responsibilities. In this context, Donaldson²⁹⁶ touches on the concept of “social contract” as a framework that strengthens companies' commitment to social responsibility as part of their contract with society. This theory, as expanded by Dunfee and Donaldson,²⁹⁷ supports the idea that companies should focus not only on profitability but also on their contributions to society and the environment. They also believe that management must make decisions based on the moral impact of such decisions, and must recognize social support and contribute to society's activities as part of its contractual obligations.

Based on Dunfee and Donaldson's view, contractual theory can explain how companies interact with various stakeholders according to modern ESG requirements, by directing companies to assume their responsibilities to the environment and society in line with contracts and their legal and ethical obligations. At the same time, this does not negate the importance of legislation's role in protecting stakeholders who do not have the power to change or control corporate activities, especially in today's reality and the proliferation of e-commerce and global commerce. These environmental and ethical obligations may lose their visibility due to the company's physical absence in all the markets it serves, making applying the concept of contract theory a challenge. Nor may foreign companies necessarily feel the same motivation to meet the requirements of communities that do not reflect their original institutional culture.

3.7. Summary

At the conclusion of this section, a comprehensive analysis of the Agency's theories, stakeholders, and contractual theory shows the importance of these theoretical frameworks in understanding and interpreting how contemporary companies deal with their obligations and responsibilities in the context of ESG.

Agency theory highlights the dynamics between shareholders and management, citing the need to balance managers' and shareholders' interests, which is crucial in shaping corporate policies that support environmental and social ethical practices. Stakeholders' theory, on the other hand, extends the circle of stakeholders to include not only shareholders but all parties that can be affected or influenced by the company, enhancing the importance of the company in balancing the interests of different parties and responding to environmental and social challenges. Contractual theory provides a strong basis for interpreting the company's legal and ethical relationships with various parties, including the legal and ethical obligations of companies in the context of contracts with different stakeholders.

²⁹⁶ Thomas Donaldson, ‘Constructing a Social Contract for Business’ in *Business Ethics: Critical Perspectives on Business and Management* (vol 1, Routledge 2001) 209; Amina Buallay, ‘Corporate Governance, Sharia’ah Governance and Performance: A Cross-country Comparison in MENA Region’ (2018) 12(2) *International Journal of Islamic and Middle Eastern Finance and Management* 216.

²⁹⁷ Thomas Dunfee and Thomas Donaldson, ‘Social Contract Approaches to Business Ethics: Bridging the “Is-Ought” Gap’ in Robert E Frederick (ed), *A Companion to Business Ethics* (Blackwell Publishers 1999).

Understanding these theories together enables companies to develop effective strategies to achieve their business goals while maintaining their commitments to society and the environment, and promoting the right governance practices. The agency's theoretical frameworks, stakeholders, and contracting thus provide a holistic view of how companies manage their responsibilities in a world where social and environmental expectations are increasing, underscoring the importance of these theories in guiding corporate behaviours and stimulating them towards ethical and sustainable practices.

3.8. UK Corporate Governance Approach and ESG Disclosures

3.8.1. Introduction

This section reviews how the UK is a leader in embracing corporate governance frameworks that support continuous development and transparency in ESG disclosures. It focuses specifically on the UK's role as a model that can contribute to a deeper understanding of the growing demands on companies to adopt more sustainable and ethical practices.

The section begins by analysing listing rules on the London Stock Exchange (LSE), reviewing disclosures required from public companies listed during the listing application phase and ongoing obligations to remain on the market. This part shows how these rules contribute to enhancing transparency and accountability among listed companies, creating an enabling environment for ESG disclosures. The second part discusses the voluntary model of corporate governance in the UK, known as the "comply or explain" principle. This model provides flexibility for companies in managing their governance obligations and environmental and social disclosures. It is a valuable model worth studying to see how Saudi Arabia can inspire and apply similar concepts in its own context. By analysing these two aspects, this section seeks to understand how the British approach can contribute to the promotion of global corporate governance practices, in particular how it can be effectively applied in the Saudi market to enhance responsibility and sustainability.

3.8.2. The UK Listing Rules

London Stock Exchange (LSE) has long been a feature of both the British and the global economy. Dating back to the 17th Century, it is one of the world's oldest and most prestigious stock market despite originating as a simple commodity market.²⁹⁸ Today, the LSE is home to a wide range of companies from across the globe, from a variety of different industries and sectors. With a total market capitalisation in trillions,

²⁹⁸ London Stock Exchange, 'Our History' (2023) <<https://www.londonstockexchange.com/discover/lseg/our-history>> accessed 20 November 2023.

it remains one of the world's largest markets, although substantial outflows in the wake of Brexit have diminished its position in recent years.²⁹⁹

Being listed on any stock exchange is an attractive proposition for most businesses. Increased investment is clearly the headline benefit that businesses are seeking to secure, but listing also carries with it reputational benefits, whether it comes to the legitimacy of a particular company or the way it elevates its profile.³⁰⁰ Such benefits are further heightened in the case of the LSE, given its size, reputation, and longstanding nature.³⁰¹ However, being listed is not without its drawbacks and costs. There are expectations of companies hoping to be listed, and these arise in several different forms. Companies must be of a certain size and structure, must comply with regulatory requirements, and demonstrate adherence to ESG principles.³⁰² It is worth noting that the UK listing system underwent a major change in 2024; The previous distinction between the standard main market (Standard Main Market – SMM) and the premium main market (Premium Main Market – PMM)³⁰³ was abolished, and replaced by a new unified system known as the “Rules for Listing Common Stock in Commercial Companies” (Equity Shares in Commercial Companies – ESCC), This is under the latest updates to the UK Listing Rules (UK Listing Rules 2024).³⁰⁴ This system aims to simplify listing requirements and enhance the global attractiveness of the London market. Therefore, references to the ancient system are included in this chapter for analytical and historical purposes only. The Financial Conduct Authority (FCA)³⁰⁵ explained in the final rules document that these amendments come in response to the requirements of the amended Financial Services and Markets Act 2000, especially with regard to enhancing the competitiveness and long-term growth of the British economy. The authority stated: “We consider our final rules should deliver more proportionate regulation and enable our markets to be competitive in attracting listings and promoting growth of UK listed companies”,³⁰⁶ which in turn would support the wider UK economy and investor returns.

Although these expectations are a natural price for companies to be accepted into the main market, they are based on clear regulatory justifications. The UK has a

²⁹⁹ Simon Foy, ‘London Stock Exchange Overtakes Paris to Regain Crown as Europe’s Biggest Market’ (The Telegraph, 19 October 2023) <<https://www.telegraph.co.uk/business/2023/10/19/london-stock-exchange-overtakes-paris-europe-market/>> accessed 20 November 2023.

³⁰⁰ Robert Battalio, Andrew Ellul and Robert Jennings, ‘Reputation Effects in Trading on the New York Stock Exchange’ (2007) 62(3) *Journal of Finance* 1243.

³⁰¹ London Stock Exchange, ‘Equity’ (2023) <<https://www.londonstockexchange.com/raise-finance/equity>> accessed 9 November 2023.

³⁰² London Stock Exchange, ‘Compare Markets for Listing Equity’ (2023) <<https://www.londonstockexchange.com/raise-finance/equity/compare-markets-listing-equity>> accessed 9 November 2023.

³⁰³ *ibid.*

³⁰⁴ Financial Conduct Authority, UK Listing Rules (FCA Handbook) <<https://www.handbook.fca.org.uk/handbook/UKLR/>> accessed 30 July 2025.

³⁰⁵ Financial Conduct Authority, *Primary Markets Effectiveness Review: Feedback to CP23/31 and Final UK Listing Rules* (Policy Statement PS24/6, 11 July 2024) <<https://www.fca.org.uk/publications/policy-statements/ps24-6-primary-markets-effectiveness-review-feedback-cp23-31-final-uk-listing-rules>> accessed 28 July 2025.

³⁰⁶ *ibid.*

relatively high level of financial regulation and therefore seeks to achieve strategic objectives related to ensuring the quality of listed companies and enhancing market integrity.³⁰⁷ For the London Stock Exchange to be able to provide reputational and reliability benefits, listed companies must adhere to high standards of transparency and accountability, as well as adhere to fair market conduct practices.³⁰⁸ The new Listing Rules (ESCC) reflect this trend Through an increasing focus on disclosures related to environmental, social and institutional governance (ESG), which reinforces the need for advanced regulatory oversight in line with the aspirations of investors and the international community.³⁰⁹

In this context, the new system of listing rules (UKLR 2024) applies to the main market of the London Stock Exchange (LSE), which now consists of specific categories, most notably the category of “commercial companies”, the category of “Shell companies and SPACs”, and the category of “closed investment funds”.³¹⁰ The AIM Market –the alternative market of the LSE for small and developing companies – is a separate track, is not part of the main market, and the securities listed in it are not considered included in Main Market. The AIM market is subject to a set of special regulations set out in the Admission and Disclosure Standards document (July 2024),³¹¹ making it outside the direct application of the UKLR 2024 rules.

3.8.3. Requirements under the Companies Act 2006

As per the CA 2006, a variety of companies can be created in the UK; public companies limited by shares, private companies limited by shares, private companies limited by guarantee and unlimited companies.³¹² It is then apparent that there are two main distinctions to be made – between public and private corporation, and between limited and unlimited corporation.

Public companies, which are allowed to offer shares to the public can be traded on public stock exchanges.³¹³ As a result, the ownership of a given company can be highly diversified amongst many individual shareholders,³¹⁴ and due to this public exposure,

³⁰⁷ Andrew Schmulow, ‘The Four Methods of Financial System Regulation: An International Comparative Survey’ (2015) 26 *Journal of Banking and Finance Law and Practice* 151 <<https://ssrn.com/abstract=3082092>> accessed 20 November 2023.

³⁰⁸ Jonathan Macey and Maureen O’Hara, ‘The Economics of Stock Exchange Listing Fees and Listing Requirements’ (2002) 11(3) *Journal of Financial Intermediation* 297.

³⁰⁹ Jonathan Macey, ‘ESG Investing: Why Here? Why Now?’ (2022) 19 *Berkeley Business Law Journal* 258.

³¹⁰ Financial Conduct Authority, *Primary Markets Effectiveness Review: Feedback to CP23/31 and Final UK Listing Rules* (Policy Statement PS24/6, 11 July 2024) <<https://www.fca.org.uk/publications/policy-statements/ps24-6-primary-markets-effectiveness-review-feedback-cp23-31-final-uk-listing-rules>> accessed 28 July 2025.

³¹¹ London Stock Exchange, *Admission and Disclosure Standards* (effective July 2024) <<https://www.londonstockexchange.com/resources/dam/documents/Admission-and-Disclosure-Standards.pdf>> accessed 29 July 2025.

³¹² Companies Act 2006, c 46, Part 1.

³¹³ Brenda Hannigan, *Company Law* (5th edn, Oxford University Press 2021).

³¹⁴ *ibid.*

public companies are subject to a higher level of oversight in order to ensure risk is kept within acceptable levels.³¹⁵ Limited companies are those which limit their liability for debts to the value of the company itself, and its assets.³¹⁶ Whilst the shareholders are still at risk to the value of their investment in the company, their assets are considered separate from the company itself and are therefore protected from claims.³¹⁷ This can be contrasted with unlimited companies, where no distinction is made between the assets of the company and the individual owner(s), which can then expose them to substantial liability.³¹⁸ This distinction is made clear in s.3 CA 2006,³¹⁹ of these two types of companies, a limited company is more highly regulated under the CA 2006.³²⁰ Again, this is explained by the level of risk represented by limited companies; since shareholders are somewhat protected from liability, their incentive is less to manage risk appropriately, making law intervention necessary to bridge this gap.

Regarding ESG disclosure requirements, these requirements vary depending on the type of company, particularly since the new listing rules for 2024 apply only to companies listed on the market regulated by the Financial Conduct Authority, which is covered by the ESCC system. Publicly listed companies, which are privileged to offer their shares to the public and have a broad shareholder base, require a higher level of transparency in their disclosures, under the new listing system (ESCC), these companies are required to comply with advanced disclosure requirements covering the areas of climate, social governance, and corporate governance. Shareholders and other stakeholders expect to be informed about the company's impact on the environment and society, as well as the management of governance risks. On the other hand, limited companies, whose shareholders are protected from claims against their assets, may not be under pressure equally similar to public disclosure, but still face certain regulatory requirements related to ESG, especially if they seek to attract external financing or improve their public image and reputation in the market. While unlimited companies, characterised by a significant obligation of owners to be directly responsible for debts and liabilities, may need to think carefully about how ESG issues are addressed, as any default may directly affect their owners. This reinforces the need for strategic planning and effective governance risk management. As a result, ESG-related disclosure and oversight requirements serve as key tools to verify compliance and strengthen corporate responsibility across different types of companies, ultimately supporting the achievement of sustainability and social responsibility goals.

³¹⁵ *ibid.*

³¹⁶ *ibid.*

³¹⁷ *ibid.*

³¹⁸ *ibid.*

³¹⁹ Companies Act 2006, c 46, s 3.

³²⁰ Hannigan (n 314).

3.8.4. Regulatory Requirements for Listing on the LSE

As noted previously in this chapter, companies must comply with certain requirements to be listed on the LSE. These requirements can be broken down into two categories: those which must be met in order to successfully apply to be listed, and those which must be continually met by listed companies for the purpose of maintaining their position. Under the new system of listing rules (UKLR 2024), Companies seeking to be listed under the 'Commercial Companies' equity shares category are subject to a comprehensive set of eligibility and continuing obligations, including financial and non-financial disclosures, governance requirements, and environmental and social risk reporting, as well as rules relating to voting, equity compositions with varying rights, dealings with related parties, and disclosure of substantive transactions.

The new rules do not require listed companies to provide a three-year historical financial record or a non-qualified working capital statement – requirements previously found in premium listing – giving companies greater flexibility when applying for listing. However, material information must be disclosed in the listing prospectus in accordance with the requirements of the Financial Bulletin Publication Regulations. Ongoing requirements after listing include periodic disclosure, annual reports, compliance with corporate governance rules; such as the UK Corporate Governance Code,³²¹ and disclosure of significant changes affecting shareholders or the company's structure. Further, listed companies are subject to various requirements – depending on the company's size and type – under the Companies Act 2006³²² (CA 2006), to match the risk levels and expectations of each market, as well as the need to meet the needs and expectations of different categories of investors. Listed companies are also subject to various conditions under the CA 2006 to ensure their adherence to appropriate legal and regulatory standards, thereby enhancing transparency and confidence in the market.

For the same reason, to ensure compliance with multiple and comprehensive standards, listed companies are monitored by a variety of organizations which promotes transparency and protects investors' and other stakeholders' interests.³²³ The Financial Conduct Authority (FCA) provides substantial levels of regulation through its Handbook, which contains rules on listing requirements, disclosure, and transparency which companies must abide by.³²⁴ Although this is the main body that will provide listing requirements, it works together with the Prudential Regulation Authority (which regulates major financial institutions)³²⁵ and the Bank of England (which provides

³²¹ Financial Reporting Council (FRC), The UK Corporate Governance Code 2024 <<https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/>> accessed 2 Aug 2025.

³²² Companies Act 2006, c 46.

³²³ Suwinto Johan, 'Financial Institution and Public Listed Companies: How the Supervision Regulated Under the Indonesian Law?' (2021) 17(2) *Varia Justicia* 171.

³²⁴ Financial Conduct Authority, 'FCA Handbook' (FCA, 2023) <<https://www.handbook.fca.org.uk/handbook>> accessed 2 Aug 2025.

³²⁵ Bank of England, 'What is the Prudential Regulation Authority (PRA)?' (BoE, 2020) <<https://www.bankofengland.co.uk/explainers/what-is-the-prudential-regulation-authority-pra>> accessed 2 August 2025.

economic oversight) in order to provide broader regulatory policy.³²⁶ Companies will also be subject to a variety of reporting and audit requirements, which are overseen by the Financial Reporting Council (FRC).³²⁷ The following sections will clarify the regulatory requirements for ESG disclosures, noting how these systems contribute to strengthening transparency and corporate social responsibility practices.

3.8.5. Applications for Listing on the LSE and Continuous Requirements

3.8.5.1. Alternative Investment Market (AIM)

The Alternative Investment Market (AIM) is a subsidiary of the London Stock Exchange (LSE) and is specifically designed to meet the needs of small and medium-sized enterprises aspiring to growth and access public capital. This market is characterized by less stringent listing requirements than the main market, while maintaining standards of disclosure and transparency, commensurate with the size of the companies listed in it and their limited capabilities.³²⁸ AIM is subject to the Alternative Investment Market Rules (AIM),³²⁹ and Admission and Disclosure Rules updated in July 2024, issued under the LSE Listing Standards (Admission and Disclosure Standards),³³⁰ which regulate admission requirements, ongoing obligations, disclosure requirements, and compliance.

The appointment of an accredited advisor known as Nomad (Nominated Advisor)³³¹ is a key pillar of AIM's regulatory framework, as no company may be accepted for listing without Nomad licensed by the LSE. The function of this advisor is to advise the company on its regulatory obligations, ensure its compliance with market requirements, and facilitate ongoing communication between it and the stock exchange.³³² The Company is fully responsible for cooperation with Nomad, and the Company is not permitted to remain listed on AIM without this designation; the loss of Nomad and the

³²⁶ *ibid.*

³²⁷ Financial Reporting Council, 'Audit, Assurance and Ethics' (FRC, 2023) <<https://www.frc.org.uk/library/standards-codes-policy/audit-assurance-and-ethics/>> accessed 2 August 2025.

³²⁸ London Stock Exchange, 'FTSE AIM All Share' (LSE, 2023) <<https://www.londonstockexchange.com/indices/ftse-aim-all-share/constituents/table>> accessed 8 Nov 2024.

³²⁹ London Stock Exchange, AIM Rules for Companies (January 2021) <https://docs.londonstockexchange.com/sites/default/files/documents/AIM%20Rules%20for%20Companies%20%2801012021%29_1.pdf> accessed 3 Aug 2025.

³³⁰ London Stock Exchange, Admission and Disclosure Standards (effective July 2024) <<https://docs.londonstockexchange.com/sites/default/files/documents/admission-and-disclosure-standards.pdf>> accessed 2 Aug 2025.

³³¹ London Stock Exchange, 'Role of advisers on AIM' (LSE, 2023). <<https://www.londonstockexchange.com/raise-finance/equity/how-list-equity-listing-journey/role-of-advisers-on-aim>> accessed 2 Aug 2025.

³³² *ibid.*

failure to appoint a replacement within a specified period will result in the suspension of trading or even the delisting.

In terms of admission requirements, no minimum market capital is required, and no minimum percentage of shares offered to the public is imposed, as is the case in the main market.³³³ However, companies must submit an acceptance document (Admission Document) that includes precise details of ownership structure, board statements, financial reports, and future expectations, and if the listing is accompanied by a public offering of securities, a prospectus must be issued in line with the rules of the prospectus and Part 6 of the Financial Services and Markets Act 2000 (FSMA 2000).³³⁴ In addition, AIM-listed companies are obligated to comply with a number of ongoing obligations,³³⁵ in particular to disclose material information that may affect the price of securities, in accordance with AIM Rule 11,³³⁶ as well as to publish progress and annual reports in accordance with AIM Rules 18 and 19. Securities are also required to be freely tradable and settled electronically, and the company is required to appoint an internal contact person responsible for communicating with the stock exchange and updating its data on an ongoing basis, in accordance with Sections 2 and 3 of the new standards.

From the above, it is clear that although AIM tends to include growth businesses, the LSE is incentivised to maintain a certain level of its standards and reputation. At the same time, applying the full scope of the FCA regulations would be relatively cumbersome for enterprises of this size due to their lower resources, some of which have a market cap of less than £1 million,³³⁷ which could be a challenge for them to meet the most rigorous demands of the major market. Meanwhile, AIM can be seen as a way for the LSE to allow younger and small businesses with a high potential for growth, listing, and accessing capital,³³⁸ Because of LSE's dual incentives to maintain its standards and reputation and ease the regulatory burden on small businesses, AIM's ESG disclosure requirements are likely less stringent than those imposed on public companies listed in the main market. This mitigation could assist smaller companies and growth businesses transition to public ownership while adhering to disclosure requirements corresponding to their limited resources. Thus, the essence of the AIM regulatory model is to achieve a balance between enabling small businesses to enter the market and protecting investors through a system based on the appointment of a formal advisor (Nomad) who is responsible for ensuring the issuer's compliance with

³³³ John Doukas and Hafiz Hoque, 'Why Firms Favour the AIM When They Can List on Main Market?' (2016) 60 *Journal of International Money and Finance* 378.

³³⁴ Financial Services and Markets Act 2000 (c 8) pt 6, as amended by the Financial Services and Markets Act 2023.

³³⁵ Neeta Shah, 'Accounting, Accountability and Governance in Junior Stock Markets' in GD Carnegie and CJ Napier (eds), *Handbook of Accounting, Accountability and Governance* (Edward Elgar 2023) 202.

³³⁶ London Stock Exchange, AIM Rules for Companies (May 2024) rr 11, 18–19.

³³⁷ London Stock Exchange, 'Issuer List Archive 2024' <<https://www.londonstockexchange.com/reports?tab=issuers>> accessed 8 November 2024.

³³⁸ Gerakos, Joseph, Mark Lang, and Mark Maffett, 'Post-listing Performance and Private Sector Regulation: The Experience of London's Alternative Investment Market' (2013) 56(2–3) *Journal of Accounting and Economics* 189.

regulatory standards.³³⁹ AIM's ongoing admission requirements and commitments also take into account the limited resources and capabilities of these companies, enhancing the market's attractiveness as an initial listing platform and paving the way for a subsequent transition to the primary market.

3.8.5.2. Main Market Listing Rules (Main Market) under UKLR 2024

The main market on the London Stock Exchange (LSE) is now comprehensively regulated under the new UK Listing Rules System (UKLR 2024),³⁴⁰ which came into effect in July 2024. Public companies included in the “commercial companies category” (Commercial Companies Category) are the central category within this system, and companies that include their common shares in this category are obligated to comply with a set of regulatory requirements designed to enhance transparency, investor confidence, and market stability.

Rule UKLR 1.5.1(R)³⁴¹ states that the “common shares of commercial companies” category is one of eleven official categories for listing on the London Stock Exchange, and the issuer must comply with all rules applicable to the category to which each listed security belongs. This system eliminated the previous distinction between premium listing and standard listing, to be replaced by a unified framework that focuses on disclosure and accountability rather than formal features, allowing greater flexibility for companies without compromising core market requirements. This new category aims to attract a broader spectrum of companies, including high-potential startups, without requiring a long financial record or unconditional working capital statement, which represents a noticeable shift from previous requirements for listing. Instead, the new system is based on the principle of full disclosure via prospectus, allowing investors to assess risks and opportunities in a more transparent and independent manner.

The process of listing public companies on the main market of the common stock category (commercial companies) is subject to a number of basic conditions that must be met before accepting listing, under the new UKLR 2024 listing rules system. These conditions include meeting disclosure, governance, and financial structure requirements, ensuring that the issuer complies with regulatory standards issued by the FCA. Under UKLR Rule 3.2.7(R)³⁴², a company applying for listing must prove that it has a market capitalization of at least £30 million on the date of application, which represents a substantial increase from the previous minimum of £700,000.³⁴³ A

³³⁹ London Stock Exchange, ‘How to List – Equity Listing Journey’ <<https://www.londonstockexchange.com/raise-finance/equity/how-list-equity-listing-journey>> accessed 2 August 2025.

³⁴⁰ Financial Conduct Authority, UK Listing Rules 2025 (UKLR), FCA Handbook <<https://www.handbook.fca.org.uk/handbook/UKLR/>> accessed 30 July 2025.

³⁴¹ UK Listing Rules (UKLR) r 1.5.1(R).

³⁴² UKLR r 3.2.7.

³⁴³ Michael Dawes and Clive Hopewell, ‘A Return to Laissez-Faire? The FCA’s Surprising Proposals to Relax the Listing Rules’ (Bird & Bird, 7 September 2023)

prospectus compliant with the disclosure requirements set out in Part 6 of the Financial Services and Markets Act 2000 (FSMA 2000), as amended in 2023³⁴⁴ is also required, with an authorized sponsor (sponsor) appointed to accompany the listing process, under UKLR 4.2.1(R).³⁴⁵

Furthermore, companies applying for listing are committed to complying with the six Listing Principles (Listing Principles) set out in UKLR 2.2.1(R),³⁴⁶ which aim to ensure proper compliance with statutory obligations. These principles include the need to maintain effective internal procedures and systems, to deal with the Financial Conduct Authority (FCA) with transparency and integrity, and to enable members of the Board of Directors to clearly understand their responsibilities and regulatory obligations, in addition to the commitment to treat all shareholders in the same category fairly and equally with regard to their rights related to listed securities, and to be careful not to issue any information that may be misleading or lead to creating an unreal image of the market. This enhances the climate of integrity and transparency and achieves adequate protection for investors. Rule UKLR 1.3.1(R)³⁴⁷ also requires the issuer to provide any information or clarifications requested by FCA during the application assessment phase or to ensure the smooth functioning of the market, including disclosures relating to the company's structure, board members, financial position, and environmental, social and governance (ESG) policies. In cases where FCA considers there has been or is likely to be a violation of the rules of listing, disclosure or transparency, it may request the company to appoint a sponsor to advise and ensure compliance, in accordance with UKLR 1.4.1(R).³⁴⁸ The obligation also includes updating the company managers' communication data and providing FCA with accurate and up-to-date information in accordance with UKLR 1.3.5(R)³⁴⁹ and 1.3.7(R),³⁵⁰ to ensure effective communication channels are available in the event of urgent developments requiring supervisory intervention from the FCA.

In light of the above, the rules for listing on the main market constitute the frame of reference that determines the conditions for initial admission of companies within the category of common shares (commercial companies). This is followed by an integrated system of ongoing obligations, which requires listed companies to maintain a high level of disclosure and regulatory compliance, which will be reviewed in the next section.

<<https://www.twobirds.com/en/insights/2023/uk/a-return-to-laissez-faire-the-fcas-surprising-proposals-to-relax-the-listing-rules>> accessed 10 August 2025.

³⁴⁴ Financial Services and Markets Act 2000 (c 8) pt VI, as amended by the Financial Services and Markets Act 2023.

³⁴⁵ UKLR r 4.2.1.

³⁴⁶ UKLR r 2.2.1.

³⁴⁷ UKLR r 1.3.1.

³⁴⁸ UKLR r 1.4.1.

³⁴⁹ UKLR r 1.3.5.

³⁵⁰ UKLR r 1.3.7.

3.8.6. Obligatory Reports

The CA 2006, in addition to both the UKLR and the DTR, provides a number of reporting requirements for companies listing on the Main Market, or any other regulated exchange. A failure to provide such reports is a criminal offence under s.451 CA 2006.³⁵¹ For a company on the Main Market, two different liabilities can then arise should reporting obligations are not met – the company can be delisted should it fail to comply with the UKLR (which includes a Rule stating companies must comply with the DTR), and the directors can themselves be held criminally liable. Notably, many of the requirements below align with the directors' duties listed under s.172 CA 2006-³⁵² that is, directors must comply with the duties included in s.172, which are -involve taking into account the potential long-term consequences of any decision, considering the interests of its employees, and strengthening business relationships with suppliers, customers, and other stakeholder groups. It must also assess the impact of its operations on the community and environment, maintain its reputation in line with high standards of business conduct, and act with integrity among the company's members-, moreover, directors must also report on how they have done so.

3.8.6.1. Annual Financial Statement

At the end of the financial year, companies must publish an annual report showing the financial statement of the company, describing the company's financial position as dictated by ss.390-409,³⁵³ including assets, liabilities, and the company's general financial position and profits or losses. In addition to this basic fiscal information, a responsibility statement from the directors endorsing the accuracy of the annual report must be provided under s.414 CA 2006.³⁵⁴

ESG disclosures integrate with financial information by providing a comprehensive view of the company's performance in the ESG issues. The United Nations Principles for Responsible Investment (PRI) report 2022/23³⁵⁵ shows that investors consider ESG disclosures as an essential part of investment decision-making, enhancing corporate transparency and increasing investors' confidence in them. This confirms that explaining the annual statement of how the company manages its environmental impacts, how it deals with social responsibilities, and the level of its commitment to good governance practices contributes to an integrated picture of the company's comprehensive practices including sustainability. This integration enhances transparency and accountability, and helps investors make sound investment decisions

³⁵¹ Companies Act 2006, s 451.

³⁵² Companies Act 2006, s 172.

³⁵³ Companies Act 2006, ch 3, ss 390–409.

³⁵⁴ Companies Act 2006, s 414.

³⁵⁵ Principles for Responsible Investment, Annual Report 2022–23 (PRI 2023) <https://dwtyzx6upklss.cloudfront.net/Uploads/z/s/n/pri_ar2023_smaller_file_8875.pdf> accessed 13 November 2024.

based on several considerations, including profitability and the company's commitment to ESG responsibilities, thus enhancing its reputation and long-term sustainability.

3.8.6.2. Strategic Report (Directors' Report)

Corporate strategic report data are closely linked to ESG disclosures by providing a comprehensive view of the company's performance in these areas. Under s.414A-419 of the CA 2006,³⁵⁶ directors must submit a strategic report addressing the company's performance and operations during the previous year, including the significant uncertainties and risks it faces. The present report includes information on environmental issues, company personnel, social and community issues, and human rights issues, which are required for quoted companies in accordance with article 414C(7)(b) of the CA 2006.³⁵⁷ These disclosures are not applicable to all companies, as there are specific requirements depending on their classification under the Act. The report also describes the company's governance arrangements and policies related to climate risks and opportunities, ensuring that environmental and social disclosures are part of the strategic report, enhancing transparency about how the company manages its environmental and social impacts.

In addition, the strategic report requires information on the representation of genders in the company, particularly regarding senior managers, directors, and company's employees as stated in s.8 of 414C of the CA 2006.³⁵⁸ This type of information is in line with governance disclosures that focus on transparency in the company's management structure and promoting diversity and inclusiveness. CA 2006 in s.416³⁵⁹ makes it clear that the report must also include details on the composition of the company's board and the recommended dividend. Furthermore, according to the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008,³⁶⁰ the report should include information on how the company engages with employees, and strengthens relationships with suppliers, customers, and other stakeholders, reflecting the company's social obligations and enhancing the transparency of its business practices.

Furthermore, Companies (Directors' Report) in s. 7 of 414C³⁶¹ (CA 2006) requires listed companies to make climate-related disclosures describing the impact of business on climate change. These mandatory disclosures ensure that investors and shareholders have a clear view of how the company deals with environmental and social risks and opportunities, and its commitment to good governance practices. This integration enhances transparency and accountability, and helps investors make informed

³⁵⁶ CA 2006, ss 415-419.

³⁵⁷ CA 2006, s 414C(7)(b).

³⁵⁸ Companies Act 2006, art 414C s 8.

³⁵⁹ Companies Act 2006, ch 5, s 41.

³⁶⁰ Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, SI 2008/410.

³⁶¹ CA 2006, Art 414C s 7.

investment decisions based on a comprehensive understanding of the company's performance and sustainability.

3.8.6.3. Corporate Governance Statement

Listed companies must submit a corporate governance statement if it is not already included as part of the directors' report. UKLR explains from UK listing rules, and Disclosure and Transparency Rules (DTR) 7.2³⁶² basic guidance on what content a corporate governance statement should cover to ensure a high level of transparency and accountability.

Paras (5) and (6) of Article UKLR 6.6.6³⁶³ refers to disclosure requirements regarding the application of UK corporate governance principles by listed companies. According to the latest update dated 28 March 2025, a listed company is required to provide a detailed statement on how it applies the principles contained in the UK Corporate Governance Code (UK CG Code 2024),³⁶⁴ including the information contained in Principles 30 and 31 of the Code. This statement helps shareholders understand and assess the extent of the company's commitment to governance principles by clarifying the policies and procedures that the company has followed to achieve governance commitments. This breakdown is a way to enable shareholders to see how the principles are translated into actual practices that enhance the company's transparency and facilitate the assessment of its commitment to regulatory frameworks.

UKLR 6.6.6³⁶⁵ contains additional requirements that the listed company must clarify its compliance with the provisions of the UK CG Code 2024 during the accounting period. The company must state that it has complied with all relevant provisions. In the event that it cannot comply with certain provisions, it must inform the public and specify which provisions it has not adhered to, while clarifying the periods of time during which it has not been able to achieve such compliance, especially for those provisions that require continuing commitments. The company must also explain the reasons that prevented compliance, so that shareholders can understand the circumstances and reasons why the company took this approach and evaluated it objectively. These paragraphs are in line with the “comply or explain” principle, which prohibits companies from interpreting the reasons behind this decision.

With regard to DTR's corporate governance requirements, the listed company must include the corporate governance statement as a specific section in the directors' report. Except for this, article DTR 7.2.9³⁶⁶ grants listed companies the option of presenting the governance statement in a separate report, or in a document on the company's website, so that the location of such information is indicated in the directors' report. The

³⁶² FCA Handbook (FCA, 4 October 2024) DTR 7.2 Corporate Governance Statements.

³⁶³ UKLR r 6.6.6(5)–(6).

³⁶⁴ Financial Reporting Council, *UK Corporate Governance Code 2024*.

³⁶⁵ UKLR r 6.6.6.

³⁶⁶ DTR r 7.2.9 Corporate Governance Statements.

Company's Governance Statement requires that it contain information covering the basic aspects of DTR 7.2.2R to DTR 7.2.7R, as well as additional information required where appropriate in accordance with DTR 7.2.8AR, as will be explained below.

DTR 7.2.2R³⁶⁷ stipulates that the statement shall include a reference to the Corporate Governance Law to which the company is subject, in addition to any other law that the company voluntarily decides to apply, including all practices that go beyond domestic legal requirements. The statement also requires, according to DTR 7.2.5,³⁶⁸ a comprehensive description of the company's internal control and risk management systems, especially those related to the financial reporting process. Furthermore, DTR 7.2.7³⁶⁹ requires that the statement contain a description of the composition and functioning of the company's governing and supervisory bodies, including remuneration, auditing and nomination committees, to ensure transparency in organizational structure and decision-making.

Diversity policy is a key part of the corporate governance statement under DTR 7.2.8AR,³⁷⁰ where the company must describe its diversity policy to governing and supervisory bodies. This description includes multiple aspects such as age, sex, race, disability, educational, professional, social, and economic backgrounds. Companies are also asked to clarify the objectives of the diversity policy, the manner in which it is applied, and the results achieved during the reporting period. If the company does not apply a diversity policy, it should explain the reasons for this to investors.

This is aligned with with the updated UKLR 6.6.6, where now companies are required to disclose figures on the gender distribution and ethnic background of board members and executive management in the form of tables specified in Appendix 1, indicating the methodology used in data collection. Companies that aim to provide details about the diversity of their bodies and committees can include digital data reflecting the level of diversity as part of the governance report. Businesses, especially SMEs, are allowed under DTR 7.2.8BG³⁷¹ to avoid some of the more detailed diversity policy requirements, allowing some flexibility for businesses that may have difficulty meeting these standards. The focus on diversity policy can be linked to ESG disclosure requirements, where "diversity and inclusion" is a central part of the social dimension of ESG standards. The commitment of listed public companies to generate comprehensive diversity reports reflects their compliance with good governance standards and enhanced transparency. The diversity and inclusiveness of companies demonstrate their ability to contain diverse perspectives and experiences and meet the growing demand of investors for this type of information.

³⁶⁷ DTR r 7.2.2R Corporate Governance Statements.

³⁶⁸ DTR r 7.2.5 Corporate Governance Statements.

³⁶⁹ DTR r 7.2.7, Corporate Governance Statements.

³⁷⁰ DTR r 7.2.8AR, Corporate governance statements.

³⁷¹ DTR r 7.2.8BG, Corporate governance statements.

3.8.6.4. Audit Report

Under Part 16 CA 2006, all of the above reports will be subject to the oversight of an independent auditor, who will state whether their content is both accurate and compliant with the applicable law.³⁷² The audit ensures the validity of financial and non-financial disclosures, including ESG disclosure. By conducting an audit, investors and shareholders can be assured that the company adheres to sustainable and responsible practices, which enhances transparency and accountability and assists in making informed investment decisions.

Briefly, listing requirements and periodic disclosures imposed on LSE listed companies have a significant impact on these companies' motivation to make disclosures on ESG matters and take these matters into account in their strategies. The obligation to submit transparent and periodic reports, including disclosure of environmental and social practices and corporate governance, enhances the level of transparency and accountability within the company. For example, rules requiring companies to disclose diversity, gender composition, and environmental risk management practices prompt companies to adopt more sustainable strategies to ensure compliance with these requirements.

In addition, continued listing obligations require companies to permanently integrate ESG issues into their management decisions. Annual and quarterly reports on financial and non-financial performance include the need to disclose environmental and social impacts and governance policies, thereby enhancing the sustainability of business processes and improving risk management. These requirements help companies better identify environmental and social risks and take effective steps to deal with them, increasing investor confidence and enhancing the company's long-term reputation. Therefore, it can be argued that continuous disclosure and listing requirements serve as a strong incentive for companies to adopt more sustainable and responsible practices in managing their operations.

3.8.7. Disclosure Requirements in Accordance with the FCA ESG Handbook

The FCA ESG Handbook³⁷³ is a modern and comprehensive regulatory framework that reflects rapid developments in sustainability disclosure requirements. This guide comes in response to increasing global changes in stakeholder expectations and attitudes towards sustainable and responsible investing, as investors, institutions, and individual customers are keener to understand the environmental, social and governance impacts of companies. This guide, which was recently updated to keep pace with shifts in market priorities, aims to ensure transparency and accountability in the

³⁷² Companies Act 2006, pt 16 Audit.

³⁷³ FCA Handbook, ESG <<https://www.handbook.fca.org.uk/handbook/ESG/1/?view=chapter>> accessed 30 July 2025.

delivery of information related to sustainability. ESG 1.1.2G and ESG 1.1.3G³⁷⁴ include strict guidance for companies to ensure that their reporting aligns with advanced standards such as the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), -which has been rolled into the International Sustainability Standards Board (IFRS Foundation) in late 2023-³⁷⁵ and ESG principles. By introducing specific disclosure requirements related to risk, opportunity, and asset performance, this guide contributes to enhancing investor confidence by enabling them to make informed decisions. This regulatory framework also reflects the FCA's commitment to promoting sustainability as a key priority in the financial system, while providing flexibility for companies to gradually adapt to these new requirements, especially in light of the challenges they face in collecting data and developing appropriate methodologies.³⁷⁶ In short, this guide not only aims to regulate ESG disclosures, but also seeks to build a sustainable investment environment that meets the growing needs of stakeholders and supports global efforts to reduce negative impacts on climate and society.

The FCA's ESG Guide has a clear division between mandatory and indicative rules. Mandatory rules are classified as R (Rules), and companies are obliged to apply them directly without exception, such as Article ESG 2.1.1 R which requires companies to prepare and publish annual climate reports in accordance with the recommendations of the Task Force on Climate Financial Disclosures (TCFD). Failure to comply with these rules may lead to regulatory action in accordance with the Procedures and Sanctions Manual (DEPP) and the Financial Conduct Authority's Enforcement Manual (EG). These procedures include penalties such as imposing fines, issuing formal warnings, withdrawing licenses, or even restricting the company's business activities. In contrast, indicative texts are classified as G (Guidance), offering companies recommendations and advice on how to comply effectively. For example, Article ESG 1.1.5 G encourages companies to disclose available data using modern analytical metrics, while allowing for explanations for any lack of disclosure due to data challenges or methodologies.

This reflects the FCA Handbook adherence to the general framework of the British governance system based on the principle of “comply or explain”, which provides flexibility for companies to provide objective explanations for non-compliance with the indicative rules. At the same time, the FCA adopts certain mandatory rules within the limits of applicable laws and substantive requirements, which will be clarified in subsequent sections.

³⁷⁴ FCA Handbook, ESG, rr ESG 1.1.2G and 1.1.3G.

³⁷⁵ Task Force on Climate-related Financial Disclosures, ‘Task Force on Climate-related Financial Disclosures’ (FSB TCFD, 2023) <<https://www.fsb-tcfid.org/>> accessed 26 November 2024.

³⁷⁶ FCA Handbook, ESG, r ESG 1.1.5G.

3.8.8. Targeted Groups for ESG Disclosure Submission

Categories that are required to disclose under the ESG Handbook in para ESG 1.1.3G and ESG 2.1.1R³⁷⁷ include companies that manage investment assets or provide financial services within the UK, including asset managers and asset owners, who are obliged to prepare detailed annual reports that comply with specific disclosure standards to ensure transparency and accountability. The obligation also extends to companies that offer sustainable investment products or use related terms such as “sustainability” and “environment” in marketing their products, reflecting the need to provide accurate and truthful information about the environmental and social impacts of these products to avoid misleading practices such as “greenwashing”.³⁷⁸ On the other hand, there are exceptions for some companies and funds, where those companies whose assets under management or under management are exempt from disclosure requirements for less than £5 billion, according to an arithmetic average for three consecutive years, giving small businesses flexibility to adapt to increased disclosure requirements.³⁷⁹ Mutual funds that are subject to liquidation or termination are also exempted to avoid incurring unnecessary costs on disclosures when there is no value added to investors or interested parties as stated in ESG 2.3.4R.³⁸⁰ These requirements demonstrate the FCA's commitment to developing a transparent disclosure system that reflects the importance of considering the ESG dimensions, taking into consideration the disparity between companies in terms of size and nature of activity. This framework aims to enhance investor and wider community confidence in the financial market and support the global trend towards sustainable investments that reflect on wider and more proactive environmental and social impacts.

3.8.9. Responsibilities of Directors in Disclosure

Directors have a key responsibility in ensuring transparency and compliance with ESG disclosures in accordance with the regulatory framework established by the UK Financial Conduct Authority (FCA). The rules require them to provide accurate and up-to-date disclosures in line with advanced standards such as the recommendations of the Working Group on Climate-Related Financial Disclosures (TCFD), as set out in ESG 2.1.5R,³⁸¹ to ensure that investors and stakeholders are provided with clear information about the company's environmental and social impacts and performance in these aspects.

In addition, directors must identify risks and opportunities related to sustainability and explain how they are managed and their impact on the company's financial performance, as stipulated in ESG 5.6.1R,³⁸² which obliges directors to include these

³⁷⁷ FCA Handbook, ESG, rr ESG 1.1.3G and ESG 2.1.1R.

³⁷⁸ FCA Handbook, ESG, r ESG 4.3.2R.

³⁷⁹ FCA Handbook, ESG, rr ESG 1A.1.2R and ESG 3.1.3R.

³⁸⁰ FCA Handbook, ESG, r ESG 2.3.4R.

³⁸¹ FCA Handbook, ESG <<https://www.handbook.fca.org.uk/handbook/ESG/1/?view=chapter>> accessed 30 July 2025.

³⁸² *ibid.*

details in their annual reports. Article ESG 5.6.3G³⁸³ stresses the importance of using recognised standards such as TCFD Recommendations to ensure consistent and methodological disclosure. These commitments are not only part of regulatory compliance but also contribute to investor confidence and support the global trend towards sustainable and responsible investments. Directors' responsibilities for ESG disclosures under the FCA guide differ from the ESG disclosure requirements of the Strategic Report set out in the UK CA 2006.³⁸⁴ This difference is due to different regulatory frameworks in scope, detail and methodology. The ESG Handbook focuses on providing comprehensive disclosures related to environmental and social risks and opportunities and their impact on a company's financial performance, while adhering to international standards such as IFRS Foundation.³⁸⁵ These disclosures require a high level of transparency and detail, including measuring greenhouse gas (GHG) emissions and identifying financial and non-financial risks to sustainability, while requiring managers to develop systems and procedures to manage these aspects.

In this regard, CA 2006 in s 414 focuses on including environmental and social disclosures as part of the strategic report for large and listed companies. This disclosure is about providing material information that helps investors and stakeholders understand the company's performance and strategy, while giving companies relative flexibility in determining which information to disclose. While ESG disclosures are more comprehensive and structured to reflect international trends, the disclosures required under the CA 2006 are intended to provide a fair and comprehensive presentation of the company's financial position from a material perspective. Therefore, both frameworks complement each other in promoting transparency and sustainability in the UK financial market, with marked variation in detail and focus.

3.8.10. Sustainable Labels and Anti-Greenwashing

FCA ESG Handbook includes a thorough regulation of the use of terminology related to sustainability and the environment in the marketing of investment products, with the aim of combating “greenwashing” practices that may mislead investors and customers. The ESG Handbook states, under ESG 4.3.2R,³⁸⁶ that the use of terms such as “sustainability” and “environment” must be supported by clear and proven criteria to ensure the accuracy of these claims. The guide also requires, according to ESG 4.2.1R,³⁸⁷ to establish strict standards for the use of “sustainability labels”, where companies are required to commit to providing transparent and verifiable information on the compatibility of their products with ESG principles. These procedures can ensure

³⁸³ *ibid.*

³⁸⁴ The UK Company Act 2006.

³⁸⁵ International Financial Reporting Standards Foundation, developed by two standard-setting boards: International Accounting Standards Board (IASB) and International Sustainability Standards Board (ISSB) <<https://www.ifrs.org/>> accessed 26 November 2024.

³⁸⁶ FCA Handbook, ESG, r ESG 4.3.2R.

³⁸⁷ FCA Handbook, ESG, r ESG 4.2.1R.

that products marketed as sustainable meet their actual expectations, and in a way that they can be assured of.

3.8.11. Priority Climate Disclosures in UK ESG Regulations

The UK focuses in particular on climate disclosures within the Framework for ESG Disclosures, as climate change is one of the most pressing and pressing global challenges. This trend reflects the UK's commitment to contribute to international efforts to combat climate change,³⁸⁸ such as the 2015 Paris Agreement,³⁸⁹ which aims to reduce global warming to less than 2C, while seeking to reduce it to 1.5 ° C above pre-industrial levels.³⁹⁰ This priority has led to strict regulations requiring companies to provide accurate and up-to-date disclosures about their climate impacts. For example, the Climate Change Act 2008 obliges large companies to disclose.³⁹¹ This focus aims to provide accurate and transparent information to investors about climate risks and their impacts on companies' financial performance, thus contributing to enhanced financial market sustainability and investor confidence.³⁹² In the context of these disclosures, companies' adherence to the recommendations of the Task Force on Climate Financial Disclosures (TCFD), which became part of the International Sustainability Standards Board (IFRS) in late 2023,³⁹³ is an important step towards complementarity with international standards. This trend ensures that climate disclosures are combined with other components of ESG disclosures, reflecting the UK's growing awareness of climate challenges and its pivotal role in achieving sustainability goals.

From the prior review, the FCA ESG Handbook³⁹⁴ is a recent extension of the legal and regulatory frameworks found in the UK CA 2006, reinforcing efforts to regulate sustainability disclosures. This guide reflects the FCA's commitment to expanding transparency and accountability in line with the provisions of the UK CA 2006, particularly those related to disclosure in strategic reports.³⁹⁵ The ESG Handbook integrates with the requirements of Section 414C of the UK CA 2006,³⁹⁶ which requires large, listed companies to submit strategic reports that include disclosures on environmental, social and governance dimensions. It also intersects with Article

³⁸⁸ Stéphane Hallegatte, 'Strategies to Adapt to an Uncertain Climate Change' (2009) 19(2) Global Environmental Change 240.

³⁸⁹ Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) UN Doc FCCC/CP/2015/L.9/Rev.1.

³⁹⁰ *ibid.*

³⁹¹ Climate Change Act 2008, c 27.

³⁹² Gareth Porter, Neil Bird, Nanki Kaur and Leo Peskett, *New Finance for Climate Change and the Environment* (Washington DC, 2008).

³⁹³ Task Force on Climate-related Financial Disclosures (FSB TCFD, 2023) <<https://www.fsb-tcfd.org/>> accessed 26 November 2024.

³⁹⁴ FCA Handbook, ESG, r 2.1.1R.

³⁹⁵ Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018, SI 2018/1155.

³⁹⁶ Companies Act 2006, s 414C.

414CB,³⁹⁷ which obliges listed companies to submit disclosures on greenhouse gas (GHG) emissions, forming the basis for climate disclosures that have become more comprehensive in the ESG Handbook.

In addition, the Handbook is consistent with the CA 2006's approach of reducing regulatory burdens on SMEs, with some of them excluded from providing extended climate disclosures, as described in Article 414B³⁹⁸ of the Act. This reflects a balanced approach between enhancing transparency and protecting small businesses from excessive compliance costs. Although the CA 2006 provides the legal basis, the ESG Guide goes further, by providing advanced guidance in line with international standards such as the recommendations of the IFRS Foundations. As such, the guide is a further step in enhancing the sustainability of the financial system and supporting global efforts to address climate and social challenges.

Obviously, this linkage between UK CA 2006 and the ESG Handbook shows the integration of legislative and regulatory efforts to promote transparency and responsibility in the business environment, meeting the needs of growing stakeholders and supporting sustainable investment trends in the UK. This is arguably an important aspect of maintaining good environmental, social and institutional standards among publicly traded companies, as they not only need to comply with stipulated regulatory standards but must also demonstrate this in a public and regular manner through periodic disclosures and reports.³⁹⁹ Instead of discovering some failures to comply with ESG standards, regulators can become clearer on an annual basis because providing information has become a legal obligation. In addition, the reputation incentive to comply with ESG standards is a key aspect of companies' motivations to comply with them. Finally, as investors become more aware of ESG matters, these reports can affect a company's reputation and motivate investors to invest in it. While damaging a company's reputation through investors will not necessarily lead companies to set better standards quickly and directly, it does provide at least an additional incentive to adhere to ESG standards.⁴⁰⁰ Although influencing a company's reputation may not always result in an immediate improvement in standards, it can serve as a long-term incentive for companies to improve their practices and ensure satisfaction with investors and stakeholders.

³⁹⁷ Companies Act 2006, s 414CB.

³⁹⁸ Companies Act 2006, s 414B.

³⁹⁹ Silvia Neri, 'Environmental, Social and Governance (ESG) and Integrated Reporting' in Stephen Vertigans and Samuel O Idowu (eds), *Global Challenges to CSR and Sustainable Development: Root Causes and Evidence from Case Studies* (Springer 2021) 293.

⁴⁰⁰ Jeroen van Erp, 'Naming and Shaming in Regulatory Enforcement' in Christine Parker and Vibeke Lehmann Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 323.

3.8.12. UK's Principle-Based Approach to Corporate Governance

The principle of “comply or explain” is a UK corporate governance trademark, as the UK's corporate governance model features several of non-binding rules. Companies apply the principles of the Corporate Governance Code or disclose their non-application to the public. In this context, the CG Code 2024⁴⁰¹ does not define a strict set of rules, but rather provides flexibility by applying principles, “comply or explain” provisions, and supporting guidance. Furthermore, CG Code 2024 also foresees companies reporting based on a results-based approach to governance reporting. In other words, when reporting companies, they should focus on actual activities and results rather than providing lengthy and unnecessary explanations of governance policies.⁴⁰² This approach helps ensure that reports clearly demonstrate the impact of governance practices, making disclosures more focused and relevant for stakeholders. It is the responsibility of councils to use this flexibility wisely, and investors and their advisers should carefully assess different approaches to companies.⁴⁰³ This approach provides the necessary flexibility to conduct business without strict restrictions, with the need to provide an appropriate explanation for the situation of non-compliance with these rules. Companies' explanation for non-implementation allows investors, beneficiaries, and rating agencies to assess company practices and the suitability of their strategy to their expectations.

The principle of “comply or explain” was first introduced by the Cadbury and Greenbury Committees⁴⁰⁴ in their 1992 recommendations to strengthen corporate governance in the UK. In May 1991, the UK Government established the Committee on Financial Aspects of Corporate Governance,⁴⁰⁵ also known as the Cadbury Committee, to investigate concerns about financial reporting standards and accountability, intending to reach proposals to strengthen good corporate governance practices. The Cadbury Corporate Governance Committee has clarified its conviction that this principle effectively creates a governance framework that suits all companies, despite their different activities and strategies. Good corporate governance is not only a question of defining specific institutional structures and complying with a number of strict rules, but also needs general and more flexible principles.

The principle of “comply or explain” reflects a balance between adherence to regulatory standards and flexibility in their application.⁴⁰⁶ On the one hand, companies are expected to adhere to accepted best practices or provide clear and documented explanations on the exceptional reasons that led them to depart from such practices. On

⁴⁰¹ FRC, The UK Corporate Governance Code 2024 <<https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/>> accessed: 11 May 2024.

⁴⁰² *ibid.*

⁴⁰³ *ibid.*

⁴⁰⁴ Committee on Corporate Governance, *Final Report* (1998) <<https://ecgi.global/sites/default/files/codes/documents/hampel.pdf>> accessed 19 May 2024.

⁴⁰⁵ Committee on the Financial Aspects of Corporate Governance and Gee and Co Ltd, *Report of the Committee on the Financial Aspects of Corporate Governance* (Cadbury Report 1992) para 1.2.

⁴⁰⁶ Committee on Corporate Governance, *Final Report* (1998) <<https://ecgi.global/sites/default/files/codes/documents/hampel.pdf>> accessed 19 May 2024.

the other hand, shareholders and stakeholders are expected to approach these interpretations flexibly, assessing them based on the specific circumstances and the relevance of the reasons given.⁴⁰⁷ The principle thus promotes a culture of transparency and accountability while allowing companies to adapt to their own needs and realities. Cheffins⁴⁰⁸ noted the Cadbury Committee's orientation towards this principle and its desire to develop leading principles on the broader concept of corporate governance, which LSE listed companies have become obliged to adhere to this principle in structuring their governance, business strategy and shareholder disclosures.

On the issue of disclosure of ESG issues, and because the principle of “comply or explain” is a central feature of the UK corporate governance model,⁴⁰⁹ UK companies are subject to obligations to disclose material information relevant to environmentally sound management standards. This includes the updates of the CA 2006 in 2026 to require the UK listed companies to disclose financial climate information in their annual strategic and financial reports, based on the “comply or explain” principle of their compatibility with the Climate Financial Disclosure Framework developed by the Climate Financial Disclosure Task Force (TCFD).⁴¹⁰

As disclosure on ESG issues follows the general framework of corporate governance, as explained in section 3.1., public companies listed in the UK will be subject to a principle-based model in ESG disclosures. Thus, companies listed on the LSE will submit ESG reports based on the principle of “comply or explain” in case of derogation from the rules governing the disclosure of ESG.⁴¹¹ This approach requires companies to be transparent in explaining why they do not comply with specific ESG standards, enhancing the reliability of reports and supporting sustainable investment.

3.8.12.1. Effectiveness of the “Comply or Explain” Approach

Although UK companies support this approach because it provides a flexible business environment and is able to adapt to different business requirements based on self-regulation, many criticisms of this approach have been made about how seriously they are committed to it.⁴¹² Despite the flexibility that the principle of “comply or explain” gives to the UK's corporate governance framework, it has been widely criticised about the effectiveness of its application.

⁴⁰⁷ *ibid.*

⁴⁰⁸ Brian Cheffins, ‘The Stewardship Code’s Achilles’ Heel’ (2010) 73(6) *Modern Law Review* 1004.

⁴⁰⁹ Andrew Keay, ‘Assessing Accountability of Boards under the UK Corporate Governance Code’ (2015) 7 *Journal of Business Law* 551.

⁴¹⁰ Companies Act 2006.

⁴¹¹ Jennifer Jennett and Victoria Tang, ‘ESG Litigation Risks: Building Momentum’ (2022) <<https://uk.practicallaw.thomsonreuters.com/w-035-5489>> accessed 19 May 2024.

⁴¹² Igho Dabor, ‘To Comply or Not to Comply: Towards an Effective UK Corporate Governance Code’ (2021) 32(6) *International Company and Commercial Law Review* 309.

Firstly, the board of directors or any other regulatory body has no authority to evaluate companies' responses to the provisions of the CG Code 2024. Keay⁴¹³ explains that while the FCA can, under section 91 of the Financial Services and Markets Act 2000, penalize companies for non-compliance or interpretation on the grounds that it would be a violation of the listing rules, if in fact that happens, it would be difficult for them to assess it. Because it is difficult to verify the quality and correctness of the explanatory data provided by companies, companies that do not comply with the rules and do not provide an acceptable explanation can escape penalty.⁴¹⁴

The independent audit of the Financial Reporting Council (Kingman Audit) published its final report on December 2018⁴¹⁵, recommending that "the Government consider whether there are any other necessary powers to assess and promote compliance. If the Code stays on what the report describes as "simply a driver of boilerplate reporting, serious consideration should be given to its abolition".⁴¹⁶ Clearly, the lack of oversight powers in any regulatory body renders the voluntary management system and the principle of "comply or explain" ineffective, leading the Kingman review to consider the termination of the Code as a step towards its ineffectiveness without stricter control over compliance. Second, MacNeil and Li⁴¹⁷ criticised the "comply or explain" approach as managers' non-compliance with code rules may not be known to shareholders, which may prevent them from seeking an explanation for their non-compliance and deciding to take any action against the Council. The reason for this negative position of shareholders is that the data of companies provided to explain non-compliance is often very vague. Dabor⁴¹⁸ provided possible reasons why companies offer "weak" explanations that sometimes boards do not have a good explanation. Also, managers may decide not to clarify the lack of commitment because they may be wary that their interpretation could expose them to criticism by potential shareholders or investors, which could cause reputational risks. In the 2009 review of the effectiveness of the Combined Code, the Financial Reporting Council (FRC)⁴¹⁹ added that standard data supporting UK corporate governance principles was a reason why companies were not obliged to provide sufficient explanations for the cause of non-compliance. Keay commented Investors and service providers said that companies used standard data excessively, making explanations seem vague or incomplete, and therefore less accountable by investors.

⁴¹³ Keay (n 421) 89.

⁴¹⁴ *ibid.*

⁴¹⁵ Independent Review of the Financial Reporting Council (Kingman Audit), *Final Report* (18 December 2018) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/765622/frc-independent-review.pdf> accessed 19 February 2025.

⁴¹⁶ *ibid.*

⁴¹⁷ Iain MacNeil and Xiao Li, 'Comply or Explain: Market Discipline and Non-compliance with the Combined Code' (2006) 14(15) *Corporate Governance International Review* 846.

⁴¹⁸ Dabor (n 424).

⁴¹⁹ Financial Reporting Council, 'Review of the Effectiveness of the Combined Code: Summary of the Main Points Raised in Responses to the March 2009 Call for Evidence' (July 2009).

The idea of the UK's corporate governance system is based on providing guidelines that represent best governance practices, leaving companies free to commit to them or providing an explanation to their shareholders as to why they are not. To ensure the quality of this model's work, shareholders are supposed to play their role in corporate oversight. Keay⁴²⁰ believes that shareholders have a responsibility to make an informed assessment as to whether non-compliance is justified, given the company's circumstances and the explanation provided by the managers. As a result, a company's failure or negligence to comply with important provisions and failure to provide an adequate explanation for the cause of non-compliance can make the company's shares less attractive to shareholders, and may result in the depreciation of its traded shares.

Cash and Goddard⁴²¹ provide clarification about the weak role of shareholders oversight, and that investors should be willing to monitor and handle the company they invest in to ensure that their investments are safe, and that they will get a good return on those investments. Although this makes sense, these investors may own investments in tens, hundreds or even thousands of companies, that is, they own diversified investment portfolios and do not focus on a particular company or sector, then it would be illogical to monitor the management of each company in which they are invested, because such monitoring takes time and money.⁴²² Due to the fact that investors have to balance all the costs and time needed to meet these obligations in order to get the highest possible returns, the option of selling their shares or transferring capital to another company may be easier, more efficient, less expensive than participating and trying to change harmful decisions or behaviours in the company. Cash and Goddard's opinion clearly points to the agency's problems with the quality of corporate oversight, as the agency's theory provides an impractical view of the shareholder's role as an owner. The Agency assumes that once shareholders invest their assets in an entity, they will exercise their supervisory role under equity ownership. Cash and Goddard⁴²³ say this is the theoretical model, while an institutional investor usually withdraws investments instead of taking an urgent stance on management to adjust its behaviour, to avoid agency cost.

When this is linked to a “comply or explain” approach in the context of ESG disclosures, it appears that this approach can suffer from the same deficiencies. Lack of strict control can lead to inadequate or inaccurate disclosures of ESG practices, impeding transparency and accountability. Strengthening oversight can therefore ensure that companies not only adhere to governance principles, but also provide accurate and comprehensive reporting on their ESG practices.

⁴²⁰ Keay (n 421) 89.

⁴²¹ David Cash and Ray Goddard, *Investor Stewardship and the UK Stewardship Code, The Role of Institutional Investors in Corporate Governance* (Palgrave Macmillan 2021).

⁴²² *ibid.*

⁴²³ *ibid.*

3.8.12.2. Effective Shareholders' Oversight of Companies

Explanations

In a study by Arcot et al⁴²⁴ corporate governance issues often lead to companies complying with code principles rather than providing high-quality explanations when failing to commit. However, shareholder intervention depends heavily on the type of investor. Individual or small shareholders often lack sufficient incentives to participate effectively in governance issues, instead focus on selling their shares as a means to deal with their dissatisfaction, and their intervention is often a reaction after a company's poor performance.⁴²⁵ By contrast, a paper conducted by Courteau, Di Pietra, Giudici and Melis⁴²⁶ indicate that institutional investors or controlling shareholders tend to take a proactive approach. These investors have strong incentives to engage in company decisions to ensure that their policies are aligned with their long-term interests, by monitoring executive performance or influencing management and internal policy decisions. This variation reflects that the type of contributor plays a crucial role in determining the level and nature of intervention. While small shareholders tend to take fewer effective positions, institutional or controlling contributors show greater ability to directly influence governance. Thus, understanding this disparity is necessary to demonstrate the dynamics of the relationship between shareholders and companies in the context of governance.

Given the varying levels of shareholder intervention and their impact on adherence to governance principles, the question arises as to the effectiveness of the 'comply or explain' principle as a mechanism to promote transparency and balance the interests of all parties concerned. Criticism and concerns about the effectiveness of the UK's principle of commitment and interpretation are offset by many solutions to increase the effectiveness of companies' adherence to the principles of the governance code or provide clear explanations that lead to the transparency necessary for investors to make their investment decisions. Among these solutions, require a regulatory authority to monitor compliance and request adequate explanations where necessary, so that corporate disclosures become sufficiently clear to investors.⁴²⁷ However, FRC⁴²⁸ replied that a regulatory control as well as a determination of the type and manner of explanations accepted by companies would deprive shareholders of their right to assess the admissibility of interpretations, which is a fundamental pillar of the concept of "comply or explain". FRC agrees with the view that interpretations should be complete and include a reference to the context and the coherent rationale. Companies should also explain how they apply the Code's principles, as well as whether the deviation from

⁴²⁴ Sridhar Arcot, Valentina Bruno and Antoine Faure-Grimaud, 'Corporate Governance in the UK: Is the Comply or Explain Approach Working?' (2010) 30(2) *International Review of Law and Economics* 193.

⁴²⁵ *ibid.*

⁴²⁶ Lucie Courteau, Roberto Di Pietra, Paolo Giudici and Andrea Melis, 'The Role and Effect of Controlling Shareholders in Corporate Governance' (2017) 21 *Journal of Management & Governance* 561.

⁴²⁷ Keay (n 421) 89.

⁴²⁸ Financial Reporting Council, 'What Constitutes an Explanation Under Comply or Explain: Report of Discussions Between Companies and Investors' (February 2012).

its provisions is temporary. FRC believes that companies' obligation to provide clear explanations, as well as the role of shareholders in overseeing and verifying interpretations, can obviate the need for regulatory interference in the content of explanation.⁴²⁹ In this regard, Dapoor⁴³⁰ argues that some companies, despite deviating from the Code, do not provide sufficient explanations whatever encouragement they receive to do so. He considers that only regulatory supervision can force companies to change and commit.

It is clear that the weak position of shareholders in their oversight role to pressure and challenge companies to perform their functions in line with the provisions of the CG Code 2024 will threaten the effectiveness of the principle of “comply or explain”, and thus the entire corporate governance system. The impact becomes more evident when the role of shareholders is weakened in relation to ESG issues. Poor oversight and oversight of ESG cases can lead to inadequate or inaccurate disclosures, impeding transparency and accountability and leading to unsustainable ESG policies. To strengthen adherence to ESG, and with the problem of companies' complacency in providing explicit explanations about their deviation from governance principles, regulatory and systematic oversight becomes necessary to ensure accurate and comprehensive reporting of corporate practices, helping to build investor confidence and achieve long-term sustainability. The FRC's disapproval of this type of regulatory control means that investors are entirely responsible for monitoring the quality of corporate disclosures on ESG issues.

3.8.13. Stakeholders Role as an Informal Enforcement Tool in the UK

The financial crisis of 2007-2008 prompted a reconsideration of the Anglo-American model of corporate governance and the tools used to oversee it.⁴³¹ One of the key issues that arose in the review of the UK's corporate governance system in particular was the purpose of corporate governance and in whose interests' corporations should be governed. The historical basis of the Anglo-American model of company law, and of corporate governance itself has long been that the company represents a nexus of contracts for the benefit of the shareholders, on whose behalf the company is run.⁴³² The company, under such a view, is merely a vehicle by which various individual investors (be they natural or legal persons) can pool their capital in an economically efficient and risk-mitigated manner.⁴³³

⁴²⁹ *ibid.*

⁴³⁰ Dabor (n 424) 90.

⁴³¹ Arad Reisberg, ‘The notion of stewardship from a company law perspective: Re-defined and re-assessed in light of the recent financial crisis?’ (2011) 18(2) *Journal of Financial Crime* 126.

⁴³² Lewis Kornhauser, ‘The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel’ (1989) 89(7) *Columbia Law Review* 1449.

⁴³³ John Armour, ‘Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law?’ (1999) University of Cambridge ESRC Centre for Business Research Working Paper No 148

The 2007–2009 global financial crisis however brought home to many the fact that corporations in the modern world have a huge impact on the society in which they exist; the large size of some global corporations and their global operations mean that their operations can cause significant harm to a variety of stakeholders, from the environment, to local communities, to individuals exploited as part of that company’s supply chain, or to its own employees.⁴³⁴ The harm wrought by systemic infection of debt amongst what appeared to be poorly managed companies in the great financial crisis, and their corporate governance failings, therefore seemed to be a natural juncture at which to review whether or not the corporation ought to be expected to work for society as a whole (or its stakeholders), rather than merely for its shareholders.

One response to this has been through the recognition of the ‘stewardship’ role which large, institutional investors such as pension funds or other fund managers can play in overseeing the corporate governance performance of their companies. Ever since the UK’s first corporate governance code came into effect (in the form of the Cadbury Code of 1992) it has been recognised that this model of corporate governance is dependant in part on the oversight displayed by the company’s shareholders who are required to ‘satisfy themselves’ that an appropriate governance model has been put in place by the board.⁴³⁵ In other words, this model of corporate governance has always had market pressure at its heart, with the Corporate Governance Code 2024⁴³⁶ being intended to open up the company and the board’s operations to scrutiny by investors; accordingly, and in theory, those companies which display good levels of corporate governance will be rewarded by increased investment, whilst poorly performing companies will not, so that a virtuous cycle of investment, performance, and sustainability is created.⁴³⁷ Boehmer and Kelly⁴³⁸ emphasise that the effective role of institutional investors not only influences corporate policies, but also improves the efficiency of the stock market; it also, as stated by Cornett et al,⁴³⁹ reduces agency conflicts and puts pressure on managers to force them to generate more wealth for shareholders.

<<https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=5e09dae0f2ec94a3dcba8a3b652677c92087eff4>> accessed 3 January 2024.

⁴³⁴ Steve May, George Cheney, and Juliet Roper, *The Debate Over Corporate Social Responsibility* (New York, NY: Oxford University Press, 2007; online edn, Oxford Academic, 31 Oct. 2023), <<https://doi.org/10.1093/oso/9780195178838.001.0001>> accessed 13 Aug 2025.

⁴³⁵ Sir Adrian Cadbury, ‘The Report of the Committee on the Financial Aspects of Corporate Governance’ (1992) HMSO <<https://www.icaew.com/-/media/corporate/files/library/subjects/corporate-governance/financial-aspects-of-corporate-governance.ashx?la=en>> accessed 3 January 2024.

⁴³⁶ Financial Reporting Council, *The UK Corporate Governance Code 2024* <<https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/>> accessed 3 Jan 2024.

⁴³⁷ Candida Bussoli and Danilo Conte, ‘The “Virtuous Cycle” Between Corporate Social Performance and Corporate Financial Performance in the European Banking Sector’ (2018) 9(2) *International Journal of Business Administration* 80.

⁴³⁸ Ekkehart Boehmer and Eric Kelley, ‘Institutional Investors and the Informational Efficiency of Prices’ (2009) 22(9) *Review of Financial Studies* 3563.

⁴³⁹ Jess Cornaggia, Yifei Mao, Xuan Tian and Brian Wolfe, ‘Does Banking Competition Affect Innovation?’ (2015) 115(1) *Journal of Financial Economics* 189.

In recent years, in recognition of the potential influence of large, institutional investors upon companies' corporate governance performance, the Financial Reporting Council has introduced the new 'Stewardship Code'.⁴⁴⁰ This is intended to encourage long-term value creation and responsible ownership by institutional investors.⁴⁴¹ Additionally, the codification of directors' duties under the Companies Act 2006 (CA 2006) resulted in some reform of the directors' duty to act to promote the interests of their company in a manner which reflects the growing emphasis on 'stakeholderism' as a theory of corporate governance.⁴⁴² From this point of view, it is clear that there has been increasing recognition of the need to promote stakeholder theory in UK corporate governance over the past years, especially after the introduction of the CA 2006. Although the Act had been passed before the global financial crisis, the implications of that crisis had contributed to an accelerated focus on stakeholders' interests in governance models. In the years since the crisis, new regulatory initiatives and tools have emerged aimed at improving transparency and accountability and promoting stakeholders' interests, such as the 2010 Stewardship code and its amendments, with its latest major update in 2026,⁴⁴³ which stressed the importance of responsible investment management and enhanced investor-corporate dialogue. Further analysis of the effectiveness of these tools in achieving this goal will now be undertaken within the UK corporate governance model.

3.8.14. The UK Reviews after the Financial Crisis: Turner and Walker Reviews

In the wake of the 2007–2009 global financial crisis, two independent reviews were conducted in the United Kingdom that marked pivotal milestones in reforming regulatory and governance frameworks. The first is the Turner Review published by the Financial Services Authority (FSA) in March 2009, which focused on analysing the causes of the crisis and making recommendations for reforming the regulatory framework, particularly in terms of liquidity oversight, risk analysis, and the effectiveness of regulatory models. The second review is Walker's review, published in July 2009 at the request of the Prime Minister, which focused on improving the governance of banks and other financial institutions, highlighting the weak role of institutional investors before the crisis.

⁴⁴⁰ Zi Xian Tan, 'Stewardship in the Interests of Systemic Stakeholders: Re-conceptualising the Means and Ends of Anglo-American Corporate Governance in the Wake of the Global Financial Crisis' (2014) 9 *Journal of Business & Technology Law* 169.

⁴⁴¹ Susan McLaughlin, *Unlocking Company Law* (3rd edn Routledge 2015) 254.

⁴⁴² Andrew Keay, *The Corporate Objective* (1st edn Edward Elgar 2011) 151.

⁴⁴³ Financial Reporting Council, The UK Stewardship Code 2026 <<https://www.frc.org.uk/library/standards-codes-policy/stewardship/uk-stewardship-code/>> accessed 16 July 2025.

The first of these reviews, known as the Turner Review, published by the UK Financial Services Authority in March 2009⁴⁴⁴ along with discussion paper DP09/2,⁴⁴⁵ came in response to a mandate from the Chancellor of the Exchequer to provide a comprehensive analysis of the causes of the global financial crisis and propose regulatory reforms to enhance the stability of the financial system. The review included a critical analysis of the theoretical hypotheses on which the previous regulatory framework was based, particularly the hypothesis of market efficiency and rationality, and indicated that relying on market discipline alone was not sufficient to avoid or contain the crisis.

The review recommended a set of fundamental reforms, most notably strengthening capital requirements, developing the liquidity system, expanding oversight to include systemically important non-banking financial institutions, and subjecting credit rating agencies to accountability and regulatory oversight.⁴⁴⁶ It also stressed the need to reform wage policies to reduce incentives for excessive risk-taking and enhance cooperation between national and international regulatory authorities.⁴⁴⁷ FSA acknowledged in the papers DP09/2 and FS09/3⁴⁴⁸ shortcomings in its previous supervisory approach, such as a weak focus on the risks inherent in business models, and a lack of technical competencies necessary to make proactive supervisory decisions. Accordingly, the Authority adopted a new approach called “intensive supervision”,⁴⁴⁹ which focuses on proactively analysing liquidity risks, governance, and business models, and on monitoring performance results, not just formal compliance with regulations.

The Turner review clearly indicates that effective regulatory oversight of the practices of publicly listed companies is not only a necessary condition for protecting the financial system, but also a central tool for ensuring that shareholder investments are protected and the interests of broader stakeholder groups are safeguarded by reducing risky behaviour and promoting transparency and accountability in the market.

⁴⁴⁴ Financial Services Authority, The Turner Review: A Regulatory Response to the Global Banking Crisis (March 2009) <https://webarchive.nationalarchives.gov.uk/ukgwa/20091002205820mp_/http://www.fsa.gov.uk/pubs/other/turner_review.pdf> accessed 16 July 2025.

⁴⁴⁵ Financial Services Authority, DP09/2: A Regulatory Response to the Global Banking Crisis (March 2009) <https://webarchive.nationalarchives.gov.uk/ukgwa/20091002211327mp_/http://www.fsa.gov.uk/pubs/discussion/dp09_02.pdf> accessed 16 July 2025.

⁴⁴⁶ The Turner Review: A Regulatory Response to the Global Banking Crisis (n 456).

⁴⁴⁷ *ibid.*

⁴⁴⁸ Financial Services Authority, FS09/3: A Regulatory Response to the Global Banking Crisis – Feedback on DP09/2 (September 2009) <https://webarchive.nationalarchives.gov.uk/ukgwa/20091002205657mp_/http://www.fsa.gov.uk/pubs/discussion/fs09_03.pdf> accessed 16 July 2025.

⁴⁴⁹ *ibid.*

On the other hand, the Walker Review⁴⁵⁰ is one of the key factors which led directly to the development of the idea of a ‘stewardship code’. It was published by the HM Treasury on July 16, 2009, is an independent review of corporate governance in UK banks and other financial institutions (BOFIs), which was conducted by Sir David Walker at the request of Prime Minister, Gordon Brown, in the aftermath of the 2008 global financial crisis. The review examined five key areas and made 39 recommendations, which were intended to be incorporated by the Financial Reporting Council (FRC) into the Combined Code on Corporate Governance.

As noted above, the Review identified the weak role of institutional investors before the financial crisis of 2008.⁴⁵¹ The review then provided specific recommendations on this aspect, with it being suggested that the FRC separate the Combined Code into a “Corporate Governance Code” and a “Stewardship Code” both on the basis of a comply-or-explain model. The Review also recommends the publication of the voting records of fund managers and other institutional investors.

In July 2009, the UK Financial Reporting Council (FRC)⁴⁵² agreed to take on the responsibility of developing and implementing a Stewardship Code for institutional investors.⁴⁵³ The FRC has confidence in that the Stewardship Code would significantly encourage investors to engage in productive and effective communication with companies, which is a crucial element to reaching a good corporate governance practice.⁴⁵⁴ The FRC also sees the Stewardship Code as complementary to the UK Corporate Governance Code, which was revised in June 2010 to increase the accountability of company boards and encourage them to maintain an ongoing dialogue with investors.⁴⁵⁵

Both reviews made important recommendations that complemented each other; Turner's review called for radical reforms in the financial supervision system, including adopting an “intensive supervision” approach, while Walker's review recommended activating the role of institutional investors, publishing their voting records, and developing their own Stewardship Code. These two reviews contributed to the formation of the UK's Corporate Governance Code and Stewardship Code, reflecting a fundamental shift in the UK governance and regulatory perspective after the crisis. This provided a coherent regulatory and governance framework that subsequently enabled

⁴⁵⁰ HM Treasury, Board Composition: The Walker Review of Corporate Governance in UK Banks (Consultation Document, July 2009) <http://www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf> accessed 3 January 2024.

⁴⁵¹ Elisabeth Dedman, ‘The Cadbury Committee Recommendations on Corporate Governance – A Review of Compliance and Performance Impacts’ (2002) 4(4) *International Journal of Management Reviews* 335.

⁴⁵² Financial Reporting Council, ‘Homepage’ <<https://www.frc.org.uk/>> accessed 16 July 2025.

⁴⁵³ Financial Reporting Council, The UK Stewardship Code 2026 <<https://www.frc.org.uk/library/standards-codes-policy/stewardship/uk-stewardship-code/>> accessed 30 July 2025.

⁴⁵⁴ *ibid.*

⁴⁵⁵ *ibid.*

the UK financial market to accommodate sustainability disclosures and ESG practices, through a dual supervisory model that combines institutional oversight by investors with formal oversight by the regulatory body.

3.8.15. Institutional Investors and Stewardship Role

Much of the focus of the UK's model of corporate governance is built on enhancing transparency, with there being an effort as noted above to ensure that shareholders are more aware of the way in which their companies' boards are complying with the requirements of the UK Corporate Governance Code through its comply-or-explain model.⁴⁵⁶ With the increasing recognition of the role which can be played by institutional investors as 'stewards', and in acknowledgment that these institutions themselves are subject to the scrutiny of their own investors and fund holders, it is not surprising to see that a similar approach has been adopted in order to help strengthen this stewardship role.

Indeed, ever since 2006, Section 1277 CA⁴⁵⁷ has allowed the Secretary of State to make institutional investors' voting records on company resolutions open to the public. Despite having this power, the government has not used these powers under the Companies Act 2006, and the section has not yet received Royal Assent. The justifications given by the Government here have been on the basis that the powers were intended to be legislated as a stand-by power, to be used only in the event that the voluntary system introduced by the Stewardship Code fails to improve disclosure and only after full consultation.⁴⁵⁸

The CA 2006 was unfortunately timed in some respects, as its coming into force was followed almost immediately by the onset of the 2008-2009 global financial crisis. The cause of the 2008 global financial crisis as said by Styhre,⁴⁵⁹ can be attributed, at least in part, to the emergence of "capitalist investor" thinking, where an investor who tends to short-term investment for profits, which led to what Butler and Wong call the "absentee landlords" that led to a weakening of the role of shareholders in oversight and participation in decision-making within the companies in which they invest.⁴⁶⁰ Whilst others such as Kirkpatrick⁴⁶¹ have suggested that it was corporate governance failings of boards themselves which were to blame for the depth and severity of the crisis, it is

⁴⁵⁶ Robert Tricker, *Corporate Governance: Principles, Policies and Practices* (4th edn, Oxford University Press 2019) 118.

⁴⁵⁷ Companies Act 2006, s 1277.

⁴⁵⁸ Practical Law Corporate, 'UK Stewardship Code 2020, A Practice Note' <<https://uk.practicallaw.thomsonreuters.com/6-502-2065>> accessed 5 Jan 2023.

⁴⁵⁹ Alexander Styhre, *Corporate Governance, the Firm and Investor Capitalism* (1st edn, Edward Elgar 2016) 108.

⁴⁶⁰ Peter Butler and Simon Wong, 'Recent Trends in Institutional Investor Responsibilities and Stewardship' (2011) 16 *Pensions: An International Journal* 80.

⁴⁶¹ Grant Kirkpatrick, *The Corporate Governance Lessons from the Financial Crisis* (vol 1, OECD 2009) <<https://www.oecd.org/finance/financial-markets/42229620.pdf>> accessed 3 January 2024.

further fair to suggest that the pressures placed on companies by short-term desire for profitability by shareholders may well have contributed to this.

In practice, these concerns were accepted by Kirkpatrick and the OECD in its 2009 report based on a fact-finding study and presenting corporate governance lessons from the financial crisis. The report referred to a number of observations about the status of shareholder practices of their rights before the crisis. Some of the key findings were as follows; Firstly, that the interests of some shareholders and those of management have been “aligned” in the past period of a bull market but this was not sustainable and was associated with a great deal of short-term behaviour.⁴⁶² It was found further that; “While there are different types of shareholders, they have tended to be reactive rather than proactive and seldom challenge boards in sufficient numbers to make a difference. Finally, it was acknowledged in the report that “Companies need to do more – and it is in their interests- to support constructive engagement with their shareholders”.⁴⁶³

Given the implications of the UK's financial crisis, it can be seen that banks and financial institutions were among the financial institutions that faced the risk of bankruptcy during the crisis, such as the Halifax Bank of Scotland (HBOS) and the Royal Bank of Scotland (RBS) and Northern Rock Bank,⁴⁶⁴ which called for widespread government intervention through financial safeguards and emergency financing.⁴⁶⁵ Remarkably, these banks' corporate governance arrangements were fully in line with the UK Corporate Governance Code at the time, reinforcing the premise that the financial crisis was a direct result of the principles-based regulatory system, weak oversight, and banks' reliance on risky financing strategies without effective oversight by the Financial Conduct Authority or shareholders.⁴⁶⁶ Tomasic⁴⁶⁷ argues that weak shareholder oversight, whether individuals or investment institutions, over boards' actions has been a major factor in worsening the crisis. Although institutional investors were expected to play an effective corporate governance oversight role, their participation in boards' accountability was limited, and there were insufficient oversight mechanisms to ensure proper risk management. This is reflected in the case of Northern Rock Bank, where the UK Treasury Board noted that the Bank's management adopted a high-risk business strategy without facing any real shareholder opposition, which contributed to its collapse.⁴⁶⁸

⁴⁶² OECD Report, ‘Corporate Governance and the Financial Crisis. Key Findings and Main Messages’ (June 2009) <<https://www.oecd.org/corporate/ca/corporategovernanceprinciples/43056196.pdf>> accessed 3 Jan 2024.

⁴⁶³ *ibid.*

⁴⁶⁴ Roman Tomasic, ‘The Failure of Corporate Governance and the Limits of Law: British Banks and the Global Financial Crisis’ in William Sun, Jim Stewart and David Pollard (eds), *Corporate Governance and the Global Financial Crisis: International Perspectives* (Cambridge University Press 2011) 50.

⁴⁶⁵ Roman Tomasic, ‘Corporate Rescue, Governance and Risk Taking-Northern Rock and its International Context’ (2008) 29(10) *Company Lawyer* 297.

⁴⁶⁶ Tomasic (n 476).

⁴⁶⁷ *ibid.*

⁴⁶⁸ Roman Tomasic (n 477) 99.

The lesson of this crisis is that simply complying with the UK's corporate governance code was not enough in itself. In the absence of supportive regulatory structures that encourage more effective stewardship from shareholders and strengthen the role of official regulators, many risks remained unaddressed until the crisis worsened. Thus, excessive reliance on self-regulation and the “comply or explain” model has not been effective in controlling financial risks, requiring a deeper review of the effectiveness of this approach in stabilising financial markets.

3.8.16. Stewardship Role and ESG

There is no doubt that the active participation of shareholders in corporate governance is one of the most important tools that can support the improvement of both financial and non-financial performance, such as environmental, social, and governance issues. As noted earlier in this chapter, the Stewardship Code was created to reinforce the role of shareholders in this regard, as pointed out by the 1992 Cadbury Committee report: “Given the weight of their votes, the way in which institutional shareholders use their power to influence the standards of corporate governance is of fundamental importance. Their readiness to do this turns on the degree to which they see it as their responsibility as owners, and in the interest of those whose money they are investing, to bring about changes in companies when necessary, rather than selling their shares”.⁴⁶⁹ Of interest here is the implicit continued acceptance by the Stewardship Code of the orthodox underpinning of the Anglo-American corporate governance model, and the corporate objective as being principally built on the idea that the company is run for, and on behalf of the shareholders, and in their interests. In other words, despite suggestions that the traditional corporate objective of UK company law was threatened by the 2008/9 financial crisis, this corporate objective appears to have largely survived in its traditional form.

Stakeholder theory however is built on the idea of redefining success, through the move away from a purely economic ‘bottom line’ to one in which the company’s environmental and social goals too are seen as being important markers of success (a so-called ‘triple bottom line’).⁴⁷⁰ Thus the Stewardship Code, and additional requirements of the Company Act which have come into force in recent years and which place further disclosure requirements upon boards in respect of their environmental performance, are all still within the overriding understanding that the company exists for the benefit of its shareholders. It is only nowadays recognised more and more

⁴⁶⁹ Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (The Committee on the Financial Aspects of Corporate Governance 1992) <<https://ecgi.global/sites/default/files//codes/documents/cadbury.pdf>> accessed 9 January 2023.

⁴⁷⁰ Güler Aras and David Crowther, *A Handbook of Corporate Governance and Social Responsibility* (1st edn, Routledge 2010) 335.

widely that there is a link between economic performance and the environmental and social governance (or ESG) of a company.⁴⁷¹

This link, as it becomes stronger and more readily acknowledged, ought theoretically to strengthen further the stewardship role of institutional investors who, over time, can be expected to shift their investment goals and assessment of their investments to one which recognises the importance of ESG for the long-term stability and growth of their holdings. In other words, it is possible that the recognition of ESG as being important as a marker of success by and amongst institutional investors might help redress some of the stewardship and corporate governance failings which led to the global financial crisis of 2008/9 as institutional investors adopt a longer-time view of their investments and as they increasingly recognise the importance of good governance indicated by good ESG performance. This is recognised by the Stewardship Code itself, which as far back as 2010 noted in its introduction that “environmental and social issues, including climate change” are becoming ever more important matters for investors, and that this ought to be considered by institutional investors when preparing their stewardship report.⁴⁷² The Code goes on to provide that;

“Signatories will be expected to take environmental, social and governance factors, including climate change, into account and to ensure their investment decisions are aligned with the needs of their clients”.⁴⁷³

As for the Stewardship Code 2020, the first principle of it was stated that what enables effective Stewardship that aspires to create long-term value for customers and beneficiaries, with sustainable benefits for the economy, the environment and society, are the goals of the signatories themselves, their investment beliefs, their strategy and their culture. Principal 1 Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment, and society. ensure their investment beliefs, strategy, and culture enable effective stewardship”.⁴⁷⁴ Certainly, this principle comes from the fact that ESG issues are inherently linked to the strategy of investment institutions and the culture of their managers. Accordingly, the investor, or the beneficiary of the work of institutional investors, can view and evaluate their strategies on environmental and social governance issues in order to make their investment decisions accordingly.

⁴⁷¹ Steve Lydenberg, ‘Disclosure of Corporate, Environmental, Social and Governance Data: Toward Effective and Sustainable Systems’ in Güler Aras (ed), *Sustainable Markets for Business: A Global Perspective for Business and Financial Markets* (1st edn, Routledge 2015) 233.

⁴⁷² *ibid.*

⁴⁷³ Financial Reporting Council, ‘Implementation of the UK Stewardship Code’ (2 July 2010) <<https://www.frc.org.uk/document-library/corporate-governance/2010/implementation-of-the-uk-stewardship-code>> accessed 9 January 2023.

⁴⁷⁴ Financial Reporting Council, The UK Stewardship Code 2020 <<https://www.frc.org.uk/investors/uk-stewardship-code>> accessed: 8 Dec 2024.

However, in the new version of the Stewardship Code 2026,⁴⁷⁵ that has been issued in June 2025, the scope of this principle was expanded to include the systematic integration of supervision and investment, so that the new principle 1 states: “Signatories integrate supervision and investment to deliver long-term sustainable value to their clients and beneficiaries”.

Principle 7 of the 2020 version,⁴⁷⁶ which was focused on the integration of the ESG, has been deleted and its content been replaced by the broader content of the new first principle. Also, the new orientation in the updated version added a special focus on the “Approach to Reporting”, whereby signatories are required to provide clear reports, supported by examples and data, showing how the principles have been applied, including successes, challenges and lessons learned, which reflects a greater commitment to transparency and accountability in the application of ESG standards.

To summarise the above discussion, the Stewardship Code and its reporting requirements provides a key disclosure tool for investors of funds to identify how well their fund managers are performing in their ESG obligations, and how their funds are being used to influence the direction of companies they are ultimately invested in.⁴⁷⁷ This, in turn, has created significant pressure upon corporate boards from the large shareholders who oversee them (enabled by the Corporate Governance Code in turn) to more properly take account of their ESG obligations.⁴⁷⁸

This is having a real influence on changing the way in which companies operating in the UK are run at present and it is certainly no longer the case (if it ever was) that ESG is merely a peripheral objective, pursued for merely public relations purposes where and as suitable.⁴⁷⁹ It is important to note for these purposes that this is all part of a holistic approach to corporate governance which has developed in recent years whereby new provisions of corporate law, set out in the CA 2006, place definite and

⁴⁷⁵ Financial Reporting Council, The UK Stewardship Code (2026), issued in 3rd June 2025 <<https://www.frc.org.uk/library/standards-codes-policy/stewardship/uk-stewardship-code/>> accessed: 12 June 2025.

⁴⁷⁶ Financial Reporting Council, The UK Stewardship Code (2026) “Principle 7 Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities”. The detailed requirements of the Stewardship Code in terms of what it expects institutional investors to include in their report is exemplified by the fact that under Principle 7, signatories should explain, amongst other things; “how integration of stewardship and investment has differed for funds, asset classes, and geographies; how they have ensured that tenders have included a requirement to integrate stewardship and investment, including material ESG issues; and how the design and award of mandates include requirements to integrate stewardship and investment to align with the investment time horizons of clients and beneficiaries”.

⁴⁷⁷ Paul Davies, ‘The UK Stewardship Code 2010–2020: From Saving the Company to Saving the Planet?’ (2020) European Corporate Governance Institute Working Paper No 506/2020 <https://www.ecgi.global/sites/default/files/working_papers/documents/davies5062020final.pdf> accessed 3 January 2024.

⁴⁷⁸ Financial Reporting Council, ‘New Research Shows Positive Impact of Revised Stewardship Code’ (2022) <<https://www.frc.org.uk/news-and-events/news/2022/07/new-research-shows-positive-impact-of-revised-stewardship-code/>> accessed 3 January 2024.

⁴⁷⁹ Afra Afsharipour and Martin Gelter, *Comparative Corporate Governance* (1st edn, Edward Elgar 2021) 97.

clear reporting obligations upon corporate directors of listed companies to report on their activities, and, since the coming into force of The Companies (Directors Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018, a strict requirement placed upon these companies to report on their carbon emissions and energy usage.⁴⁸⁰ All of these requirements feed into the Corporate Governance Code's mechanisms which further enhance disclosure and dialogue between the company and its large institutional investors, and now, with the advent of the Stewardship Code, these investors too are placed under scrutiny to their own investors to highlight how their ESG objectives and stewardship of companies they invest in are being discharged. There is no doubt that this model of corporate governance represents a significant improvement on the position which was occupied prior to the global financial crisis. Whether it is sufficient however to ensure that such governance and stewardship failings that led in part to that global financial crisis do not again occur, remains to be seen.

3.8.17. The Current Situation of Institutional Investors Stewardship

The UK's corporate governance structure is characterised by the pivotal role institutional investors play as the most important category of shareholders. Nevertheless, studies suggest that these investors often show a negative trend in exercising their voting rights, enhancing managers' strength at the expense of shareholders. According to a study by Franks, Meyer and Renneboog,⁴⁸¹ managers rely on their voting power to strengthen their personal position, limiting shareholders' ability to oversee and change the board of directors, resulting in poor corporate performance. The UK's governance system is also characterized by proxy voting mechanisms, which aim to facilitate shareholder participation in corporate decision-making without the need for actual presence. Section 324 of the Companies Act 2006⁴⁸² regulates this mechanism, giving shareholders the right to appoint an agent to vote on their behalf, enabling the agent to attend meetings, participate in discussions, and cast votes in accordance with the shareholder's directives. However, this mechanism, despite its benefits in promoting participation, may weaken governance's effectiveness if it is not supported by effective oversight by institutional investors. While proxy voting provides shareholders with an opportunity to express their views and participate in strategic decisions, the absence of strict oversight by institutional investors can give managers excessive flexibility, which can lead to decisions that do not fairly reflect all shareholders' interests. Therefore, the role of institutional investors as key observers is highlighted to ensure that the Council's decisions are taken in the interest of good

⁴⁸⁰ The Companies (Director's Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018, SI 2018/1155.

⁴⁸¹ Julian Franks, Colin Mayer and Luc Renneboog, 'Who Disciplines Management in Poorly Performing Companies?' (2001) 10(3) *Journal of Financial Intermediation* 4.

⁴⁸² Companies Act 2006, s 324.

governance, the protection of the interests of all relevant parties and in line with the requirements of corporate law.

The latest data from the Office for National Statistics (ONS) for 2022 indicates that institutional investors –both foreign and domestic – own the largest share of shares listed on the London Stock Exchange (LSE), with total percentages estimated at 75.7% of the total market capitalization.⁴⁸³ This share includes international and domestic institutional investors such as investment funds, pension funds and insurance companies. Nevertheless, studies suggest that the decline in the average tenure of investor enterprises' equities, as demonstrated by the OECD,⁴⁸⁴ reflects a shift towards short-term investment behaviour. This shift, which has become more evident over the past two decades, poses new challenges to the effectiveness of institutional investors' corporate governance.

Academic literature points to the importance of institutional investors' investment horizon in improving institutional performance. According to a study by Yin, Ward, and Tsolacos,⁴⁸⁵ long-skilled investors, who have held shares for more than three years, demonstrate a greater commitment to engaging in corporate surveillance and contributing to improving their performance. Their results have shown that increasing the proportion of long-term investors yields higher investment returns and a significant improvement in companies' performance. In addition, Ozdemir and Kilincarslan's⁴⁸⁶ research confirms that long-horizon investors exert a positive impact on dividend policy, preferring high distributions as a means of monitoring the market and reducing agency costs, while short-horizon investors are associated with negative impacts on this policy.

With regard to ESG matters, long-term investments play a key role in promoting corporate social responsibility. According to Glossner⁴⁸⁷ studies, social responsibility can increase the value of companies in the long term, especially when there are long-term institutional investors supporting these practices. Glossner⁴⁸⁸ notes that long-term investors can be a catalyst for enhancing corporate sustainability, contributing to reducing the impact of agency problems and guiding companies towards achieving sustainability goals. On the other hand, Erhemjamts and Huang⁴⁸⁹ point out that short-

⁴⁸³ Office for National Statistics, 'Ownership of UK Quoted Shares: 2022' (4 December 2023) <<https://www.ons.gov.uk/economy/investmentpensionsandtrusts/datasets/ownershipofukshares>> accessed 15 July 2025.

⁴⁸⁴ OECD, *OECD Institutional Investors Statistics 2020* (OECD Publishing 2020).

⁴⁸⁵ Chao Yin, Charles Ward and Sotiris Tsolacos, 'Motivated Monitoring: The Importance of the Institutional Investment Horizon' (2018) 60 *International Review of Financial Analysis* 197.

⁴⁸⁶ Ozgur Ozdemir and Erhan Kilincarslan, 'The Governance Role of Shareholders and Board of Directors on Firm Performance: An Eclectic Governance-Performance Model' (2021) 29(4) *International Journal of Accounting & Information Management* 493.

⁴⁸⁷ Simon Glossner, 'Investor Horizons, Long-Term Blockholders, and Corporate Social Responsibility' (2019) 103 *Journal of Banking & Finance* 78.

⁴⁸⁸ *ibid.*

⁴⁸⁹ Otgontsetseg Erhemjamts and Kershen Huang, 'Institutional Ownership Horizon, Corporate Social Responsibility and Shareholder Value' (2019) 105 *Journal of Business Research* 61.

term investors weaken social responsibility and governance practices, reflecting the importance of balancing these two categories to ensure corporate sustainability.

These studies suggest that the duration of institutional investors' holding shares is a critical factor in determining the extent of their positive or negative impact on companies. While long-term investors contribute to stimulating companies to achieve environmental, social and governance goals, short-term investors exert pressure that will focus on making short-term profits. This analysis therefore reflects the importance of institutional investors' role in striking a delicate balance between investor requirements and corporate responsibilities, contributing to effective and long-term sustainability.

3.9. Conclusion

At the conclusion of this chapter, the relationship between corporate governance and the effectiveness of ESG was reviewed, with a focus on the UK's principle-based model. The discussions addressed the flexibility of this model in adapting to regulatory and economic variables through a “comply or explain” approach, allowing companies to adapt their disclosures to market requirements and environmental and social developments. Conversely, the discussions demonstrated how difficult it is to obtain effective application of this approach without regulatory control from financial market bodies. The chapter also highlighted the importance of involving stakeholders and institutional investors in disclosures and their role in enhancing transparency and accountability, which contributes to improving the quality of environmental and social reporting and reducing greenwashing risks. In addition, the chapter reviewed the regulations governing listing on the UK's money market, and the disclosure requirements imposed on listed companies, both through listing rules and through the directives issued by the FCA. The discussions touched on the concept of dynamic materiality, which reflects the changing nature of environmental and social standards, compared with traditional concepts such as financial materiality and dual materiality, while illustrating how the UK adopts this approach in developing ESG disclosure policies.

This chapter contributes to the answer to the research question of the extent to which the corporate governance framework contributes to enhancing the effectiveness of ESG disclosures, by focusing on the UK's principled governance approach and adopting the concept of dynamic materiality. The discussions concluded that the UK regulatory framework provides a flexible and effective model that contributes to enhancing transparency and accountability, making it an experience that can be leveraged when considering Saudi capital market reforms. This chapter sets the stage for the discussions of Chapter 5, where the possibility of Saudi Arabia adopting a similar approach based on “comply or explain”, and the compatibility of the current framework of corporate governance in the Saudi market with the concept of dynamic materiality, will be analysed. By reviewing the UK experience, the applicability of these

practices will be assessed in the Saudi market environment, taking into account the legal, economic and social challenges that may affect the effectiveness of ESG disclosures in Saudi Arabia.

Chapter 4: Saudi Arabia's ESG Approach and Challenges

4.1. Introduction

This chapter addresses Saudi Arabia's approach to ESG disclosure, focusing on the legal and regulatory framework governing companies listed in the Saudi capital market "Tadawul", including the Saudi corporate system, the CMA Corporate Governance Regulation, listing rules and ongoing disclosure requirements. The chapter also reviews the role of regulators such as the Capital Market Authority (CMA), the Central Bank of Saudi Arabia (SAMA) and the Ministry of Commerce (MoC) in monitoring listed companies, ensuring their compliance with disclosure standards, and their role in promoting transparency and responsibility in the financial market. Furthermore, the chapter discusses the social, economic, technical and legal challenges associated with the application of ESG disclosure standards, such as adaptation to global ESG standards in the context of Saudi society's unique values, the impact of high reliance on the oil sector, and legal challenges associated with non-compliance with international environmental standards. The chapter also discusses the obstacles that listed companies may face in moving from voluntary disclosures to mandatory disclosure obligations, and the extent to which this affects market compliance and transparency.

In the second section of the chapter, the sample study is presented from companies listed in the Tadawul market, which includes startups, small and medium-sized companies in the parallel market "Nomu", along with major companies listed in the "Main" market and their performance analysis in sustainability disclosures and ESG practices. This analysis aims to compare the extent to which both markets adhere to ESG disclosure standards, and identify regulatory, legal and technical challenges that may affect the quality of disclosures. It also discusses the disparity in corporate disclosures, the extent to which the absence of binding legislation affects the credibility of sustainability reports, and the risks of "greenwashing" in the Saudi market. Through this analysis, the chapter contributes to answering the key research question on how listing in the Saudi capital market, according to the rules-based governance model, facilitates ESG disclosure requirements, taking into account the economic, social and legal challenges that may face this shift. These discussions provide a basis for recommendations in subsequent chapters on improving the Saudi regulatory framework to align disclosure requirements with international best practice, such as the UK "comply or explain" approach.

4.2. The History and Development of the Saudi Capital Market

Saudi Arabia's capital market began with unregulated capacity in the 1950s, and this model continued until the 1990s when the government decided to establish basic regulations to regulate the market.⁴⁹⁰ Based on this initiative, the market has undergone

⁴⁹⁰ Khalid Falgi, 'Corporate Governance in Saudi Arabia' (PhD thesis, University of Glasgow 2009).

structural changes, including the promulgation of the Capital Market Act by Royal Decree No. (M/30) of 31 July 2003, which led to the establishment of the Capital Market Authority (CMA).⁴⁹¹ The Authority enjoys financial and administrative independence and is directly linked to the Prime Minister, giving it broad regulatory powers without interference from any other government entity as stated in Article 4A, CMA Law.⁴⁹² The Commission's functions include overseeing the regulation and development of the financial market in accordance with Articles 5 and 6 of the Law.⁴⁹³

Although Saudi Arabia's capital market is new compared to global stock markets, Saudi Arabia has taken ambitious steps, through Vision 2030, to restructure the financial sector and strengthen legislation in line with future economic aspirations. These efforts aim to make the Saudi capital market an attractive environment for domestic and international investment. Internationally, Saudi Stock Exchange (Tadawul) is the ninth largest stock exchange among 67 members of the World Exchange Federation, and the third among emerging markets.⁴⁹⁴ It also represents the largest financial market in the Gulf Cooperation Council (GCC) and the Middle East and North Africa (MENA) region, with a market value of US \$2.72 trillion (SAR 10.21 trillion) in November 2022, according to official data of the Tadawul website.⁴⁹⁵

The Saudi capital market and listed companies are regulated by a legal framework and regulations based on the Saudi Companies Law 2022.⁴⁹⁶ The market is subject to regulatory practices from several regulators, including the Central Bank of Saudi Arabia (SAMA), the Capital Markets Authority (CMA) and the Saudi Capital Market (Tadawul). This diversity of regulators promotes efficiency in market supervision and provides protection for small shareholders and other stakeholders, creating a positive impression among current and potential investors about the safe and attractive environment for investing in the Saudi capital market.

4.3. Listed Companies in Saudi Company Law

In general, companies with business headquarters in Saudi Arabia are subject to the Companies Law 2022,⁴⁹⁷ which regulates the types of companies allowed to operate in Saudi Arabia. The law includes procedures for establishing companies, determining the responsibilities of founders and the company itself, while emphasising that most companies have financial responsibility independent of their founders. In this context,

⁴⁹¹ Saudi Capital Market Law 2003 <<https://laws.boe.gov.sa/BoeLaws/Laws/LawDetails/50924f95-f74e-430e-820c-a9a700f1abfa/1>> accessed 6 January 2025.

⁴⁹² Capital Market Law, art 4A.

⁴⁹³ Capital Market Law, arts 5-6.

⁴⁹⁴ Saudi Stock Exchange, 'Homepage' <<https://www.tadawulgroup.sa/wps/portal/tadawulgroup/portfolio/saudi-exchange>> accessed 6 Jan 2025.

⁴⁹⁵ *ibid.*

⁴⁹⁶ Saudi Companies Law 2022, Royal Decree No (M/132) of 12/1/1443 AH (30 June 2022), Cabinet Resolution No (678) of 29/11/1443 AH.

⁴⁹⁷ *ibid.*

Millon⁴⁹⁸ points out that corporate laws have long been used by states to limit corporate power by including provisions aimed at protecting the public from unfair practices, such as inadequate capital reserves or abusive price structures. This proposition can be applied to the subject of ESG Disclosures to illustrate how laws can ensure that companies adhere to responsible practices that protect stakeholders' rights. However, a question may arise as to the effectiveness of these provisions in balancing the company's interest with that of other parties.

The Modern School of Legal Thought, as Al-Zumai and Al-Hayan⁴⁹⁹ explained, addresses the concept of a company as a group of contracts between individuals, reducing state interference in contractual relationships within companies, based on the principles of freedom of contract and the independence of individuals. From the perspective of ESG, this school can be seen as advocating enhanced transparency and adherence to disclosure rules, without reducing the efficiency or complexity of companies' operations. Furthermore, the Modern School calls for enabling public shareholders' associations to exercise their roles in amending the statute and appointing or removing managers,⁵⁰⁰ practices that are supported by the Saudi Companies Law.

Historically, the first corporate law was enacted in 1965, based on the UK Companies Act, to regulate businesses in Saudi Arabia. Since then, the law has been updated several times to keep abreast of developments in the business sector and strengthen the corporate governance framework. For example, updating the Companies Law 2016 included significant changes to improve corporate governance and strengthen corporate governance disclosures, which Alshowish⁵⁰¹ described as a necessary step to reform the Saudi Arabia's corporate sector. These updates were also an attempt to deal with governance issues by clarifying ambiguous aspects and closing gaps in legislation. Arguably, these changes marked the beginning of strengthening ESG practices in Saudi companies.

The latest Companies Law was passed in 2022, and is considered a comprehensive restructuring of Saudi Arabia's Companies law. Chapter 5 of the Law⁵⁰² is devoted to clarifying the various aspects of the establishment of shareholding companies, including the way they are administered and the terms of public associations. The chapter, in particular article 58, provides that a shareholder's capital shall be divided into equity shares that are transferable or tradable in the market, and that the company shall be liable for its debts independently of its members. This legal framework lays the foundation for the governance of listed companies, and emphasizes the need to protect

⁴⁹⁸ David Millon, 'Theories of the Corporation' (1990) 39(2) Duke Law Journal 201.

⁴⁹⁹ Fahad Al-Zumai and Abdullah Al-Hayan, 'Evolution of the Philosophical Perspective of the Idea of a Joint Stock Company and its Impact on the Legal System' (2019) 2018(2) International Review of Law, issued by the College of Law, published by Qatar University Press.

⁵⁰⁰ *ibid.*

⁵⁰¹ Abdulrahman Alshowish, 'An Evaluation of the Current Rules and Regulatory Framework of Corporate Governance in Saudi Arabia: A Critical Study in Order to Promote an Attractive Business Environment' (2016) PhD thesis, Lancaster University.

⁵⁰² Companies Law 2022, c 5.

shareholders' rights by providing a clear and durable legal environment⁵⁰³. Chapter 2 of the Corporate Governance Regulation (CG Regulation) also refers to shareholders' rights, which include amending the statute, increasing or reducing capital, and monitoring the performance of the Board of Directors. Articles 5, 9 and 10 of the CG Regulation⁵⁰⁴ emphasise the role of shareholder public associations in ensuring companies' compliance with relevant laws, including ESG disclosures. In addition, chapter 3 of the Regulations⁵⁰⁵, which deals with the Board of Directors, provides that Council members are obliged to comply with the Companies Law and the Financial Market Regulation.). In the context of ESG, these texts reinforce adherence to disclosure standards, thereby contributing to transparency and accountability. Thus, the Saudi Companies Law 2022 is arguably the legal basis for protecting shareholders' rights and promoting ESG-related disclosure practices. Through this framework, Saudi Arabia can contribute to enhancing its transparency and market attractiveness for local and international investors, a goal aligned with Vision 2030.

4.4. Types of Shareholding Companies

Regarding the classification of Saudi Companies Law 2022⁵⁰⁶ for types of joint stock companies, it can be said that the law differentiates between two main types: closed joint stock companies and open joint stock companies. Closed joint stock companies are allowed a limited number of shareholders, with shares distributed among a small group of individuals without being publicly traded. This type of company in Saudi Arabia tends to be owned by families or founders, reflecting a focused ownership structure. Singal and Singal⁵⁰⁷ argue that this emphasis on ownership, characterized by this type of company, contributes to reducing agency costs according to the agency's theory, improving institutional value.

On the other hand, public joint stock companies are available for public offering, where their shares can be traded on the exchange by a large number of shareholders, whether individuals or enterprises. The Saudi Companies Law adopted the Anglo-Saxon governance model, which is characterised by the distribution of equity ownership among many shareholders. According to Desender⁵⁰⁸, this type of ownership structure requires advanced governance mechanisms to ensure effective corporate governance, including regulating financial markets, establishing legal rules to oversee companies, and providing contractual incentives. This division reflects the need to adapt regulatory frameworks to the nature of each type of company, whether listed or

⁵⁰³ Turki Algoere and Hasani Ali, 'Saudi Arabia Regulations on Corporate Governance' (2019) 9(2) *International Journal of Asian Social Science* 229.

⁵⁰⁴ Companies Law 2022, arts 5-9-10.

⁵⁰⁵ Companies Law 2022, art 28.

⁵⁰⁶ The Saudi Companies Law <<https://mc.gov.sa/en/Regulations/Pages/Details.aspx?lawid=07140004-6a05-48e3-bb04-a8250094bb85>> accessed: 17 Mar 2025.

⁵⁰⁷ Manisha Singal and Vijay Singal, 'Concentrated ownership and firm performance: Does Family Control Matter?' (2011) 5(4) *Strategic Entrepreneurship Journal* 373.

⁵⁰⁸ Kurt Desender, 'The Relationship between the Ownership Structure and Board Effectiveness' (2009) University of Illinois at Urbana-Champaign, College of Business Working Papers 09-0105.

not. While listed companies are under the supervision of the CMA, non-listed companies remain in need of special regulation, leading stakeholders to issue indicative regulations to ensure effective governance and protect stakeholders' rights.

In this context, the Ministry of Commerce established the Directorate-General of Governance and Corporate Commitment to oversee the application of the Corporate System and Regulations to all companies under the Ministry's oversight, including closed non-listed shareholders.⁵⁰⁹ The Ministry aims to strengthen governance by monitoring the implementation of its controls, supervising the holding of public associations, monitoring compliance with the provisions of commercial regulations, and studying irregularities to provide opinion and advice.⁵¹⁰ This procedure is an essential step in regulating the corporate market and achieving compliance to ensure the protection of shareholders' and stakeholders' rights. While listed companies face greater transparency and accountability challenges due to the fragmentation of the shareholder base, this regulatory and legal environment for listed and non-listed companies is essential to understanding the framework within which Saudi companies operate. This framework forms the basis for discussion of listed companies' obligation to provide ESG disclosures in subsequent sections of the study.

As mentioned earlier, this thesis does not address non-listed shareholding companies, to guarantee that the restricted number of shareholders are given sufficient access to information and meetings of Shareholders' General Assembly. Thus, shareholders' interests in non-listed companies do not face the same risks as shareholders in listed companies whose ownership is distributed to a wide number of investors data, making access to the right data and information in a timely manner difficult and not always achieved without oversight from oversight and stakeholders' accountability.

4.5. Corporate Governance Regulation for Listed Companies

Saudi Arabia's first corporate governance regulation was issued on November 12, 2006, by the Saudi Capital Market Authority (CMA) Decision No. 1-212-2006. As Al-Faryan explained, this was due to the significant collapse in the Saudi stock market in 2006, which prompted the CMA to develop measures designed to protect investors, improve the efficiency and attractiveness of the market, and avoid any other financial crises in the future⁵¹¹. The Riyadh Chamber of Commerce and Industry in 2007⁵¹² explained that in order to access best practices in governance, the CMA could benefit from the adaptation of governance principles of international organisations such as the

⁵⁰⁹ Ministry of Commerce, General Governance and Corporate Commitment. <<https://mc.gov.sa/ar/About/Departments/bi/Departments/Pages/03.aspx>> accessed 7 Jan 2025.

⁵¹⁰ *ibid.*

⁵¹¹ Mohammed Al-Faryan, 'Corporate Governance in Saudi Arabia: An Overview of Its Evolution and Recent Trends' (2020) 10(1) Risk Governance and Control: Financial Markets & Institutions 23.

⁵¹² Riyadh Chamber of Commerce and Industry, 'Corporate Governance: The Definition, the Principles, and the Saudi Experience' (2007) Arabic edn 10.

Organisation for Economic Cooperation and Development (OECD), as well as from state governance, such as the UK-issued recommendations in the Cadbury and Greenbury reports, as stated by al-Kahtani⁵¹³ and Al-Faryan.⁵¹⁴ The adoption of these recommendations could contribute to strengthening financial market regulatory frameworks, especially regarding improving transparency, accountability and investor confidence, which are in line with ESG disclosure requirements.

As outlined above, the Saudi Companies Law 2022 regulates joint stock companies, the capital of which is divided into equal shares, whether they are listed in the stock exchange market or closed shareholding/unlisted companies. The Companies Law is the sole basis for the Corporate Governance Regulation 2023,⁵¹⁵ which is intended to regulate the structure of listed corporate governance,⁵¹⁶ and thus non-listed companies are outside the scope of application of this regulation.

A question may arise as to the importance of the existence of a regulation on corporate governance with mandatory rules, given the prior existence of a corporate law regulating shareholding companies in general in terms with regard to their establishment and the composition of their boards of directors, the powers of public associations, the responsibilities of both the board and shareholders, as well as the annual reports of the board of directors, financial reports and the reports of the audit committees. Alaish⁵¹⁷ argues that the need to regulate governance rules in an independent legal regulation means that the Companies Law and the applicable commercial and financial laws lack covering new rules and practices, leading policymakers to issue separate regulations covering the deficiencies of the forced laws. Critically, this view is sensible somehow, noting that some regulations do not bring new, but rather interpret the texts of the articles of the law already in force. But at the same time, there are several independent regulations issued by the CMA, which regulate aspects that have not been regulated in any other applicable law. Such as the Credit Rating Agencies Regulations, and the Market Conduct Regulation.

In fact, this view has merit in countries with one type of shareholding company, but in the case of Saudi Arabia, as previously highlighted, shareholding companies are of two types (i.e., closed/non-listed, or listed on the stock market). The Saudi CMA's Corporate Governance Regulation regulates the governance framework of listed companies only, in some detail, in certain aspects of governance such as disclosures and reporting, which are not required of non-listed shareholding companies. Corporate governance requirements for reporting and disclosure of critical information required

⁵¹³ Faleh Al-Kahtani, 'Corporate Governance from the Islamic Perspective' (2014) 28 Arab Law Quarterly 231.

⁵¹⁴ Al-Faryan (n 523) 111.

⁵¹⁵ Corporate Governance Regulations, amended by Resolution of the Board of the Capital Market Authority, 18 January 2023 <<https://cma.org.sa/en/RulesRegulations/Regulations/Pages/default.aspx>> accessed 17 March 2025.

⁵¹⁶ *ibid.*

⁵¹⁷ Ebrahim Alaish, 'Corporate Governance between Laws and Regulations' (2016) 4 International Review of Law <<https://journals.qu.edu.qa/index.php/IRL/article/view/1227>> accessed 12 August 2025.

will be explained in the following section which focuses on the continuing obligations of listed companies.

4.6. Monitoring Listed Companies in Saudi Tadawul

The companies listed in the Saudi Tadawul are monitored by three supervisory authorities. This branching out of the supervisory authorities is due to the different specialisations of each, and according to the type of activities practiced by the listed company as will be evident in the following sections. The first and most important of these bodies is the CMA,⁵¹⁸ which is primarily concerned with monitoring the capital markets and setting rules and standards that it deems fair, as well as preserving the interests of all shareholders, regardless of their percentage of capital ownership. The second entity is the Saudi Central Bank is concerned with monitoring some aspects of the activities of listed companies in terms of funds, loans, and financing, such as the activities of banks, insurance companies, and finance companies listed in the capital market. Finally, The Ministry of Commerce (MoC) regulates all types of companies including public companies listed through the Companies Law 2022,⁵¹⁹ which is the basis for all CMA regulations concerning listed companies. This distribution in the terms of reference allows an integrated and comprehensive regulation of companies listed in the Saudi stock market.

4.7. The Capital Market Authority (CMA)

Capital markets play a major role in the economy and the optimal investment of resources. In the financial markets, the surplus funds of individuals and companies can be channelled into shares in projects that are productive for the local economy. The efficiency of the economy lies in the optimal use of financial resources. As explained by Mohamed et al,⁵²⁰ countries with large capital markets and developed regulations grow at faster rates than countries with small financial markets and non-modern financial systems. Therefore, well-functioning capital markets increase the efficiency of the economy, whilst the opposite is true for capital markets that are inefficient. Therefore, the existence of an authority to regulate capital markets is imperative to monitor the market and follow up on its operations to fulfil the purpose of the existence of the stock market.

⁵¹⁸ The Capital Market Authority (CMA) main functions are “to regulate and develop the Saudi Arabian Capital Market by issuing required rules and regulations for implementing the provisions of Capital Market Law. The basic objectives are to create an appropriate investment environment, boost confidence, and reinforce transparency and disclosure standards in all listed companies, and moreover to protect the investors and dealers from illegal acts in the market” CMA Official website <<https://cma.org.sa/en/AboutCMA/Pages/AboutCMA.aspx>> accessed 8 Jan 2025.

⁵¹⁹ Saudi Companies Law 2022.

⁵²⁰ Moataz Mohamed, Sa'd Al Wabel and Abbas Hassan, ‘The Efficiency of Financial Markets in the GCC Countries: Case Study of Listed Banks for the Period from 2005 to 2015’ (2018) 4(3) Global Journal of Economic & Business 395.

The Capital Market Law (CML 2003) defines the powers and responsibilities of the CMA. The latter, in accordance with the Law, is responsible for supervising the regulation and development of the financial market. Specifically, it bears responsibility for issuing the necessary regulations, rules, and instructions for implementing the provisions of the CML 2003. All these responsibilities should be organised with the aim of providing an appropriate climate for investment in the market and increasing investor confidence. In addition, CMA's objectives are linked to minority shareholders' rights, as it seeks to ensure proper disclosure and transparency of registered companies, while protecting investors and securities traders from illegal market practices. One of the Commission's core functions, as stipulated in the CML 2003,⁵²¹ is to protect investors from unfair and improper practices such as fraud, deception, manipulation or trading based on internal information. These functions include regulating and controlling the disclosure of securities information and its issuers, as evidenced by articles 5,6 of the CML 2003. These articles grant the authority to examine and evaluate listing requests to ensure investor protection, with the possibility of requesting additional documentation or clarification from the issuer prior to the decision to accept or reject.

Furthermore, the CMA is committed to achieving fairness, efficiency and transparency in securities transactions. Article 40 of Chapter 7 of CML 2003,⁵²² stipulates that the issuer, the issuer's follow-up or the coverage contractor may not offer financial papers relating to that issuer or its subsidiary without submitting the prospectus to the Authority and publishing it in the manner stipulated in the article. Article 45 of the CML 2003⁵²³ also made all data on periodic reports confidential information that is prohibited from being disclosed to entities that do not adhere to the confidentiality of such information before it is formally announced by the Authority. This commitment confirms the Authority's role in ensuring transparency, protecting sensitive information and equity among investors, thus enhancing confidence in the Saudi stock market.

4.8. The Saudi Central Bank (SAMA)

Previously, the Saudi Central Bank was the body responsible for monitoring and supervising the stock market. In 1984, a ministerial committee was formed from the Ministry of Finance and National Economy, the Ministry of Commerce (MoC), and the Saudi Arabian Monetary Agency (SAMA) - currently the Saudi Central Bank - with the aim of regulating and developing the stock market. SAMA was entrusted with the task of operating and organising the daily business of the market. In the same year, banks operating in Saudi Arabia, on the initiative of the Monetary Agency, established the "Saudi Shares Registry" company, with the aim of settling transactions related to shares. The situation continued until 1st July 2004, when supervision of the stock

⁵²¹ Capital Market Law 2003, art 5(A4).

⁵²² Capital Market Law 2003, art 40(B).

⁵²³ Capital Market Law 2003, art 45(A/C).

market was transferred from the Monetary Agency to the CMA after the issuance of the royal decree establishing the Council of the CMA on that date, according to SAMA's official website.⁵²⁴

Currently, the Saudi Central Bank monitors and protects deposit funds in banks. One of the reasons why the Central Bank performs this function, according to Haddah, is the role that commercial banks play in protecting the financial sector,⁵²⁵ whereby investors' money is deposited either by buying shares or in public offerings through banks. Therefore, according to Alshareff,⁵²⁶ the protection of the central bank for deposit funds is a necessity, as the money managed by each bank, whether it belongs to depositors or shareholders, must be subject to protection and preservation. Also, the funds provided by shareholders for the purpose of investing by buying shares, participate in profit and loss, and therefore these funds are exposed to the risk of asset loss, which requires the control of the Central Bank.⁵²⁷ Alshareff adds that this control is for all the bank's financial activities, including accounts, data, and statistics, with the aim of detecting abuses that may cause risks to the credit sector, and thus risks to the financial sector in general.⁵²⁸

It is important to note that the Saudi financial system is essentially based on the principles and provisions of Islamic Sharia, which contradicts open market laws based on usurious interests. In the Islamic financial system, as Khan and Mirakhor⁵²⁹ assert, financial and monetary relations are regulated and managed in a way that prevents the use of any form of usurious interests. This restriction, as Khan and Mirakhor claim, makes the Islamic financial system fundamentally and critically different from those found in the traditional capitalist system. Alternatively, Islamic banking uses the Sharing system which is compatible with Islamic financial law. This method makes the financial system more diversified and comprehensive, which facilitates the task of the Central Bank in influencing the volume of credit and the amount of money available, according to the requirements of the economic situation. The Sharing system has been explained by Khan & Mirakhor,⁵³⁰ and Khaldi and Hamdouni,⁵³¹ as profit sharing between the two sides of the bank's balance sheet assets and liabilities through a process known as double speculation. The bank, in turn, contracts with a third party, "the steward", which is ready to share the profit with the bank according to a certain

⁵²⁴ The Saudi Central Bank, 'SAMA History' <<https://www.sama.gov.sa/ar-sa/About/Pages/SAMAHistory.aspx>> accessed 20 Dec 2024.

⁵²⁵ Rais Haddah, *The Role of the Central Bank in Renewing Liquidity in Islamic Banks* (Itrak Printing, Publishing and Distribution 2009, Amman).

⁵²⁶ Amal Alshareff, 'The Effect of SAMA Control on The Financial Performance of Saudi Banks from The Perspective of Workers in General Supervision of Banks' (2020) 4(12) *Journal of Economic, Administrative and Legal Sciences* 133.

⁵²⁷ *ibid.*

⁵²⁸ *ibid.*

⁵²⁹ Mohsin Khan and Abbas Mirakhor, 'Monetary Management in an Islamic Economy' (1994) 6(1) *Journal of King Abdulaziz University: Islamic Economics*.

⁵³⁰ *ibid.*

⁵³¹ Khadidja Khaldi and Amina Hamdouni, 'Islamic Financial Intermediation Compared to Ribaoui Financial Intermediation: A Theoretical and Mathematical Analysis' (2018) 8(3) *International Journal of Economics and Financial Issues* 268.

percentage. These profits are a diverse mix sourced from the bank's various activities, and they are divided accordingly between the bank, the depositors, and shareholders in accordance with the relevant contracts.

Based on the above, it is clear the Central Bank, under the Sharing system, intervenes through open market operations to buy and sell securities, according to the requirements of prevailing economic conditions. This enables it to control the volume of financing, money supply and investment trends to a greater extent than central banks can in interest-based systems. This compatibility with the doctrinal principles of Islamic economics stems from the concept of the trading of shares and securities as investment tools by buying and selling as common shares in the assets of listed companies. Islamic banking permits this behaviour as a type of buying and selling trade.

4.9. Ministry of Commerce

The Ministry of Commerce plays a pivotal role in regulating companies listed in the Saudi Stock Exchange (Tadawul), including public shareholding companies, through a corporate system that is the basic legislative framework for all regulations issued by the CMA concerning registered companies. The Ministry is responsible for establishing and supervising controls and procedures for the establishment of joint stock companies, including ensuring compliance with financial and regulatory disclosure requirements. In accordance with Article 63⁵³² of the Companies Regulation, the Ministry works in coordination with the CMA to determine the necessary documents and procedures for the establishment of public shareholding companies, and to organize the IPO at the establishment stage. Through the Companies Law 2022,⁵³³ the Ministry of Commerce also regulates companies' adherence to best disclosure practices and avoids conflicts of interest in board membership, which ultimately aims to achieve good governance and enhance transparency in the private sector.

⁵³² Saudi Companies Law 2022, art 63.

⁵³³ Saudi Companies Law 2022, arts 71-72.

4.10. Requirements for Listing on Tadawul⁵³⁴

According to Article 3 of the Rules on the Offer of Securities and Continuing Obligations 2024 (the Rules 2024),⁵³⁵ the offering of securities for trading in the Saudi market, “Tadawul”, can be classified into four main scenarios. The first scenario is the “Exceptional Offering”,⁵³⁶ which refers to cases in which securities are exempted from basic disclosure requirements or continuing obligations, and is applied in specific circumstances including State and sovereign funds securities. The second scenario is the “Private Offering”,⁵³⁷ where securities are offered through a financial market institution to a limited number of qualified investors and institutional investors in accordance with the controls established by the Authority.

The third scenario is “IPO”, the most detailed proposition scenario in the Rules due to its importance as stated in Section 4 of the Rules 2024,⁵³⁸ where securities are presented to the general investor with full compliance with the disclosure and transparency standards imposed by laws and regulations to ensure investor protection and enhance market efficiency. Finally, the “parallel market offering”,⁵³⁹ an option for SMEs or those that cannot meet the requirements of listing in the main market. Although it is a less regulated but controlled market that ensures a reasonable level of disclosure and compliance. This classification shows the flexibility of the Saudi stock market in accommodating the needs of different companies, whether they seek to reach out to individual investors or private groups, or even those seeking to finance while adhering to less stringent regulatory requirements.

The requirements for offering in the Saudi capital market have been covered in a number of different laws and regulations, such as Saudi Companies Law 2022 and Capital Market Laws. There are a wide number of ongoing requirements and obligations on companies listed in the Saudi capital market, such as; the company requested public offering must take a joint stock company form, which is not permitted for other types of companies to be listed⁵⁴⁰. Also, the company must be at least 3 years

⁵³⁴ “The Saudi Exchange is a fully owned subsidiary by Saudi Tadawul Group and was established in March 2021 following the transformation of the Saudi Stock Exchange (Tadawul) into a holding company, Saudi Tadawul Group. As Saudi Arabia’s dedicated stock exchange and the largest stock exchange in the Middle East, the Exchange carries out listing and trading in securities for local and international investors. The official source of all market information, Saudi Exchange is instrumental to achieving long-term growth plans for the Group and providing market participants with attractive and diversified investment opportunities...”. “The legal status, duties, and responsibilities of the Exchange and Depository Centre are explicitly defined in the Capital Market Law (CML) issued by Royal Decree Number (M/30), dated on June 16, 2003” Saudi Exchange Official Website <https://www.saudiexchange.sa/wps/portal/tadawul/about/company/about-tadawul!/ut/p/z1/04_Sj9CPykssy0xPLMnMz0vMAfIjo8zi_Tx8nD0MLIy8LcxDA0czVwDzFzNjA0NDEz1w8EKjlycLQwtTQx83D39zA0cAx09wtzCQowNDEz0o4jRb4ADOB0Q1h-FX4kJVAEuJ_obE1AANwGPIwtyQyMMMj3TAf80RmE!/dz/d5/L0IDUmlTUSEhL3dHa0FKRnNBLzROV3FpQSEhL2Vu/> accessed 9 Jan 2025.

⁵³⁵ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 3.

⁵³⁶ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, arts 5-6.

⁵³⁷ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, arts 7-8-9-10-11.

⁵³⁸ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, sec 4.

⁵³⁹ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, sec 8.

⁵⁴⁰ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 23 para (1).

active, which allows companies to submit at least three financial and annual reports to potential investors⁵⁴¹. This section will clarify the most important requirements of corporate governance and reporting, which give a greater understanding of the direction of the Saudi capital market in relation to disclosures required by companies, thus providing a closer understanding of how ESG reports are prepared.

4.10.1. Obtaining the Required Approvals for Public Offering

Article 17 of the Rules 2024 indicates that the listing applicant must not list any securities before obtaining the approvals required under the company's statutes, Companies Law, and executive regulations.⁵⁴² Article 63 of the Companies Law 2022⁵⁴³ also gives the Ministry of Commerce and the CMA the right to establish the necessary requirements and controls and to determine the necessary documents for approval for the establishment of a shareholding company that owns the right to make its shares public and be listed on the stock market. Furthermore, Article 30 of the Rules 2024⁵⁴⁴ provides that the approval by the CMA of the application for registration and listing of securities is also conditional on the Stock Exchange (Tadawul)'s approval of the listing application submitted under the listing rules. The Rules 2024 also provide several appendixes⁵⁴⁵ showing the minimum information required to submit applications, ensuring transparency and compliance with regulatory standards. This framework facilitates rollout and listing processes, while ensuring full compliance with regulatory requirements.

4.10.2. Prospectus

Article 41 listing rules require that the submission of an application for a securities offering be accompanied by a prospectus.⁵⁴⁶ Article 27 of the Rules 2024⁵⁴⁷ elaborates on the contents of the prospectus, which must contain all necessary information with which an investor can assess the company's activity, financial performance, and directors, and assess the expected opportunity for profit or loss of investment in the company. Article 31 of the Rules⁵⁴⁸ also obliges the issuing company to publish the prospectus and ensure that it is made available to the public at least 14 days prior to the beginning of the listing. The issuer must also make the prospectus available on its the websites, as well as the websites of the CMA, Tadawul.⁵⁴⁹ These requirements reflect

⁵⁴¹ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 23 para (3).

⁵⁴² CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 17.

⁵⁴³ Companies Law 2022, art 63.

⁵⁴⁴ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 17 para (1/a).

⁵⁴⁵ The Rules on the Offer of Securities and Continuing Obligations 2024 has 30 appendixes which set out the minimum data to be available in any application submitted by the issuer of securities to the CMA, such as Annex 12 to the Stock Issuance Prospectus and Annex 26 to the Registration Document.

⁵⁴⁶ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 41.

⁵⁴⁷ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 27.

⁵⁴⁸ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 31 para (a).

⁵⁴⁹ CMA, The Rules on the Offer of Securities and Continuing Obligations 2024, art 31 para (b).

the commitment of CMA to achieving the highest standards of transparency and governance, as the prospectus, according to Bhabra and Pettway⁵⁵⁰ is a vital tool for investors to assess risks and opportunities. This action contributes to enhancing investor confidence, especially given the challenges associated with evaluating startups or unsettled performers. However, some companies may face challenges in adhering to the prospectus's detailed requirements, especially with regard to the collection and transparency of data. Therefore, the provision of clear indicative forms by the CMA can help issuers effectively meet these requirements, which the CMA already provide through the Rules 2024, containing 30 guiding annexes for filing applications for securities registration, debt instruments and capital adjustment requests for increase or reduction.

4.10.3. Reports and Continuing Obligations of Listed Companies in Saudi Tadawul

In addition to the listing requirements that companies must adhere to, listed companies are obliged to continue to meet the financial market requirements required by market regulations and laws, in order to avoid any infraction that may lead to the suspension of trading their shares or the removal of the company from the market list. The majority of ongoing corporate governance obligations and corporate disclosures in the annual reports will be reviewed below the most important reports on sustainability practice disclosures and corporate social responsibility.

4.10.3.1. The Board of Directors Report

The CMA's Corporate Governance Regulations⁵⁵¹ indicate what should be included in the board report, as it must contain a presentation of its operations during the last fiscal year, and all factors influencing the company's business. Article 87,⁵⁵² also notes that the Board of Directors report must state the applicable provisions of these Regulations and explain any exceptions. In fact, in explaining the contents of the Board report, the Regulations contain 41 mandatory rules and one voluntary paragraph, bringing the total requirements of the Board's report to 42. One example of the mandatory rules is that the company must explain its budget through a schedule that displays its assets, liabilities and business results during the last five years, and clarification of the composition of the Board of Directors and the classification of its members between executive members, non-executive members and independent members. The report must also contain a description of the Board's committees, their

⁵⁵⁰ Harjeet Bhabra and Richard Pettway, 'IPO Prospectus Information and Subsequent Performance' (2003) 38(3) Financial Review 369.

⁵⁵¹ Corporate Governance Regulations, The last amendments have been created by Resolution of the Board of the Capital Market Authority in 18/1/2023 <<https://cma.org.sa/en/RulesRegulations/Regulations/Pages/default.aspx>> accessed 18 Mar 2025.

⁵⁵² Corporate Governance Regulations, art 87 para (1).

functions, emoluments, number of meetings, and dates, such as the Audit Committee, the Nominations Committee, and the Remuneration Committee.⁵⁵³ The committees must be as mentioned here, but not necessarily exclusively, as the Board of Directors may deem it necessary in the company's interest to develop other committees such as the Risk Committee or the Governance Committee. The report must also disclose any penalty, sanction, or precautionary measure imposed on the company by the Authority or by any other supervisory, regulatory, or judicial authority, indicating the reasons for the violation, the ways in which the company remedied it, and how it will avoid the same offence in the future.⁵⁵⁴ Finally, with regard to corporate social responsibility, article 87 obliges companies to disclose details of social contributions, if any, in the Board's report.⁵⁵⁵ Although making social contributions is not mandatory, their disclosure is part of the requirements of transparency and regulatory compliance. It should be noted that social contributions are one aspect of the social dimension of sustainability, but they do not cover the entire concept of sustainability, which includes environmental, social, and more inclusive and strategic governance dimensions.

4.10.3.2. The Audit Committee Report

According to the Regulation on Corporate Governance Article 75,⁵⁵⁶ the internal audit department prepares a written report on its business and submits it to the BoD and the Audit Committee at least quarterly. The report must detail performance, the Audit Committee's recommendations and its opinion on the adequacy of the company's internal and financial control and risk management systems.⁵⁵⁷ The Internal Audit Department also prepares and submits to the BoD and the Audit Committee a written general report on audits conducted during the financial year, comparing these with the approved plan, and explaining the reasons for any deviation from the plan, if any, during the quarter following the end of the certain financial year.⁵⁵⁸

Due to the importance of the audit report, Article 14 of the Governance Regulations⁵⁵⁹ obliged to ensure that it was posted on both the company and the Saudi Tadawul's websites at the time of the announcement of the General Assembly, so as to enable any contributor to obtain a copy of it and to read the summary of the Audit Committee's report during the session of the General Assembly. This procedure aims to enable shareholders to make investment decisions and vote based on reliable information. As stipulated in article 76,⁵⁶⁰ a listed company is also required to archive

⁵⁵³ Corporate Governance Regulations 2023, art 87 paras (6-7-8).

⁵⁵⁴ Corporate Governance Regulations 2023, art 87 para (9).

⁵⁵⁵ *ibid.*

⁵⁵⁶ Corporate Governance Regulations 2023, art 75.

⁵⁵⁷ *ibid.*

⁵⁵⁸ *ibid.*

⁵⁵⁹ Corporate Governance Regulations 2023, art 14 para (c).

⁵⁶⁰ Corporate Governance Regulations 2023, art 76.

audit reports and work documents, so as to clearly reflect what has been done, the findings and recommendations of the reports and the company's actions thereon.

4.10.2.3. The Annual Financial Statement

The responsibility for preparing and approving the listed company's financial statements prior to their public publication falls on the Board of Directors, in accordance with Article 21 of the Corporate Governance Regulation. The regulations also give the Audit Committee responsibility for monitoring the integrity of the company's reports and financial statements. Article 52, paragraph (A1) of the Regulation states that it is the task of the Audit Committee to examine and express views on initial and annual financial statements prior to their presentation to the Governing Council, to ensure the integrity, fairness, and transparency of the information available in the financial statements. It is also the Audit Committee's responsibility with respect to the financial statements to verify the accounting estimates for the material matters contained in those lists to protect shareholders' rights and not mislead them with information that gives an inaccurate perception of the company's financial situation.⁵⁶¹

4.10.2.4. Islamic Shariah Committee Report

What distinguishes the Saudi financial system from other financial systems in the world is that it derives its foundations and rules from two important sources. One of these is legal regulations, which are enacted as needed and in line with international best practices. The second and most important is the foundation of Islamic Shariah in financial transactions. Indeed, even the laws regulating the financial sector, although they are in line with best practices in the international financial sector, should not violate the rules of Islamic Shariah. This condition derives its strength from the Basic Law of Governance⁵⁶² - the Constitution - as it states in the first article of the General Principles: “The Kingdom of Saudi Arabia is an Arab Islamic state with complete sovereignty, its religion is Islam, and its constitution is the Book of God Almighty – the Qur'an - and the Sunnah of His Messenger, may God’s prayers and peace be upon him....”. This principle was also emphasised by Article 7 of the Law: “Governance in the Kingdom of Saudi Arabia derives its authority from the Holy Qur'an and the Sunnah of the prophet Mohammed. They are the rulers of this law and all other laws of the state”. This indicates that all regulations and legislation in the Kingdom of Saudi Arabia should be in line with the laws of Islamic Shariah and its texts contained in the Holy Qur'an and the Sunnah (prophetic traditions) of the Prophet. Otherwise, the regulation

⁵⁶¹ *ibid.*

⁵⁶² The Basic Law of Governance was issued on 01/03/1992, by Royal Decree No. A/90 on 27/8/1412. The Law includes the following headings: general principles, system of governance, components of Saudi society, economic principles, rights and duties, state authorities, affairs Finance, general provisions <<https://laws.boe.gov.sa/BoeLaws/Laws/LawDetails/16b97fcb-4833-4f66-8531-a9a700f161b6/1>> accessed 13 Sep 2024.

that violates the Islamic Shariah can be challenged by the Supreme Court to cancel the enforcement of its provisions.

There are many researchers who have clarified what is meant by Islamic economics and Islamic finance. For example, Chapra,⁵⁶³ Khan,⁵⁶⁴ and Arif⁵⁶⁵ believe that Islamic economics is one of the branches of science that aims to achieve human well-being through the allocation and distribution of resources in accordance with the purposes of Shariah, based on cooperation and participation. Hasanuzzaman⁵⁶⁶ also defined it as the application of the orders and rules of Shariah in a way that prevents injustice in the acquisition and disposal of material resources. In accordance with the purposes of Islamic law based on cooperation and participation. This comprehensive approach to the Islamic economy is in line with the principles of Islamic finance, which focuses on promoting business and investment activities compatible with Islamic values, thereby contributing to economic development and human well-being. In this regard, scholars Iqbal and Molyneux;⁵⁶⁷ Asutay;⁵⁶⁸ Austy*;⁵⁶⁹ and Ayub⁵⁷⁰, emphasise that Islamic finance is based mainly on the prohibition of dealing with any commercial activities that contradict Islamic values, including the principle of the absence of transactions based on usurious interest, and the principle of avoiding financial and commercial activity that includes speculation, trading in alcohol, drugs or arms, and gambling. Islamic finance also focuses (in particular) on risk-sharing and partnership or profit and loss-sharing contracts, and the method of financing is based on investing in real and permanent assets of the shareholder instead of speculation and credit.

According to the CMA's annual report for 2022, foreign investors' ownership of free shares in the main market was 14.2%. This indicates that the proportion of investors in the Saudi capital market is more than 80% national investors.⁵⁷¹ These investors, being Muslim Saudis, demand that their investments be Islamic Shariah-compliant. In case the company claims that its shares are Shariah-compliant, it must disclose its legitimate governance procedures. Therefore, in June 2022, the CMA issued the

⁵⁶³ Muhammad Chapra, *The Future of Economics: An Islamic Perspective* (The Islamic Foundation 2000).

⁵⁶⁴ Ajaz Khan, 'Islamic Economics, Nature and Need' (1984) 1(2) *Journal for Research in Islamic Economics*.

⁵⁶⁵ Muhammad Arif, 'Toward a Definition of Islamic Economics' (1984) 2(2) *Journal for Research in Islamic Economics*.

⁵⁶⁶ Syed Zaman, 'Definition of Islamic Economics' (1984) 1(2) *Journal for Research in Islamic Economics*.

⁵⁶⁷ Munawar Iqbal and Philip Molyneux, *Thirty Years of Islamic Banking: History, Performance and Prospects* (Palgrave Macmillan 2005).

⁵⁶⁸ Mehmet Asutay, 'Conceptualisation of the Second Best Solution in Overcoming the Social Failure of Islamic Banking and Finance: Examining the Overpowering of Homoislamicus by Homoeconomicus' (2007) 15(2) *Journal of Economics and Management*.

⁵⁶⁹ Mehmet Asutay, 'Islamic Banking and Finance and its Role in the GCC and the EU Relationship: Principles, Developments and the Bridge Role of Islamic Finance' in Christian Koch and Leif Stenberg (eds), *The EU and the GCC: Challenges and Prospects* (Gulf Research Center 2010)

⁵⁷⁰ Muhammad Ayub, *Understanding Islamic Finance* (John Wiley & Sons 2007).

⁵⁷¹ Capital Market Authority, *Annual Report 2022* <https://cma.org.sa/Market/Reports/Documents/CMA_Report_2022.pdf> accessed 29 May 2023.

Instructions for Shariah Governance in Capital Market Institutions,⁵⁷² which includes a set of guidelines - except 3 mandatory paragraphs⁵⁷³ for Shariah governance of financial market institutions that provide in whole or in part products or services compatible with Islamic financial provisions and principles.

The Instructions defines the Shariah governance framework in Article 2, paragraph c/3,⁵⁷⁴ as the Company's internal Shariah governance model, and includes the requirements of the work of the Shariah Committee, shariah compliance, and internal Shariah audit. The Shariah governance framework also includes the mechanism for preparing reports for the Shariah committee and determining its administrative link with the rest of the company structure and the powers delegated by the Board of Directors. In this sense, Shariah governance can be defined as a comprehensive system that ensures that the company's activities, products and services comply with the provisions and principles of Islamic law. It adds a distinctive dimension to public governance, focusing on achieving legitimate commitment in all activities, while preventing practices that run counter to Islamic values such as usury and speculation in companies with unethical investment activities, including prostitution, human trafficking, the sale of alcohol and tobacco.

Listed companies that provide products aligned with Islamic finance now must comply with Article 3 of the Instructions as it has two mandatory paras. 3 and 7,⁵⁷⁵ which give the responsibility to the company's board of directors for developing and adopting a Shariah governance framework for a company that provides products or services that are publicly declared to be in accordance with Islamic law. It is the responsibility of the Board of Directors of the Company to adopt the annual report of the Shariah Committee and to disclose it to the public, either independently or in the annual report of the Board of Directors.

The Shariah Committee as stated in Article 8, para. 6⁵⁷⁶, is required to prepare an annual report on the compatibility of the company's products and services with the provisions and principles of Islamic Shariah, and to include in the report the legitimate criteria on which the Committee relied to issue its decisions and submit it to the Board of Directors for adoption and disclosure. The Shariah Committee should also be competent to inform the Board of Directors in the event of any activities incompatible with Islamic law and to recommend appropriate measures to avoid such inconsistencies⁵⁷⁷. Furthermore, the Shariah Committee according to the Instructions⁵⁷⁸

⁵⁷² Capital Market Authority, the Instructions for Shariah Governance in Capital Market Institutions 2022 <https://cma.org.sa/RulesRegulations/Regulations/Documents/The_Instructions_for_Shariah_Governance_in_Capital_Market_InstitutionsAR.pdf> accessed 20 Jan 2025.

⁵⁷³ The Instructions states that in accordance with Decree No. 3-77-2022 of 22 June 2022 of the Commission's Council, art 3 paras (2,7), and art 8 para (6) of these Instructions shall be enforced from 19 Jan 2025.

⁵⁷⁴ The Instructions for Shariah Governance in Capital Market Institutions, art 2 para (c/3).

⁵⁷⁵ The Instructions for Shariah Governance in Capital Market Institutions, art 3 paras (3,7).

⁵⁷⁶ The Instructions for Shariah Governance in Capital Market Institutions, art 8 para (6).

⁵⁷⁷ The Instructions for Shariah Governance in Capital Market Institutions, art 8 para (4).

⁵⁷⁸ The Instructions for Shariah Governance in Capital Market Institutions, art 8 para (5).

should be competent to advise on legitimate matters relating to the operations of the listed company as requested, given that the members of the Shariah Committee have expertise and competence in Islamic finance matters.

In this context, Shariah governance can be considered as a system that complements the overall governance framework. While the overall governance framework provides key foundations for corporate governance, such as enhancing transparency and accountability and protecting stakeholders' rights, legitimate governance adds an additional dimension linked to compliance with Islamic principles, in line with the requirements of stakeholders who make up the vast majority of investors in the Saudi stock market (Tadawul). From the Instructions' definition the shariah governance framework, it can be considered to derive from general governance framework, which focus on increasing disclosures on sharia-compliant products. Thus, it can be argued that shariah governance adds to general governance an ethical dimension that enhances the credibility of companies that provide sharia-compliant financial services, in fulfilment of the stakeholders' expectations aiming to make investments compatible with Islamic finances.

When considering Shariah governance from a broader perspective, it can be understood as an investment model that complements ethical investment principles and promotes ESG matters. As discussed in Chapter 2,⁵⁷⁹ ethical investment focuses on adopting standards such as transparency, responsibility, and adherence to ethical values, while avoiding activities that negatively affect society or the environment. In this context, Shariah governance overlaps with this trend by establishing clear restrictions prohibiting usury, gambling, and unethical activities such as human trafficking and the sale of alcohol. These constraints reinforce companies' commitment to ethical investment principles, reflecting a compatibility between universal moral values and Islamic principles focused on promoting social justice and sustainable development. Furthermore, as the previously mentioned Eccles, Ioannou, Serafeim's⁵⁸⁰ study explained, adherence to ESG standards not only enhances companies' long-term financial performance, but also increases the satisfaction of investors, employees and customers. Similarly, legitimate governance provides a framework for achieving these goals by emphasising ethical and legitimate compliance, while managing resources in a sustainable way that promotes justice and avoids financial exploitation. In short, Shariah governance is a model that supports ESG standards by ensuring the sustainability of business and financial activities and directing investment towards sectors that add real economic and social value. They not only seek to conform to the principles of transparency and responsibility promoted by ESG standards, but also offer additional dimensions of adherence to Islamic principles. These principles prohibit harmful activities and support the protection of the environment and society, making legitimate governance a model framework that promotes ethical investment and balances social responsibility and financial performance.

⁵⁷⁹ See section 2.3.1, 'Linkages between ESG and CSR', 2–23.

⁵⁸⁰ Eccles and others (n 101) 22.

4.11. ESG Reporting by Listed Companies in Tadawul

Through its parts, the Corporate Governance Regulation 2023.⁵⁸¹ provides comprehensive guidance. Part 7, titled with 'Stakeholders', describes the principles and obligations that companies must abide by when managing their relationships with stakeholders. Disclosing corporate activities related to social responsibility, emphasising clarity and responsibility in reporting practices. Article 83⁵⁸² refers to the most important aspects that companies must consider when developing their policy with stakeholders and social responsibility reports. Overall, the company in this regard should develop a policy to build good relationships with different stakeholder groups that include resolving stakeholders' complaints about company practices, and ways to compensate them for any harm caused by any infringement of their rights. Emphasise the principle of fairness and equality among all the company's stakeholders, including employees, suppliers, customers, and shareholders, and ensure that they have access to the correct and adequate information relevant to their activities on an equal basis in time. The company should also establish a code of conduct that the company's employees should consider, emphasising the confidentiality of customer information, suppliers, and other stakeholders as stated in Article 86.

With regard to aspects of corporate social responsibility, Article 85 encourages companies to implement incentive programmes aimed at enhancing employees' participation and well-being. The article highlights the importance of involving the company's employees in discussing issues and topics that require important decision-making through specialised committees and workshops, thereby enhancing effective communication within the working environment. In addition, the article calls on companies to approve an internal system that includes giving employees shares or a proportion of corporate profits, as well as providing pension programs, while emphasising the need to establish a separate fund to manage this program to ensure its sustainability. Furthermore, article 85 encourages companies to establish social organizations aimed at supporting their employees' interests and promoting their sense of belonging and stability.

Article 87 gives the General Assembly of shareholders the power to develop a corporate social responsibility policy on the recommendation of the Board of Directors, which ensures a balance between the company's objectives and those of society. Because it is the responsibility of the Board of Directors to prepare corporate social responsibility initiatives and policies, article 88 addresses the explanation that such programmes should include; Linking the company's performance indicators to its social initiatives and comparing them with other companies in the same industry; Disclose and sensitize employees and the community about the company's social responsibility

⁵⁸¹ Capital Market Authority, *Corporate Governance Regulations 2023* (amended 18 January 2023) <<https://cma.org.sa/en/RulesRegulations/Regulations/Pages/default.aspx>> accessed 18 March 2025.

⁵⁸² Corporate Governance Regulations 2023, art 83.

objectives; and the disclosure of social responsibility plans in the company's periodic reports.⁵⁸³

It is also noted in Article 85 para. 1 that it has requested the board of directors of the listed company voluntarily to develop indicators that measure the impact of the company's social initiatives on its performance. This may be an incentive for companies to take the initiative when they see the positive impact of social responsibility on a company's reputation and performance; at the same time, however, it may be adversely reflected when the impact on performance is not positive. Aside from comparing the company's social performance with other companies working in its field, it may not be a sufficient catalyst for companies listed in Saudi Arabia to offer significant initiatives in social and environmental responsibility.

4.11.1. Saudi Tadawul's Guidelines on ESG Disclosures

According to the Sustainable Stock Exchanges initiative (SSE),⁵⁸⁴ which is a UN Partnership Programme organised by UNCTAD, the UN Global Compact, UNEP FI and the PRI recent years have seen a strong upward trend in the number of exchanges involved in sustainability activities. A key task for SSE is providing a global platform for exploring opportunities for exchanges, through collaboration with investors, companies (issuers), regulators, policymakers, and relevant international organizations, to enhance performance on ESG issues and promote sustainable investment.⁵⁸⁵ Significantly, the number of green or sustainable bond listing sectors tripled from five in 2016 to 15 in the third quarter of 2018, and many global exchanges joined this initiative. This includes the Saudi Tadawul Stock Exchange, which joined in December 2018.⁵⁸⁶ By joining this initiative, the Saudi Stock Exchange announced its voluntary commitment to promoting sustainable and transparent capital markets to become an SSE Partner Exchange. Tadawul joins 7 other exchanges in the MENA region, and another 80 exchanges globally committed to enhancing sustainability in capital market activities.⁵⁸⁷

To ensure that all issuers are aware of ESG practices and receive the necessary support upon disclosure, Saudi Tadawul has issued ESG Disclosure Guidelines to listed companies.⁵⁸⁸ These guidelines, as explained by the Saudi Tadawul,⁵⁸⁹ are specifically designed to aid understanding of ESG practices the reasons that make them important,

⁵⁸³ *ibid.*

⁵⁸⁴ Sustainable Stock Exchanges Initiative, About <<https://sseinitiative.org/about/>> accessed 1 June 2023.

⁵⁸⁵ *ibid.*

⁵⁸⁶ Sustainable Stock Exchanges Initiative, 'Tadawul joins United Nation partnership programme for sustainability' (17 December 2018) <<https://sseinitiative.org/all-news/tadawul-joins-united-nation-partnership-programme-for-sustainability/>> accessed 1 June 2023.

⁵⁸⁷ *ibid.*

⁵⁸⁸ Saudi Stock Exchange (Tadawul), ESG Disclosure Guidelines 2021 <<https://www.saudiexchange.sa/wps/portal/saudiexchange/listing/issuer-guides/esg-guidelines>> accessed 21 January 2025.

⁵⁸⁹ *ibid.*

to identify, prioritise and assess factors of ESG practices that are most important to their business, to manage and understand the constantly changing situation of ESG practices, and finally, to build on various corporate reporting initiatives and frameworks to be considered in the preparation of ESG reports. The Guidelines also demonstrate the benefits of preparing ESG reports in details,⁵⁹⁰ so that companies can adopt these practices with conviction, considering the importance of providing sustainability disclosures on their business and financial performance in both the short and long term, as clarified in the following section.

4.11.2. Benefits of Preparing Environmental, Social, and Governance Practices Reports

Although the ESG Disclosures Guidelines issued by Tadawul Saudi Arabia represent an important step towards enhancing transparency and sustainability in the Saudi market, their guiding nature raises questions about their effectiveness in pushing companies to truly embrace ESG practices. The absence of obligation, coupled with the lack of uniform standards and oversight mechanisms, makes adherence to these principles highly dependent on individual companies' will, leading to significant disparities in application. This is in line with what Aghamolla and An⁵⁹¹ have pointed out, as their study shows that mandatory disclosure of ESG practices significantly promotes the spread of sustainable investment compared to voluntary disclosures, highlighting the importance of a mandatory framework to drive companies towards more effective sustainability practices. This disparity in application will be analysed in depth in this research by studying a sample of companies listed in the Saudi market. Sample inspection will help assess companies' compliance with these voluntary guidelines.

In contrast, the UK offers an advanced regulatory model based on mandatory standards for climate, environmental and social disclosures, which promotes transparency and sustainability. As discussed in chapter 3, the UK approach has moved from the Climate-Related Financial Disclosure Framework (TCFD) to more comprehensive standards developed within the framework of the IFRS's International Sustainability Standards Board (ISSB).⁵⁹² According to Krueger et al.,⁵⁹³ this mandatory regulation enhances equity liquidity and improves the information environment, especially when supported by strong enforcement mechanisms. These findings confirm that the adoption of mandatory regulation offers greater effectiveness than voluntary guidance.

The absence of mandatory standards and regulatory control over Saudi capital market companies highlights a clear gap compared to the UK model, which is an

⁵⁹⁰ *ibid.*

⁵⁹¹ Cyrus Aghamolla and Byeong-Je An, 'Mandatory vs Voluntary ESG Disclosure, Efficiency, and Real Effects' (10 December 2024) Nanyang Business School Research Paper No 22-41.

⁵⁹² See sections 3.8.7–3.8.8, 84–86.

advanced example and supported by a rigorous regulatory framework –as explained in Chapter 3⁵⁹³- and effective enforcement mechanisms to integrate ESG practices into companies' corporate strategies and culture. However, Saudi Arabia's experience in Saudi Arabia shows how mandatory legislation can lead companies to boost their social contribution and support the local economy. Saudi Listed Companies Governance Regulations 2023⁵⁹⁴ obliged listed companies to disclose the number of employees and the proportions of Saudi Arabia, resulting in a significant increase in the employment rate of Saudi citizens, especially in senior positions and technical and technical fields. In September 2017, the Ministry of Human Resources in Saudi Arabia applied the “Nitaqat” program,⁵⁹⁵ which is a program that classifies companies in domains according to the Saudi ratios they achieve among their total number of employees. Nitaqat program aims mainly to localize some types of jobs and limit them to Saudi citizens, in order to reduce unemployment rates, raise the participation of the private sector in generating jobs, and contribute to raising the GDP. Soon after the program's application in 2017, according to the Saudi General Authority of Statistics, the rate of Saudi employed people in the private sector has increased from 15.49%⁵⁹⁶ in the 2nd quarter of 2017, to 17.28% by the last quarter of 2019 of the workers' total number in Saudi Arabia.⁵⁹⁷ The percentage of Saudization of senior jobs and the positions of specialists and technicians increased from 41.40% in 2017 to 63.88% according to the 2021 last quarter statistics.⁵⁹⁸

This progress shows that mandatory regulation is capable of achieving tangible results in pushing companies towards an effective contribution to social and economic objectives, especially in sensitive areas such as employment and reduced unemployment. In addition, article 84 of the governance regulations highlights the role of legislation in promoting transparency and compliance, whereby companies are obliged to establish clear policies for reporting non-compliant practices, while ensuring confidentiality of communications and stakeholders' protection. These policies reflect the impact of mandatory regulation on improving the information environment and investors' confidence. However, the scope of mandatory disclosures in Saudi Arabia continues to focus on the social pillar and some elements of governance, with a marked lack of compulsory environmental aspects. By comparison, the UK model shows a different approach of including mandatory climate disclosures in the Companies Act

⁵⁹³ See sections 3.8.7–3.8.8, 84–86; see also Companies Act 2006, ss 414CB and 414C.

⁵⁹⁴ Capital Market Authority, Corporate Governance Regulations 2023.

⁵⁹⁵ Ministry of Human Resources and Social Development, *Increase the Localization Rates in Nitaqat*, Decision 939 <<https://www.hrsd.gov.sa/en/knowledge-centre/decisions-and-regulations/ministerial-decisions/122615>> accessed 25 January 2025.

⁵⁹⁶ Saudi General Authority of Statistics, ‘Labour Market 2nd Quarter 2017’ <<https://www.stats.gov.sa/en/statistics-tabs/-/categories/1333429?tab=436312&category=1333429&delta=20&start=2>> accessed 25 Jan 2025.

⁵⁹⁷ Saudi General Authority of Statistics, ‘Labour Market Fourth Quarter 2019’ <<https://www.stats.gov.sa/en/statistics-tabs/-/categories/1333429?tab=436312&category=1333429&delta=20&start=2>> accessed 25 Jan 2025.

⁵⁹⁸ Saudi General Authority of Statistics, ‘Register-based Labour Market Statistics- Q4, 2021’ <<https://www.stats.gov.sa/en/814>> accessed 3 Jan 2025.

2006, reflecting a focus on the three pillars of sustainability. This variation points to different priorities between the two systems, with the Saudi model focusing mainly on social dimensions, while the UK model shows greater interest in environmental aspects as well as other dimensions.

4.12. Challenges of Implementing ESG Principles in Business and Investment

Chapter 2 of this thesis presented the expected challenges that could be faced by the legislative bodies of capital markets. Prompting listed companies to make disclosures about their environmental and social activities will be accompanied by many challenges that the CMA and policymakers must take into account when adopting any legislation relating to the transition to a responsible and ethical investment environment. In the Saudi context, which is the focus of this section, there are societal challenges related to local and Islamic values of local stakeholders, which may confront Saudi legislation in the face of global values of sustainability. Global crises and their impact on sustainability requirements, such as wars and pandemics, could put a great strain on Saudi Arabia's oil-based economy,⁵⁹⁹ and Saudi listed companies in the oil industry - Aramco as an example. This hence requires further analysis of the nature of ESG and its development in Saudi Arabia. In addition, there are technical challenges. The Saudi business environment presents several technical challenges about ESG reporting. Firstly, there is a lack of uniform and clear classifications for ESG, making it difficult to navigate and assess the sustainability practices of businesses. Secondly, the shortage of experienced professionals in the field adds to the complexity and limited capacity for comprehensive ESG reporting. Finally, the high financial cost required to adhere to sustainability standards and prepare comprehensive ESG reports is an obstacle for many companies, especially small and medium enterprises. These challenges hinder the effective implementation of ESG practices in Saudi Arabia and require strategic solutions for sustainable business development. This section focuses on clarifying the challenges facing decision makers in the Saudi stock market, as follows.

4.12.1. Social and Economic Challenges with Global Variables

Given the United Nations' 17 Sustainability Goals 2015,⁶⁰⁰ which aim to reduce the carbon emissions that cause climate change and promote the well-being of the planet and its population, it becomes clear that achieving these goals requires radical changes in the behaviour of individuals, institutions and communities. This includes rethinking economic, social and cultural practices to achieve a shift towards sustainability. In the context of listed companies' sustainability practices, setting global goals may run counter to the specific characteristics and habits of each State's business environment,

⁵⁹⁹ Hasan Bamahros and others, 'Corporate Governance Mechanisms and ESG Reporting: Evidence from the Saudi Stock Market' (2022) 14(10) Sustainability 6202.

⁶⁰⁰ United Nations, Department of Economic and Sustainable Development <<https://sdgs.un.org/goals>> accessed 21 Aug 2023.

where individual States and societies face different environmental and social challenges, as well as the different governance structures of each State based on its economic objectives and the nature of its investment environment, as discussed in Chapter 2. In this section, social, environment, and economic challenges and global events that are relevant to the Saudi side will be discussed.

4.12.1.1. Universal ESG Standards and the Unique Values of Saudi Society

The achievement of the aforementioned ambitious goals is hindered by nation states' differing social, economic, and cultural circumstances and priorities⁶⁰¹. In particular, the social and economic priorities of Saudi Arabia lean heavily towards traditional and conservative values, including maintaining the role of Islam and Sharia compliant businesses in the country's economy.⁶⁰² This is further influenced by the Arabic culture of Saudi Arabia, which is strongly rooted in concerns around emotion and faith, creating demands firstly for collective loyalty towards the state and the major groups within it.⁶⁰³ This loyalty can create demands and influences that override general demands around sustainability in areas such as the environment and governance, in favour of maintaining Saudi society. Further to this, cultural differences between Saudi Arabia and the West can create conflict around issues such as human rights and women's position in society, leading to a cultural rejection of wider Western values around ESG, in pursuit of a more specific Saudi solution.⁶⁰⁴

Saudi society derives its values, ethics, and laws primarily from Islamic law, and this characteristic distinguishes it from many Western and Eastern societies. This Saudi Basic Law of Governance⁶⁰⁵ (Constitution Law) affirmed in Article 1 "The Kingdom of Saudi Arabia, an Arab Islamic State, with full sovereignty, its religion of Islam, its constitution, the Book of Allah Almighty "Qura'an" and the Sunna of the Apostle of God. Its language is Arabic, with Riyadh as its capital". This makes the call for uniform global sustainability standards and global ESG classifications likely to be inconsistent with the diversity of local communities. At the same time, Islamic law also provides sufficient flexibility for its followers to adapt to different circumstances at every time and place. The rules of Islamic Shariah are characterized by the ability to adapt to various circumstances, even what is new in the modern era, as they provide a legal

⁶⁰¹ International Young Nature friends. 'Sustainable Development and its Challenges in Developing Countries' <<https://www.iynf.org/2018/08/a-guide-to-sustainable-development-and-its-challenges-in-developing-countries/>> accessed 20 Aug 2023.

⁶⁰² Mohammad Alaraki, 'The Impact of Critical Total Quality Management Practices on Hospital Performance in the Ministry of Health Hospitals in Saudi Arabia' (2014) 23(1) Quality Management in Health Care 59.

⁶⁰³ Valerie Goby and Catherine Nickerson, 'The Impact of Culture on the Construal of Organizational Crisis: Perceptions of Crisis in Dubai' (2015) 20(3) Corporate Communications: An International Journal 310.

⁶⁰⁴ Stephanie Jones, 'Training and Cultural Context in the Arab Emirates: Fighting a Losing Battle?' (2008) 30(1) Employee Relations 48.

⁶⁰⁵ Basic Law of Governance 1992, art 1.

infrastructure with vital elements that have recently been able to develop the Islamic financial sector significantly.⁶⁰⁶ Islamic Shariah law derives its adaptability in the general jurisprudence of transactions, including financial and commercial transactions, from two characteristics; Diligence, and prioritising the public interest side.⁶⁰⁷

Diligence is a process of independent thinking by qualified scholars to obtain legal rules from Islamic Shariah sources using the tools of reasoning and extrapolation, thus, what results from this process is referred to as jurisprudence.⁶⁰⁸ Diligence cannot be used in cases where the Qur'an and the Prophet Mohammed's Sunna have explicit views, considering jurisprudence as a rational approach to the development of laws⁶⁰⁹. Through Diligence, jurists reach jurisprudence based on the principles of Shariah and the opinions of former jurists that serve to expand the scope of Islamic law, and increase its adaptability for the transactions of the time in which it was issued and for future ages.⁶¹⁰

The other instrument of Islamic law adaptability is to consider the priority of the public interest as one of the purposes of law or jurisprudence.⁶¹¹ This interest is achieved by balancing the needs of members of society. Thus, the realization of people's interests in Islamic law should serve as a basis for diligence to establish new rule frameworks for that interest. Undoubtedly, the purpose of all legislation and jurisprudence is to achieve the public interest, but the purposes of Islamic law differ from that of being defined as not inconsistent with the provisions of the Holy Qur'an and the Prophet's Sunna. They also achieve moral virtues at the expense of utility and individual interest, some of which exist in different legislative systems.⁶¹² Therefore, the Islamic sharia prohibits trade in gambling, usury, prostitution, organ trade and any psychotropic substances.

Islamic Shariah as discussed early in this Chapter⁶¹³ demonstrates a clear commitment to reject activities that harm the individual or society, making it a framework that supports the values of social justice and the protection of human and environmental resources. These principles, regarded as part of the core legitimate rules, are highly in line with the ESG sustainability concept, both of which aim to promote sustainability and social responsibility. However, these same principles, based on Islamic values, may not correspond to the diverse values that govern other societies of different religions or secular societies. In this context, recent studies suggest that

⁶⁰⁶ Habib Ahmed, 'Islamic law, Adaptability and Financial Development' (2006) 13(2) Islamic Economic Studies.

⁶⁰⁷ *ibid.*

⁶⁰⁸ Hussain Hassan, 'The Jurisprudence of Financial Transactions (Fiqh Al Muamlat)' in Ausaf Ahmad and Kazim Raza Awan (eds), *Lectures on Islamic Economics* (Islamic Research and Training Institute, Islamic Development Bank 1992)

⁶⁰⁹ Parviz Owsia, 'Sources of Law under English, French, Islamic and Iranian Law: A Comparative Review of Legal Techniques' (1991) Arab Law Quarterly 3.

⁶¹⁰ Habib Ahmed, 'Islamic law, Adaptability and Financial Development' (2006) 13(2) Islamic Economic Studies.

⁶¹¹ Muhammad Mas'ud, *Shatibi's Philosophy of Islamic Law* (Adam Publishers 2006).

⁶¹² *ibid.*

⁶¹³ See sec 4.10.2.4, 130-134.

sustainability reporting and ESG practices are heavily influenced by local cultural and social values.⁶¹⁴ For example, norms considered ethical or sustainable in Western societies may differ from those considered acceptable under Islamic law, such as usurpation transactions and the sex and liquor trade, which are legal in some global legislation, but strictly prohibited under Islamic law. These discrepancies highlight the key challenge in standardizing ESG globally, where cultural, religious and social differences lead to divergence in social and environmental responsibility priorities between states and societies.⁶¹⁵ Therefore, although Islamic law supports the general objectives of sustainability, its ability to absorb other universal values remains limited when considering the need for common standards that encompass all nations.

In this context, legislation emerges as an essential tool for balancing local values with global sustainability requirements. The role of the law was discussed in Chapter 1 as an effective means of changing behaviours when there is a need for state intervention to enact legislation that supports sustainability without prejudice to local values. Carroll⁶¹⁶ argues that laws often reflect long-term changes in local ethics and values, but may also be used as a tool to accelerate change on issues of greatest importance, such as protecting the environment and supporting a sustainable economy. In recent years, Saudi Arabia has used legislation to achieve tangible changes in individuals' behaviour and business environments in support of Vision 2030 goals. For example, in the respect of (E) of ESG, Saudi Arabia by the Environmental Protection Law 2020⁶¹⁷ banned hunting in deserts and marine coral reefs for any endangered animals, their trade, products or transport from their natural environment, increase the numbers of endangered animals such as the Arabian leopard⁶¹⁸. This approach can extend to other sectors, such as the stock market, to drive companies to adopt ESG practices more effectively.

4.12.1.2. Saudi Oil-Based Economy

The Saudi economy is based on oil, according to the budget Statement for fiscal year 2023, about 70% of the state's revenue is from oil exports.⁶¹⁹ In particular, the ability of Saudi companies to attend to environmental concerns is restricted by the nature of the country as a Petro-state which depends on polluting activities for much of its economy. This poses a challenge for the CMA as a capital market policymaker to take into account the cultural, environmental, and social background when preparing a classification or evaluation of any corporate practice on sustainability issues. Chapter 2

⁶¹⁴ Marko Hermawan and Alan Handoyo, 'Harmonizing ESG in A Local Context; Integrating Social Dimension and Kekeluargaan Values in the Context of Indonesia Culture' (2024), Corporate Social Responsibility and Environmental Management 2225.

⁶¹⁵ *ibid.*

⁶¹⁶ Carroll (n 100) 22.

⁶¹⁷ Environment Protection Law 2020, art 26.

⁶¹⁸ Royal Commission for AlUla, Initiative of Arabian Leopard Programme <<https://www.rcu.gov.sa/en/strategic-initiatives/arabian-leopard-program-fund>> accessed 26 Jan 2025.

⁶¹⁹ Ministry of Finance, Budget Statement, Fiscal Year 2023 <<https://www.mof.gov.sa/en/budget/2023/Pages/default.aspx>> accessed 27 January 2025.

of this thesis mentioned the impact of global events such as the COVID-19 pandemic in 2020⁶²⁰ and the Russian invasion of Ukraine in 2022 on sustainability and green investment issues.

The war in Ukraine has shown a new challenge for oil. Despite the neutrality of Saudi Arabia's position on the crisis,⁶²¹ it has faced considerable international pressure to increase oil production, which may oppose its sustainability strategy and pose a challenge to achieving its objectives in this field.⁶²² This experience raises the question of whether Saudi energy companies will be affected by its rating accordingly. If oil companies and arms companies are granted an exception because of those circumstances, the UN Sustainability Goals, ESG standards, and responsible investment will face duplication and fluctuation of the standards whenever the world faces a state of war or any global crisis. In the event of Russia's invasion of Ukraine in 2022, Saudi Arabia faced requests to raise oil production from countries representing the Western military wing, so the Saudi government's response to those demands could lose the Saudi market to current and potential investors standing with the eastern side in the war on Ukraine – Russia, China, and some East Asian countries.⁶²³ These assumptions are serious and cannot be ignored if the Saudi CMA wants to ensure that Saudi companies listed on the exchange do not enter into any future obstacles related to the lower ESG rating, as they do not meet the requirements of sustainability and green investment.

Global crisis scenarios pose a challenge to the CMA as a policy maker to ensure that Saudi companies listed in any future do not meet any obstacles related to sustainability and green investment, that lower their ESG rating. Furthermore, to ensure that ESG issues remain a priority, despite any global crisis, so that listed companies are not affected by these variables.

4.12.2. Governance Challenges

4.12.2.1. Legal Adaptation of Corporate Non-Compliance Cases of ESG Infractions

Talk of a classification of ESG infractions on the Saudi side is relatively early. The reason is that there are no binding regulations that define these practices and clarify companies' environmental and social obligations, thus providing a clearer understanding of these irregularities on which is able to be base the adaptation of any mistake made by companies and their operating processes. In contrast, each aspect of

⁶²⁰ Barb  ris and Bri  re (n 156) 34.

⁶²¹ Zhongxiang Liu and Meng Shu, 'The Russia–Ukraine Conflict and the Changing Geopolitical Landscape in the Middle East' (2023) *China International Strategy Review* 99.

⁶²² Kristian Ulrichsen, Michael Finley and Jim Krane, 'The OPEC+ Phenomenon of Saudi-Russian Cooperation and Implications for US-Saudi Relations' (October 2022) Houston: Rice University's Baker Institute for Public Policy <https://doi.org/10.25613/0B0F-J592>.

⁶²³ *ibid.*

ESG is regulated by a different entity in Saudi Arabia. Besides Environmental E, there is the Environment Law 2020,⁶²⁴ which regulates the issue of environmental protection,⁶²⁵ establishing measurements to measure pollution and harmful substances prohibited from entering Saudi Arabia and conditions of entry, as well as establishing a regulation of violations of the Environment law 2020. Another regulations for the protection of the Ozone layer,⁶²⁶ and the Air Quality Regulation 2020.⁶²⁷ The Environment Law is concerned with regulating all matters relating to environmental protection in Saudi Arabia, establishing requirements for companies or entities engaged in activities related to the environment,⁶²⁸ and the penalties imposed on entities that violate the rules of the environment.⁶²⁹ Article 42 of the Environment Law 2020⁶³⁰ excludes certain environmental offences and gives them criminal status, i.e. the Public Prosecutor's Office investigates and charges them. The classification of certain environmental crimes as criminal offences can reflect treating the environment as a priority security and legal issue. While this classification means a trend towards environmental sustainability practices, it needs more studies on the effectiveness of applying these provisions in practice. Furthermore, violations of Article 35⁶³¹ of the Law, which relate to pollution of groundwater, include contamination of any means of sea-water transport by dumping hazardous. This article shows a focus on the side of air pollution response that can be derived from for improvements that bring it in line with ESG's international standards, meanwhile, it raises the question about other environmental aspects that do not have the same level of control or of control or regulation.⁶³² However, two things are noted in the request for such disclosures: first, that such disclosures are not mandatory for stakeholders and society or are published in the annual report or separate reports; and, secondly, these disclosures and the level of commitment to the allowable emissions and toxic gases are binding only on industrial companies, energy companies and petrochemical companies. This means that listed companies with other areas such as financial and service companies, food companies, technical companies, and others are not required to make disclosures to the competent authority on any environmental protection practices only voluntarily, as long as they do not have factories or operations with carbon emissions, gases, and toxic substances dangerous to the environment.

⁶²⁴ Environment Law, Royal Decree No M/165 of 19 Dhu al-Qi'dah 1441 (10 July 2020).

⁶²⁵ Environment Law, art 2.

⁶²⁶ Unified Law on Ozone-Depleting Substances for GCC States (Amended) 2014, Royal Decree No M/72 of 24 Dhu al-Qi'dah 1435 <<https://laws.boe.gov.sa/BoeLaws/Laws/LawDetails/c1a67dbf-6959-437d-bb86-a9a700f2a126/1>> accessed 27 January 2025.

⁶²⁷ Ministry of Environment, Water and Agriculture, Executive Regulations for Air Quality 2020 <<https://www.mewa.gov.sa/en/InformationCenter/DocsCenter/RulesLibrary/Pages/default.aspx>> accessed 27 January 2025.

⁶²⁸ Environment Law 2020, art 36.

⁶²⁹ Environment Law 2020, arts 38-40.

⁶³⁰ Environment Law 2020, art 42.

⁶³¹ Environment Law 2020, art 35.

⁶³² Environment Law 2020, art 40.

On the social side of S, the Labour Law 2005⁶³³ deals with regulating workers' rights, labour contracts, setting the minimum wage,⁶³⁴ preventing the employment of minor children,⁶³⁵ and establishing special requirements for harsh working conditions, such as working in mines and quarries,⁶³⁶ working hours during fasting Ramadan,⁶³⁷ limiting the hours of prohibition of working in the sun from the hour for exposed work throughout the summer months,⁶³⁸ and other requirements that companies must adhere to. In the social aspect, there are many requirements for companies to adhere to towards their employees, such as staff development and training programmes.⁶³⁹ The Ministry of Human Resources is responsible for identifying infractions of the Labour Law and penalties for each breach, and monitoring companies' compliance with those requirements⁶⁴⁰. considering the needs of the labour market. However, although these obligations are clear in law, there are no explicit requirements for companies included in the Saudi capital market to “Tadawul”; This may constitute a regulatory gap in transparency regarding corporate social responsibility.

Finally, the G side of governance means accountability, transparency, integrity, and justice among all stakeholders. On the financial market side, increasing the governance of listed companies means increasing market stability by preventing trading on the basis of unannounced internal news to all concerned with that information, thereby damaging the rest of the shareholders, especially small shareholders. Capital market laws and regulations, including the Saudi Capital Market,⁶⁴¹ classify such practices as criminal in order to provide the necessary deterrence to such practices because of their strong impact on the State's financial sector and thus on the local economy in general. According to Skeel,⁶⁴² states resort to criminalising certain corporate offences, because of the societal blame accorded by that Criminal law, in such a way as to provide the necessary deterrence to such behaviour.⁶⁴³ This makes it logical that any practices that lead to manipulation of the financial markets be considered criminalized, as they relate to investors' funds, stability of the financial sector and preservation of its reputation.

⁶³³ Labour Law 2025, Royal Decree No M/51 of 23 Sha‘ban 1426 (27 September 2005), amended 2025.

⁶³⁴ Labour Law 2025, art 6.

⁶³⁵ Labour Law 2025, arts. 161-162.

⁶³⁶ Labour Law 2025, title 12, arts 185–193.

⁶³⁷ Ministry of Human Resources, Executive Regulations of the Labour Law, Ministerial Resolution No 115921 (18 February 2025) art 23.

⁶³⁸ Ministry of Human Resources, Prohibition of Work under the Sun, Resolution No 1559 (2010).

⁶³⁹ Labour Law 2025, art 44.

⁶⁴⁰ Labour Law, title 12, arts 229-239.

⁶⁴¹ Capital Market Authority, Market Conduct Regulation, pt 3 (Insider Trading) arts 4–6; pt 4 (Untrue Statements) arts 7–9.

⁶⁴² David Skeel, ‘Shaming in Corporate Law’ (2001) 149(6) *University of Pennsylvania Law Review* 1811.

⁶⁴³ Miranda Forsyth and Valerie Braithwaite, ‘From Reintegrative Shaming to Restorative Institutional Hybridity’ (2020) 3 *International Journal of Restorative Justice* 10.

In the future, Nelson⁶⁴⁴ expects the conduct of companies contrary to ESG standards is expected to be criminalized, owing to changes in society standards and other international pressures that over time may change the classification of such offences to criminal conduct, i.e. civil liability rises to criminal liability. In contrast, Park⁶⁴⁵ stands against this opinion as he argues that while it is important to address climate change and reduce its environmental damage, changing corporate laws and financial markets will have a negative impact on companies in the long run.⁶⁴⁶ This turmoil stems from Governments' expansion of regulation and market intervention, thus contradicting the traditional concept of regulation as a government against a company.

Reducing climate change cannot be considered more important than the financial system,⁶⁴⁷ for that reason, the Saudi Capital Market Authority (CMA) should take into account not proceeding sharply to reach the targets of responsible investment without considering the current and future corporate aspects. In fact, the change in the classification of environmental and social offences to a criminal would create a problem in terms of the CMA's jurisdiction over such criminalization. The Authority regulates the market and monitors companies' adherence to the applicable regulations and laws, criminalizes any behaviour that is harmful to the market and breaches the principle of fairness and transparency necessary for market stability, but at the same time, it is not within its competence to criminalize the practices of companies related to their regulation by other regulatory and supervisory bodies such as environmental issues of the Ministry of Environment and social issues governed by the Ministry of Human Resources.

These issues are usually addressed through coordination between different stakeholders. There may be conventions or cooperation mechanisms that allow them to exchange information and coordinate the monitoring and punishment of companies that commit environmental and social offences. This aims to avoid any undesirable overlap and ensure the effective application of laws and regulations. Possible overlaps should be considered and mechanisms identified that allow coordination and cooperation between different actors to ensure that common objectives are effectively achieved without affecting each other's competence.

4.12.3. Technical Challenges and Companies' Desire to be Listed on the Tadawul Stock Market

Saudi Arabia's stock market and its regulatory rules provide a clear example of the many technical challenges companies face when deciding to disclose their sustainable

⁶⁴⁴ Josephine Nelson, 'The Future of Corporate Criminal Liability: Watching the ESG Space' (2022) <<https://ssrn.com/abstract=4057736>> accessed 19 Jul 2025.

⁶⁴⁵ Stephen Park, 'Legal Strategy Disrupted: Managing Climate Change and Regulatory Transformation' (2021) 58(4) American Business Law Journal 711.

⁶⁴⁶ *ibid.*

⁶⁴⁷ *ibid.*

and ethical practices through ESG reports.⁶⁴⁸ One of these technical challenges is the lack of expertise and experts in sustainability risks and ESG reports, such as; the use of experts to conduct evaluations, prepare reports, and integrate ESG standards into companies' strategies. Bearing in mind that listing costs and ongoing commitments are already high,⁶⁴⁹ the imposition of additional requirements may cause some companies to refrain from listing in the Saudi Stock Exchange (Tadawul), which may negatively affect the achievement of Vision 2030's goals⁶⁵⁰ of enhancing the number of new listings and increasing transparency in the market.

In this context, a study on the German Stock Exchange -Prime Standard, Germany's top regulated stock market sector, conducted by Bessler et al,⁶⁵¹ on 518 listed companies between 2003-2015, 243 companies left the market. The study of Bessler et al, identified the factors that led to those companies being excluded from the sector. The study found that small businesses with profitability and low liquidity have the likelihood of leaving this sector of the market is greater.⁶⁵² In contrast, for larger companies with a high liquidity size, the likelihood of them remaining in the main standard is greater. This gives a breakthrough that the size of the company is one of the most important factors in determining the decision to move to the less regulated securities market sector. The study also concludes that small companies, through voluntary write-offs or privatization, seek to obtain lower transparency standards by changing the sector to a lower sector in regulatory costs, to raise growth, liquidity, and profitability opportunities.⁶⁵³ While these results relate to different financial markets, they highlight a phenomenon that may be relevant to the Saudi stock market, particularly as it moves towards strengthening the disclosure requirements of ESG practices.

In addition to the regulatory costs associated with ESG disclosure, companies also face operational costs associated with implementing the sustainability strategies themselves.⁶⁵⁴ According to the Balakrishnan et al,⁶⁵⁵ adherence to ESG standards not only includes compliance with disclosure regulations, but also requires investments in operational operations, increasing financial burdens on listed companies.

⁶⁴⁸ Saudi Stock Exchange Company (Tadawul) Listing Rules 2023, <<https://cma.org.sa/RulesRegulations/Consulting/Docu>> accessed 20 Mar 2025.

⁶⁴⁹ Xinlai Liu, Haoye Wu, Wei Wu, Yelin Fu and George Q Huang, 'Blockchain-Enabled ESG Reporting Framework for Sustainable Supply Chain' in SG Scholz, RJ Howlett and R Setchi (eds), *Sustainable Design and Manufacturing 2020* (Smart Innovation, Systems and Technologies vol 200, Springer 2020) 200.

⁶⁵⁰ The Financial Sector Development Program <<https://www.vision2030.gov.sa/en/vision-2030/vrp/financial-sector-development-program/>> accessed 16 Mar 2025.

⁶⁵¹ Wolfgang Bessler, Johannes Beyenbach, Marc Rapp and Marco Vendrasco, 'Why Do Firms Down-list or Exit from Securities Markets? Evidence from the German Stock Exchange' (2023) 17(4) *Review of Managerial Science* 1175.

⁶⁵² *ibid.*

⁶⁵³ *ibid.*

⁶⁵⁴ Geoffrey Sprinkle and Laureen Maines, 'The Benefits and Costs of Corporate Social Responsibility' (2010) 53(5) *Business Horizons* 445.

⁶⁵⁵ Ramji Balakrishnan, Konduru Sivaramakrishnan and Geoffrey B Sprinkle, *Managerial Accounting* (8th edn, John Wiley & Sons 2008).

The costs of complying with ESG reporting standards are a major challenge for the Saudi stock market, especially regarding their impact on listing decisions and companies' willingness to bear these costs against the expected returns of adhering to sustainability standards. Therefore, striking a balance between enhancing transparency and sustainability without imposing financial burdens that may lead to declining listings remains a challenge for the Saudi Capital Market Authority. These considerations require consideration of legislative and regulatory aspects, which will be discussed in more detail in the following chapter on possible legislative amendments to the Saudi capital market.

4.13. A Pilot from Saudi Tadawul companies Sustainability and ESG Disclosures

As part of the ESG Disclosures approach in Saudi Arabia, this section aims to analyse the level of commitment to voluntary disclosures within the Saudi capital market. A sample of companies listed on “Nomu” Parallel Market and the Main Market was selected to provide a comprehensive view of the extent to which companies react to sustainability requirements.

This analysis aims to assess the current gaps and challenges faced by Saudi companies in providing transparent and detailed reports that align with the aspirations of investors and stakeholders, while highlighting the differences between voluntary and mandatory disclosures. This approach enhances our understanding of the relationship between disclosure requirements and the implementation of ESG practices, in line with the Kingdom's Vision 2030 to promote sustainability and transparency in the financial market.

4.13.1. “Nomu” Listed Companies Sustainability Performance

The parallel market “Nomu” at the Saudi Exchange represents an important platform for startups and SMEs seeking to expand and strengthen their position in the Saudi market. With the increasing importance of environmental, social and governance (ESG) standards both locally and globally, assessing Nomu-listed companies' commitment to voluntary sustainability disclosures has become an essential tool to understand investor aspirations and market demands.

This analysis aims to measure the extent to which Nomu companies adopt sustainability-related disclosures, with a focus on providing comparative insights with companies listed on the main market to identify gaps and challenges facing these companies. This comes in the context of exploring the relationship between the size of the company, the nature of the sector, the resources available and the level of compliance with disclosures. This analysis is designed based on specific criteria that ensure a balanced and comprehensive view, focusing on the following aspects.

4.13.1.1. Duration of Listing and Data Sources

The sample was limited to companies on the parallel market for more than two years, to ensure sufficient data to analyse sustainability performance and assess the company's commitment to voluntary disclosures. Reports published on each company's page on the official website of the Saudi Stock Exchange (Tadawul),⁶⁵⁶ including the Board of Directors reports for 2023, have been relied upon as a major source of information used in the analysis.

4.13.1.2. Diversity of Sectors

Two companies were randomly selected from each major sector within the parallel market, with the aim of ensuring comprehensive representation of different sectors. This approach allows a deeper understanding of the differences between sectors regarding compliance with ESG standards and the level of voluntary disclosure. It also helps assess the quality of published reports and their compatibility with international disclosure standards, as well as their ability to effectively meet investors' and stakeholders' expectations.

4.13.1.3. Focus and Analysis

The analysis of voluntary disclosures of sustainability and ESG issues from companies listed in the parallel market “Nomu” is an essential step to understand the commitment to transparent reporting that meets investors' and stakeholders' expectations. This analysis contributes to assessing the gaps and challenges facing these companies, as well as comparing their performance with those listed in the major market, providing a broader view of the evolution of sustainability practices in the Saudi market. Challenges of different sectors that affect the comprehensiveness and quality of disclosures, such as limited resources or lack of awareness of the importance of sustainability reports. Compare with the performance of companies listed on the main market to identify structural differences in disclosure compliance.

4.13.1.4. Preliminary Results

This analysis provides a framework for understanding the performance of Nomu-listed companies in relation to voluntary sustainability and ESG disclosures, contributing to recommendations to improve transparency and corporate compliance with ESG reporting.

⁶⁵⁶ Saudi Tadawul, Nomu Parallel Market
<<https://www.saudiexchange.sa/wps/portal/saudiexchange/ourmarkets/nomuc-market-watch?locale=en>> accessed 22 Dec 2024.

Industry	Company Name	Report Year	Time of listing (Years)	ESG Disclosures ⁶⁵⁷	Notes
Consumer Services	Shatirah House Restaurant Co. (Burgerizzr)	2023	3	No	The company has presented in the annual report on its community initiatives for a number of charities to support orphans and persons with disabilities. ⁶⁵⁸
	Jahez International Co. for Information Systems Technology Group ⁶⁵⁹	2023	2	No	Jahez demonstrates good commitment to its social responsibility through multiple initiatives focused on human development, the environment, and health. Initiatives such as the training of rescuers and the care of persons with disabilities demonstrate their commitment to investing in society. Its efforts to localise the delivery sector and promote consumption of organic products demonstrate its desire to improve

⁶⁵⁷ This section's information has been taken from Saudi Tadawul official website, as all listed companies reports should be evolved to the company's page on Saudi Tadawul website.

⁶⁵⁸ Shatirah House Restaurant Co, 'Annual Report 2023' (Shatirah House Restaurant Co Official Website) <<https://www.burgerizzr.com/ar/copy-of-financial-reports-1>> accessed 4 August 2024.

⁶⁵⁹ Jahez International Co for Information Systems Technology Group, 'Financial Information' (Jahez International Co for Information Systems Technology Group Official Website) <<https://jahezgroup.com/financial-information/>> accessed 5 August 2024.

					<p>citizens' lives and achieve sustainable development.</p> <p>However, there was no mention of their reliance on specific international standards in disclosures such as GRI, IFRS, which made it difficult to measure their social and environmental performance by interested investors⁶⁶⁰.</p>
Food & Beverages	Arabian Food and Dairy Factories Co. (FADECO) ⁶⁶¹	2023	2	No	<p>-The report explained that the company has developed written policies approved by the Board of Directors and the General Shareholders Assembly to ensure compliance with good governance rules and practices and include the company's readiness to develop.</p> <p>-The report also stated that the company applies all provisions of the CMA Corporate Governance</p>

⁶⁶⁰ Saudi Tadawul, 'Jahez International Co for Information Systems Technology Group 2023 Board Report' (Saudi Tadawul Official Website) <https://www.saudiexchange.sa/Resources/fsPdf/2663_0_2024-03-27_11-19-01_En.pdf> accessed 5 August 2024.

⁶⁶¹ Arabian Food and Dairy Factories Company (FADECO), 'Homepage' (Arabian Food and Dairy Factories Company Official Website) <https://fadeco.com/> accessed 7 August 2024.

					Regulation, with the exception of the indicative provisions, including the articles on corporate social responsibility. ⁶⁶²
	Aljouf Mineral Water Bottling Co. (Hilwa) ⁶⁶³	2023	2	No	<ul style="list-style-type: none"> - The company's report focused on various aspects of governance and risk. - In the report, there is a section on social responsibility, but it comes in the form of charitable and humanitarian work that serves the local population of the company's area of operation.⁶⁶⁴
Consumer Discretionary Distribution & Retail	Amwaj International ⁶⁶⁵	2023	2	No	<p>The report stated that there are sustainability plans that the company aims to achieve during 2024, including:</p> <ul style="list-style-type: none"> -Human resources: Focus on attracting competencies, developing and developing staff skills through advanced training programs. -Customer service: Improve the quality

⁶⁶² *ibid.*

⁶⁶³ Hilwa – Pure Water, ‘Homepage’ <<https://hilwa.com.sa/>> accessed 6 August 2024.

⁶⁶⁴ Saudi Tadawul, ‘Aljouf Mineral Water Bottling Company 2023 Board Report’ <https://www.saudiexchange.sa/Resources/fsPdf/2883_0_2024-03-28_14-37-38_En.pdf> accessed 6 August 2024.

⁶⁶⁵ Amwaj International, ‘Homepage’ <<https://www.amwaj-trd.com/en#about>> accessed 5 August 2024.

					<p>of service and raise the level of customer satisfaction by implementing new technologies and tools.</p> <p>-Technology and innovation: investing in modern technologies to enhance process efficiency and achieve operational excellence.⁶⁶⁶</p>
	Alhasoob Co. ⁶⁶⁷	2023	3	No	<p>- The company's report focused on financial performance and did not address any disclosures related to corporate governance, not even corporate social responsibility or sustainability aspects⁶⁶⁸.</p>
	Mohammed Hasan AlNaqool Sons Co.		2	No	<p>-The Company's report did not address any social responsibility initiatives or contributions such as those related to employee development or job generation, or even</p>

⁶⁶⁶ Saudi Tadawul, 'Amwaj International 2023 Board Report' <https://www.saudiexchange.sa/Resources/fsPdf/3163_0_2024-03-31_22-48-02_Ar.pdf> accessed 5 August 2024.

⁶⁶⁷ Alhasoob Co, 'Homepage' <<https://alhasoob.com/>> accessed 6 August 2024.

⁶⁶⁸ Saudi Tadawul, 'Alhasoob Company Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/2442_0_2024-04-02_23-13-33_En.pdf> accessed 6 Aug 2024.

Materials					environmental initiatives. -The report noted that the company applies all the provisions of the Companies Regulation except the guiding rules. ⁶⁶⁹
	Watani Iron Steel Co. ⁶⁷⁰	2023	3	No	- The company applies mandatory regulations and policies relating to the functions of the audit committee. The board report indicates that the company applies to part of the CMA Corporate Governance Regulation, which is a guiding regulation for companies included in the parallel market “Nomu”, but has applied some aspects of it that are consistent with its strategy. ⁶⁷¹ - Since aspects of social responsibility have been provided in the Companies Regulation in an indicative manner,

⁶⁶⁹ Saudi Tadawul, ‘Mohammed Hasan AlNaqool Sons Co. Board Report 2024’ <https://www.saudiexchange.sa/Resources/fsPdf/2082_0_2024-03-31_14-16-54_En.pdf> accessed 5 Aug 2024.

⁶⁷⁰ Watani Iron Steel Company ‘Board Reports’ <<https://watanisteel.sa/boarreports/>> accessed 5 Aug 2024.

⁶⁷¹ Saudi Tadawul, ‘Watani Iron Steel Co. Board Report 2023’ <https://www.saudiexchange.sa/Resources/fsPdf/1941_0_2024-03-14_17-31-58_En.pdf> accessed 5 Aug 2024.

					the Governing Council's 2023 report did not address any aspect of social responsibility.
Capital Goods	GAS Arabian Services Co. ⁶⁷²	2023	2	No	<p>-The report includes a section dedicated to sustainability and environmental and social governance (ESG), which indicates the company's interest in sustainability and ESG risks management.</p> <p>-Disclosures on ESG aspects are not detailed. Efforts have been mentioned in the application of occupational health and safety and procedures to ensure the reduction of accidents and injuries, as well as initiatives to support community development and sustainable projects, localization, privacy and data security, training, and development of employees.</p> <p>-There is no specific mention of their reliance on specific international standards in</p>

⁶⁷² GAS Arabian Services 'Homepage' <<https://gasarabian.com/investors-relations/?initialslide=5>> accessed 5 Aug 2024.

					disclosures such as GRI, and IFRS, which made it difficult to measure their social and environmental performance by interested investors. ⁶⁷³
	National Building and Marketing Co. (NBM) ⁶⁷⁴	2023	6	No	<p>- NBM's report is high with disclosures related to corporate governance, and there is a section on sustainability, but this section has talked more about sustainability goals that the company focuses on achieving and has not mentioned any action taken to achieve these goals.</p> <p>- The report indicated that the company adheres to all the requirements of the listed corporate governance regulation, except for the guiding rules, including employee development and motivation programs, social responsibility, and</p>

⁶⁷³ Saudi Tadawul, 'Gas Arabian Services Co. Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/2744_0_2024-03-28_10-12-54_En.pdf> accessed: 5 Aug 2024.

⁶⁷⁴ National Building and Marketing Co, 'Homepage' <<https://www.nbm.com.sa/>> accessed 6 August 2024.

					social work initiatives. ⁶⁷⁵
Health Care Equipment & Svc	Canadian Medical Center Co. ⁶⁷⁶	2023	3	No	The board report seems interested in demonstrating the company's commitment to the implementation of the corporate governance regulation, but at the same time noted that the company has excluded the application of the materials contained in the Corporate Governance Regulation on the social responsibility of the company because it is indicative and non-binding ⁶⁷⁷ .
	AME Company for Medical Supplies ⁶⁷⁸	2023	2	No	The report showed high disclosures on aspects of the company's governance and the composition of the Board of Directors but stated that it did not adhere to the governance materials on social responsibility and

⁶⁷⁵ Saudi Tadawul, 'National Building and Marketing Co. Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/1181_0_2024-03-31_15-47-35_En.pdf> accessed 6 Aug 2024.

⁶⁷⁶ Canadian Medical Center Company 'Homepage' <<https://www.canadian-mc.com/>> accessed 6 Aug 2024.

⁶⁷⁷ Saudi Tadawul, 'Canadian Medical Center Company Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/2183_0_2024-03-31_01-19-42_En.pdf> accessed 7 Aug 2024.

⁶⁷⁸ AME Company for Medical Supplies 'Homepage' <<https://ame.med.sa/>> accessed 7 Aug 2024.

					community action initiatives because they were guiding. ⁶⁷⁹
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4.13.1.5. Data Analysis

Through the data shown in the sample, it is clear that sustainability disclosures in companies listed in the parallel market “Nomu” still require significant improvements. Most of the companies analysed in this sample did not provide comprehensive and detailed disclosures about ESG aspects. Instead, their reports focused primarily on financial aspects and governance, with a clear exclusion of sustainability and social responsibility initiatives. For example, companies such as “Burgerizzr” and “Jahez” have introduced some social initiatives to support orphans and persons with disabilities, but these efforts have not been integrated into the ESG disclosures framework, reducing their ability to influence the evaluation of the company's social and environmental performance. The absence of the use of recognised international standards such as GRI or IFRS in disclosures makes it more difficult to assess these companies' performance by investors interested in sustainability.

The analysis of data revealed that all companies in the sample have met the required minimum mandatory corporate governance regulation, while excluding compliance with all non-binding guideline articles. This attitude has led to a marked weakness in social responsibility and sustainability disclosures. The fact that companies are more committed when there is binding legislation, whereas they are less committed when there is no binding legislation is indicative of the urgent need for mandatory legislation in the area of sustainability disclosures. Based on this data, it seems necessary to encourage or oblige companies to submit comprehensive and detailed ESG reports. This step will contribute to enhancing transparency and meeting the expectations of current and potential investors, as well as improving companies' commitment to long-term sustainability practices. Adherence to mandatory governance legislation highlights the importance of a binding legal framework that encourages companies to provide integrated disclosures that contribute to sustainable development.

4.13.2. Sustainability Performance of Main Market Listed Companies

This analysis examines the extent to which Main market companies are committed to voluntary disclosure of sustainability practices and ESG dimensions. The main objective of this analysis is to assess the level of disclosures and their compatibility with international standards, providing a deeper understanding of gaps between

⁶⁷⁹ Saudi Tadawul, ‘AME Company for Medical Supplies Board Report 2023’ <https://www.saudiexchange.sa/Resources/fsPdf/2684_0_2024-03-31_21-47-36_En.pdf> accessed 4 Mar 2025.

different sectors and contributing to making recommendations to improve the regulatory framework for disclosures.

4.13.2.1. Sample Data and Selection Methodology

To ensure the quality and accuracy of the analysis, the sample was selected based on specific criteria that ensure the comprehensiveness of the results and their link to the basic study question. The sample included companies listed on the main market for at least five years, to ensure adequate data for analysis and to assess the continuity of compliance with voluntary disclosures.

Data has been collected from reports posted on the official website of Saudi Tadawul⁶⁸⁰ or the official websites of listed companies, ensuring the credibility and conformity of information to official sources. These data represent sustainability reports or ESG reports, and if they are not available, the Board's 2023 reports have been relied upon as the latest available source.

4.13.2.2. Sample Diversity and Relevance

To ensure cross-sectoral representation, two companies from each major sector of the main market were selected at random, reflecting the diversity of the Kingdom's economic sectors. Some sectors such as transportation, financial services and renewable energy technology funds were excluded as they did not meet the time-listing requirement specified in the sample.

The selection of this sample contributes to the study's goal of comparing the level of voluntary disclosures between the main market and the "growth" market, reflecting the challenges and opportunities facing Saudi companies in adopting ESG practices. The results of this analysis provide clear insights for regulators and decision makers on existing gaps and support efforts to develop the regulatory framework for disclosures in line with the Kingdom's Vision 2030.

4.13.2.3. The Importance of the Sample in Achieving the Study's Objectives

This sample allows an integrated understanding of the differences between voluntary disclosures between major market listed companies and smaller companies included in the parallel market. This helps to determine the impact of the current regulatory framework and the need for enhanced commitment to disclosures. Furthermore, sectoral analysis highlights sector-specific challenges, enabling stakeholders to

⁶⁸⁰ Saudi Tadawul, 'Main Market' <https://www.saudiexchange.sa/wps/portal/saudiexchange/ourmarkets/main-market-watch?locale=en> accessed 22 Dec 2024.

formulate policies geared to more accurately meeting each sector's needs. This approach can ensure that practical results are drawn to support the development of regulatory policies and legislation necessary to enhance the level of transparency and sustainability in the Saudi stock market.

Industry	Co. Name	Listing period (years)	ESG Report	SDGs No. (out of 17)	Standards	Notes
Energy	Saudi Arabian Oil (Aramco)	5	Yes	13	- GRI Standards - SASB , the report confirmed adherence to these standards for ESG disclosures. - TCFD standards to guide climate change disclosures.	In Aramco's 2023 Sustainability Report, the company demonstrated a strong commitment to ESG standards, as it sought to integrate sustainability into its operational strategy comprehensively. The report highlights the company's commitment to reducing carbon emissions and improving energy efficiency, with a focus on renewable energy innovation and carbon capture and storage techniques ⁶⁸¹ .
	Rabigh Refining and Petrochemical Co.	16	Yes	N/G	Not Clear	-After examining the data contained in the company's website, it can be noted that the

⁶⁸¹ Aramco, 'Sustainability Report 2023' <<https://www.aramco.com/en/sustainability/sustainability-report/our-esg-data-and-assurance>> accessed 12 Aug 2024.

	(PETRO RABIGH) ⁶⁸²					<p>company has taken into account all aspects of ESG:</p> <p>Environmental Disclosures: The company has shown a commitment to reduce carbon and build opportunities for a circular economy. However, no specific details have been provided on how these initiatives will be applied at the day-to-day level of operations.</p> <p>Social disclosures: The focus was on diversity and inclusiveness, but the details provided were general and did not adequately demonstrate how these values are implemented across the company or their actual impact on employees and society.</p> <p>Governance disclosures: Petro Rabigh has shown good commitment to governance according to national and</p>
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⁶⁸² Petro Rabigh, ‘Sustainability’ <<https://www.petrorabigh.com/en/Sustainability>> accessed 12 Aug 2024.

						<p>international standards but without explicit mention of the use of specific standards such as GRI or SASB.</p> <p>The clarification provided by Petro Rabigh on its site reflects a strong commitment to ESG practices with a clear focus on standards such as diversity and inclusion, compliance with national and international standards, occupational safety, circular economy, and interaction with stakeholders. These principles are in line with global and local goals such as the UN Global Compact and Vision 2030, which places the company within a broad and multidimensional commitment to sustainability.</p> <p>While Petro Rabigh demonstrates a strong commitment to sustainability across the three aspects of ESG, disclosures do not</p>
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						clearly indicate the adoption of global standards such as GRI or SASB. This may be an indication that the company follows an internal framework rather than recognized international standards. Adopting global disclosure standards can enhance the company's transparency and help provide more detailed and specific reporting, which can increase investor and stakeholder confidence. ⁶⁸³
Materials	Takween Advanced Industries Co. (Takween)	12	No	N/G	N/G	The company has not published any disclosures about its sustainable performance or ESG. Only the company's website has indicated its vision to take environmental and social responsibility into account, by complying with environmental standards in all its activities and operations. as well as compliance with

⁶⁸³ *ibid.*

						all laws and regulations in accordance with CSR standards and support for social activities. It could be understood that they linked their compliance with those issues only if mandatory legislation existed. ⁶⁸⁴
	Saudi Arabian Mining Co. (Maaden)	16	Yes	11	GRI SASB	The Ma'aden Sustainability Report 2023 shows strong and tangible commitment in ESG areas, with Ma'aden setting 11 UN Sustainable Development Goals that she sees as the most influential and close to her industry. This reflects a strong commitment to sustainable development at the global level. - E aspects: the report shows that minerals achieved a 14.6% reduction in CO2e emissions from 2020. In addition, Ma'aden succeeded in reducing groundwater

⁶⁸⁴ Takween Advanced Industries Co. (Takween) 'Homepage' <<https://takweenai.com/about-us>> accessed 12 Aug 2024.

					<p>consumption by approximately 10%, while saving 2.446 million metric tons of water, reflecting a strong commitment to environmental sustainability practices.</p> <p>- S aspects: The report included detailed information about the company's programmes to support education and community development, including the investment of SAR 158 million in "Schools of Excellence" programs, which reflects a commitment to human resource development and support for the next generation of leaders. Minerals also promote diversity and inclusiveness in the working environment through partnerships such as that with Women in Mining Worldwide.</p> <p>- G aspect: The Report shows a</p>
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						strong commitment to advanced corporate governance practices. By adopting international governance standards and focusing on transparency, compliance, and risk management, as well as business ethics such as anti-corruption policies and the Code of Conduct, Ma 'aden emerges as a firm with a solid governance framework. ⁶⁸⁵
Commercial & Professional Svc	Maharah Human Resources Co. (Maharh)	5	Yes	8	N/G	<p>-The sustainability report of Maharah Human Resources 2022 shows a clear commitment to ESG standards. At the same time, the company did not publish a sustainability report for 2023.</p> <p>-The report shows that Skill contributes to achieving 8 of the UN's Sustainable Development Goals (SDGs), which encompass a variety</p>

⁶⁸⁵ Maaden, 'Sustainability Report 2023' <<https://www.maadens.com.sa/en/sustainability/report>> accessed 13 Aug 2024.

					<p>of goals such as poverty eradication, good health and well-being, gender equality, decent work and economic growth. The report also detailed statistics on the company's performance in several sustainability aspects such as responsible energy consumption, recycling, and community engagement. The report also addresses strengthening the internal working environment, enhancing shareholders' confidence, improving the quality of services provided to clients, and raising gender equality rates in recruitment and leadership positions.</p> <p>-With respect to IFRS, there is no explicit mention of the use of GRI, SASB, or other universally recognised standards in</p>
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						measuring the level of commitment or providing disclosures. This may indicate that disclosures may be more reliant on local frameworks or internal standards rather than global ones. ⁶⁸⁶
	Sadr Logistics Co. (Sadr)	7	No	N/A	N/A	The company has not published any sustainability reports on its website. The board's annual report for 2023 did not contain any disclosures or data on sustainability aspects ⁶⁸⁷ .
Consumer Services	Seera Group Holding ⁶⁸⁸	12	No	N/A	N/A	Seera did not submit any sustainability report and ESG standards according to recognized global standards such as GRI or SASB. Even the information provided in the 2023 Annual Board report was very weak in mentioning the sustainability strategy and clarifying aspects of

⁶⁸⁶ Maharah Human Resources Company, 'Investors' <<https://maharah.com/investors/>> accessed 13 Aug 2024.

⁶⁸⁷ Sadr Logistics Company, 'Board of Directors Reports' <<https://www.sadr.com.sa/board-of-directors-reports/>> accessed 13 Aug 2024.

⁶⁸⁸ Seera Group Holding, 'Investors' <<https://www.seera.sa/en/investors/reports/>> accessed 14 Aug 2024.

						the company's performance on ESG issues. ⁶⁸⁹
	Abdulmohsen Alhokair Group for Tourism and Development (Alhokair Group)	10	No	N/A	N/A	<p>-The AlHokair Group has not published any independent sustainability reports, but the 2023 Board Report contains a section on the company's sustainability and social responsibility strategy.⁶⁹⁰</p> <p>-The report addresses in general and in detail the company's focus sustainability and social responsibility objectives, such as aspects of individuals and society, environment, public health, employees, and the local economy, but there is no explicit mention of the use of international standards such as GRI or SASB to measure performance in the areas of</p>

⁶⁸⁹ Saudi Tadawul, 'Seera Group Holding Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/378_0_2024-03-31_21-49-30_En.pdf> accessed 14 Aug 2024.

⁶⁹⁰ Alhokair Group, 'Investors' <<https://www.alhokair.com/Investors>> accessed 14 Aug 2024.

						sustainability (ESG). ⁶⁹¹
Consumer Durables & Apparel	Naseej International Trading Co. (Naseej)	14	No	N/A	N/A	-Naseej has not published any Sustainability report since it was listed on the premium market. - The Board report 2023 of Naseej company did not dedicate a section for sustainability or ESG practices, or even mention this information through the report. ⁶⁹²
	ARTEX Industrial Investment Co.	17	No	N/A	N/A	- The company has not published any sustainability reports before. - In the report of the Board of Directors of the Company 2023, it mentioned some of the Company's initiatives on social responsibility without detailing the nature of those contributions and their impact on the Company's long-term strategy.
						- Environmental aspects: The report shows that eXtra

⁶⁹¹ Saudi Tadawul, 'Alhokair Group Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/604_0_2024-03-31_22-48-01_En.pdf> accessed: 14 Aug 2024.

⁶⁹² Saudi Tadawul, 'Naseej Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/372_0_2024-03-30_10-18-34_En.pdf> accessed: 15 Aug 2024.

Consumer Discretionary Distribution & Retail	United Electronics Co. (eXtra)	13	No	7	UN SDGs	<p>focuses on reducing its environmental impact by improving energy efficiency and reducing waste. Several initiatives to improve environmental performance were implemented, but the report did not elaborate on the quantitative results of these initiatives.</p> <p>- Social aspects: The company is interested in improving the working environment and promoting diversity and inclusiveness. There are references to training programs and skill development for staff. The company also focuses on community participation through several social initiatives.</p> <p>- Governance: eXtra is committed to applying best governance practices, and the relevant sections of the report show how to manage risks and comply with domestic and</p>
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						international standards. -eXtra appears to be committed to improving its sustainability performance, but the report lacks quantitative details and references to recognized global standards such as GRI and SASB. The company's report links all aspects of sustainability and the materials on which it focuses to Vision 2030 and the UN SDGs. ⁶⁹³
	(SACO)	9	No	N/A	N/A	-The company has not published any reports before about its performance in the aspects of ESG. -The Board 2023 report did not include any section or details about the company's sustainability performance
						Almarai 'a Sustainability Report 2023 reflects a comprehensive and serious commitment to global sustainability standards, covering

⁶⁹³ Saudi Tadawul, 'eXtra Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/434_0_2024-03-31_12-24-21_En.pdf> accessed 16 Aug 2024.

Food & Beverages	Almarai Co.	19	Yes	Not clear	GRI ISO 50001	<p>a wide range of initiatives and activities in line with best practices in the areas of environment, social responsibility and governance (ESG). Using global standards such as GRI and ISO enhances the credibility of disclosures, and the report indicates that the company is on track to achieve its strategic sustainability goals by 2025.</p> <p>- Report's comprehensiveness: the report includes comprehensive coverage of all aspects of sustainability including environmental protection, employee welfare, health and safety, sustainable agriculture and resource management such as water and waste. Detailed information on initiatives and achievements in each of these areas is provided, with</p>
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						<p>future goals clearly defined.</p> <ul style="list-style-type: none"> - Stakeholder engagement: Pastures attach great importance to engaging stakeholders, including consumers, employees and regulators, to ensure that sustainability goals are achieved. - (SDGs): The report highlights the company's contribution to the achievement of the United Nations Sustainable Development Goals (SDGs) and indicates that the company focuses on several goals, including good health and well-being, quality education, gender equality⁶⁹⁴.
	Savola Group	33	YES	10	SDGs GRI Carbon Initiative Dow Jones Sustainability Index.	<p>-The company has not published a new Sustainability Report since 2022.</p> <p>-The report is comprehensive and covers many ESG aspects. The report refers to several environmental and</p>

⁶⁹⁴ Almarai, 'Sustainability Report 2023' <<https://sustainability.almarai.com/ar/index.html>> accessed 16 Aug 2024.

						<p>social initiatives undertaken by the company, as well as detailed information on how to manage risks and improve social and environmental performance.</p> <p>-The report shows Savola's commitment to international standards for measuring sustainable performance, with GRI criteria used to disclose sustainability. The report also states that the company relies on other international initiatives and standards such as the Carbon Initiative and the Dow Jones Sustainability Index.</p> <p>- Savola has set 10 SDGs in its strategy. These include multiple aspects such as eradicating hunger, improving health and well-being, ensuring quality education, and</p>
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						promoting gender equality. ⁶⁹⁵
Consumer Staples Distribution & Retail	Abdullah Al Othaim Markets Co. (A.Othaim Market)	16	Yes	7	SDGs GRI SASB	<p>-ESG report covers a wide range of topics including governance, transparency and risk management, as well as the company's efforts in promoting environmental and social practices. The report highlights initiatives such as reducing energy consumption, improving waste management, and promoting health and safety in the workplace.</p> <p>- The company provided accurate details about its sustainability policies and procedures, including its commitment to achieving SDGs and community initiatives.</p> <p>-The report refers to the use of GRI criteria for sustainability disclosures, as well as some SASB guidelines. These</p>

⁶⁹⁵ Savola Group, 'Sustainability Report 2022' <<https://www.savola.com/docs/default-source/publications/savola-sr22-arabic-180923.pdf>> accessed 17 Aug 2024.

						standards enhance the transparency of the report and allow investors and stakeholders to better compare the company's performance internationally ⁶⁹⁶ .
	Saudi Marketing Co. (Farm Superstores)	10	No	N/A	N/A	The 2023 Board report did not elaborate on the company's ESG practices ⁶⁹⁷ .
Health Care Equipment & Svc	Middle East Healthcare Co. (Saudi German Health)	8	No	N/A	N/A	The 2023 board report briefly mentioned a section on the company's social responsibility practices such as the establishment of clubs for children, mothers, and orphans. The report did not elaborate on ESG aspects ⁶⁹⁸ .
	Dallah Healthcare Co. (Dallah Health)	12	No	N/A	N/A	The Company's Board of Directors Report 2023 did not elaborate on the ESG aspects ⁶⁹⁹ .
Pharma, Biotech & Life Science	Saudi Pharmaceutical	30	Yes	9	SDGs	-The report covers multiple aspects of

⁶⁹⁶ Saudi Tadawul, 'AlOthaim Market ESG Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/432_0_2024-05-30_11-37-19_En.pdf> accessed 17 Aug 2024.

⁶⁹⁷ Saudi Tadawul, 'Saudi Marketing Company's Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/582_0_2024-03-28_16-14-11_En.pdf> accessed 17 Aug 2024.

⁶⁹⁸ Saudi Tadawul, 'Middle East Healthcare Company's Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/685_0_2024-04-02_00-58-14_En.pdf> accessed 18 Aug 2024.

⁶⁹⁹ Saudi Tadawul, 'Dallah Healthcare Company's Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/435_0_2024-03-31_15-45-44_En.pdf> accessed 18 Aug 2024.

	Industries and Medical Appliances Corp. (SPIMACO)					<p>sustainability such as environmental risk management, social responsibility, and governance.</p> <p>Initiatives related to reducing carbon footprint and improving resource efficiency were mentioned, reflecting a commitment to environmental and social affairs.</p> <p>- The report made no clear reference to the use of specific international standards such as GRI or SASB to measure performance in sustainability areas.</p> <p>- The report contained references to contributing to the achievement of the UN's Sustainable Development Goals (SDGs), but no details were provided on how they could be clearly integrated into its strategy⁷⁰⁰.</p>
	Al Rajhi Bank	36	Yes	11	Loans Market Association	- Al Rajhi Bank presented two

⁷⁰⁰ Saudi Tadawul, 'SPIMACO Company's Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/387_0_2024-04-21_15-13-57_En.pdf> accessed 18 Aug 2024.

Banks					<p>Guidelines (LMA)</p> <p>Environmental and Social Bond Guidance and Sustainability Bond Guidance for the International Capital Market Association (ICMA)</p>	<p>sustainability reports: Al Rajhi Bank Allocation & Impact Report 2024⁷⁰¹.</p> <p>Sustainable Finance Framework⁷⁰².</p> <p>- Al Rajhi Bank demonstrates a strong and comprehensive commitment to sustainability by issuing reports on the impact of sustainable finance and the details of the sustainable finance framework. The reports reflect the Bank's commitment to provide accurate and comprehensive disclosures about the use and allocation of proceeds to sustainable projects, as well as the environmental and social impact assessment of these projects.</p> <p>-The reports address many aspects of ESG, and provides details about</p>
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⁷⁰¹ Al Rajhi Bank, Investors Relations, 'Al Rajhi Bank Allocation & Impact Report 2024' <<https://www.alrajhibank.com.sa/-/media/Project/AlrajhiPWS/Shared/PDFS/Alrajhi-Group/AlRajhi-Bank-Allocation--Impact-Report-2024.pdf>> accessed 18 Aug 2024.

⁷⁰² Al Rajhi Bank, Investors Relationship, 'Sustainable Finance Framework' <https://www.alrajhibank.com.sa/-/media/Project/AlrajhiPWS/Shared/Home/about-alrajhi-bank/Investor_Relation/Additional-Info/Sustainable_Finance_Framework.pdf> accessed 18 Aug 2024.

					<p>sustainable projects that have been funded, including renewable energy, energy efficiency, and water and waste management. The report provides accurate figures and metrics that enhance transparency and credibility.</p> <p>-The reports refer to the use of recognized international standards such as the Environmental and Social Bond Guidance and the Sustainability Bond Guidance of the International Capital Market Association (ICMA). Reference was also made to the Loan Market Association's (LMA) guidelines to ensure that financing conforms to environmental and social principles.</p> <p>- Impact assessment: Impact assessment methodologies based on an ICMA-compliant framework have</p>
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						<p>been used, enhancing the accuracy of disclosures and assisting in transparent reporting on the environmental and social impact of funded projects.</p> <p>- The report shows that Al Rajhi Bank has identified 11 Sustainable Development Goals (SDGs) within its strategy and is working to achieve these goals through its financing and investment initiatives. These include poverty eradication, decent work and economic growth, clean and affordable energy and gender equality.</p>
	Alinma Bank	16	Yes	12	Green and Social Bond Guidance and the International Capital Market Association's Sustainable Bond Guidance (ICMA).	<p>-Alinma Bank provided comprehensive disclosures about ESG practices through multiple documents, where these disclosures cover various aspects of ESG. 2023 ESG Report,⁷⁰³</p>

⁷⁰³ Alinma Bank, 'Sustainability ESG Report 2023' <<https://ir.alinma.com/media/3p3ev0pc/alinma-bank-ar-f-1.pdf>> accessed 18 Aug 2024.

					European Bank for Reconstruction and Development (EBRD) standards	<p>Sustainable Finance Framework,⁷⁰⁴ and ESG Position Statement.⁷⁰⁵</p> <p>The reports focus on the Bank's commitment to achieving sustainability goals, and clearly show how the Bank integrates ESG factors into its investment and financing processes.</p> <ul style="list-style-type: none"> - The Bank has a framework for sustainable financing through which capital is directed towards projects with positive environmental and social impact. This framework includes rigorous procedures for assessing environmental and social risks and selecting eligible projects for financing. - The report refers to the use of international standards such as ICMA. In addition, EBRD standards are used to classify
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⁷⁰⁴ Alinma Bank, Sustainability, 'Sustainable Finance Framework' <<https://ir.alinma.com/media/ougifku2/sustainable-finance-framework.pdf>> accessed 18 Aug 2024.

⁷⁰⁵ Alinma Bank, Sustainability, 'ESG Position Statement' <https://ir.alinma.com/media/kucl5aiq/alinma_esg-position-statement.pdf> accessed 18 Aug 18 2024.

						<p>environmental and social risks, as well as equator principles.</p> <p>-Alinma has developed ESG's due diligence assessment tools that help accurately and systematically assess and manage ESG-related risks.</p> <p>- Alinma Bank has identified several sustainable development goals within its strategy. These include aspects such as climate, clean energy, water and sanitation, and clean transport, as well as other goals aimed at promoting social and environmental sustainability.</p>
Insurance	The Company for Cooperative Insurance (Tawuniya)	19	Yes	7	GRI	<p>The report covers a wide range of topics such as environmental risk management, social responsibility, and governance. The report details initiatives undertaken by the company to improve environmental and social performance, such as reducing</p>

						<p>water and energy consumption, and adhering to ethical standards in the business.</p> <p>-The report contains precise details about environmental consumption and production, such as greenhouse gas emissions, water and energy consumption, and waste management. These details support transparency of disclosures.</p> <p>- The company became the first Saudi insurance company to become a member of the United Nations Sustainable Insurance Principles Initiative (PSI), reflecting its commitment to adopt sustainable practices at a global level⁷⁰⁶.</p>
	Malath Cooperative Insurance Co. (Malath Insurance)	17	No	N/A	N/G	<p>- Malath's annual report highlights the strategies the company is pursuing to ensure the sustainability of its business,</p>

⁷⁰⁶ Saudi Tadawul, 'Tawuniya ESG Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/485_0_2024-05-23_13-15-56_En.pdf> accessed 19 Aug 2024.

					<p>including the use of digital technology and improving customer experience.</p> <p>- While the report provides some details about financial performance and operations, it does not clearly and detailed include integrated disclosures related to ESG aspects, such as environmental impacts reports, social performance and in-depth governance.</p> <p>-It is clear that the company has adopted IFRS 17 and IFRS 9 in its financial reports. However, the company does not appear to have directly referred to the use of international standards for sustainability reports such as GRI or SASB to evaluate performance in ESG aspects.</p> <p>- The report does not clearly indicate the number or quality of SDGs</p>
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						that the company focuses on within its strategy. ⁷⁰⁷
Software & Services	Al Moammar Information Systems Co. (MIS)	5	No	N/A	N/A	<p>The Company's Board report did not mention any disclosures about the Company's strategy and performance on sustainability issues and ESG.</p> <p>-The report cited some aspects of social responsibility that the company was interested in working on, such as staff development and interest in the company's human resources development, as well as some of the company's voluntary contributions to some philanthropic entities and initiatives⁷⁰⁸.</p>
	Arab Sea Information System Co. (Arab Sea)	7	No	N/A	N/A	-The Company's Board Report 2023 did not elaborate on any sustainable practices undertaken by the

⁷⁰⁷ Saudi Tadawul, 'Malath Insurance Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/486_0_2024-03-31_16-00-18_En.pdf> accessed 19 Aug 2024.

⁷⁰⁸ Saudi Tadawul, 'MIS Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/1361_0_2024-03-31_15-00-12_En.pdf> accessed 19 Aug 2024.

						company or placed in its strategy. -The company's report indicated that it excluded the application of the provisions of the articles of the Corporate Governance Regulation on Social Responsibility because they are indicative and non-binding. ⁷⁰⁹
Real Estate Mgmt & Dev't	Emaar The Economic City (Emaar EC)	18	No	N/A	N/A	Emaan EC Board Report 2023 did not elaborate on any sustainable practices undertaken by the Company. The Company's report noted that the company considers and targets the future sustainability position in all its operations to align with the objectives of Vision 2030. ⁷¹⁰
	Jabal Omar Development Co. (Jabal Omar)	17	No	N/A	N/A	Jabal Omar Board Report 2023 did not elaborate on any sustainable practices

⁷⁰⁹ Saudi Tadawul, 'Arab Sea Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/1621_0_2024-03-31_12-27-52_En.pdf> accessed 19 Aug 2024.

⁷¹⁰ Saudi Tadawul, 'Emaar EC Board Report 2023' <https://www.saudiexchange.sa/Resources/fsPdf/457_0_2024-04-01_15-52-43_En.pdf> accessed 19 Aug 2024.

						undertaken by the company. ⁷¹¹
Telecommunication Services	Saudi Telecom Co. (STC)	21	Yes	11	SDGs GRI SASB	<p>- The report details the company's environmental and social initiatives, such as reducing carbon emissions, managing water and waste, and promoting diversity and inclusiveness.</p> <p>- In social aspects, the company focused on developing human capital through digital innovation. STC is also interested in improving health and safety in the working environment through multiple initiatives including training in safety and health standards, and enhancing employee welfare.</p> <p>- The report contains quantitative data and measures that reflect an assessment of the company's environmental and social performance, thereby enhancing</p>

⁷¹¹ *ibid.*

						<p>transparency and credibility.</p> <p>- STC used GRI and SASB standards in addition to adherence to United Nations Principles (UNGC) and GSMA directives. The company's objectives were also verified by the Scientific Goals Initiative (SBTi).</p> <p>- The report focuses on 11 UN Sustainable Development Goals (SDGs) and shows how the company seeks to achieve these goals through its diverse strategies and initiatives.⁷¹²</p>
	Etihad Etisalat Co. (Mobily)	20	Yes	11	<p>GRI</p> <p>ISO 26000</p> <p>AA1000</p> <p>UNGC</p>	<p>- The company did not provide disclosures about its sustainability performance for 2023, and only reported 2022.</p> <p>- Mobily's 2022 report provides comprehensive sustainability disclosures, covering ESG aspects. The report addresses the company's</p>

⁷¹² Saudi Tadawul Official website, to review STC ESG Report 2023 see: https://www.saudiexchange.sa/Resources/fsPdf/480_0_2024-06-24_10-09-21_En.pdf. Last Accessed: 20 Aug 2024.

						<p>initiatives in the areas of environmental management, digital innovation, and data protection, along with health, safety, diversity and inclusiveness in the workplace.</p> <p>- The report contains quantitative data and measurements on the company's environmental and social performance, enabling it to measure progress in the areas of sustainability.</p> <p>-The report was prepared following GRI standards, and the company used ISO 26000 social responsibility standards and AA1000 for accountability principles. In addition, the principles of the United Nations Global Compact (UNGC) have been followed to ensure that the strategy is aligned with international best practices.</p> <p>-On the governance side, reference was</p>
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						made to the company's acquisition of ISO certificates such as ISO 22301 related to business continuity management and ISO 31000 risk management. ⁷¹³
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4.13.2.4. Data Analysis

1. Energy Industry

When comparing the quality of ESG disclosures between Petroabagh and Saudi Aramco, the following differences can be noted:

In terms of quality disclosures, Saudi Aramco provided very detailed disclosures about ESG, relying on global standards such as GRI and SASB. The report includes specific figures and clear objectives related to environment, social, and governance, reflecting a strong commitment to transparent reporting that investors and stakeholders can rely on, and makes it easier to compare a company's performance with that of other global companies. Petrurabagh, in contrast, despite its commitment to sustainability principles, disclosures were less detailed. No clearly defined global standards were used in disclosures, and the data provided were more general, focusing on basic principles without going into practical detail or providing specific performance indicators; This can make disclosures less reliable for international investors.

In terms of strategic direction to integrate sustainability into the organization's objectives, Saudi Aramco disclosures are in line with a clear vision to achieve sustainability goals, with specific performance indicators and results accounting standards. The company has also shown a clear direction towards achieving the sustainable development goals and contributing to the circular economy. Petrurabag has also adopted a good strategic approach to sustainability, but without the same level of transparency and detail as Aramco. Disclosures can be improved by providing more comprehensive reporting and reviewing the details of the objectives achieved and the company's progress towards achieving them.

⁷¹³ Saudi Tadawul, 'Mobily ESG Report 2022' <https://www.saudiexchange.sa/Resources/fsPdf/481_0_2023-10-10_11-51-09_En.pdf> accessed 20 Aug 2024.

2. Materials Industry

Ma'aden's 2023 report reflects a strong commitment to sustainability principles and shows remarkable progress in achieving its environmental and social objectives, with a clear commitment to global disclosure standards. The report is characterized by great detail about resource consumption and a comprehensive approach to enhancing sustainability. Although Ma'aden is the only one in the core sector that has met sample standards, with no other company in the same sector that has completed 5 years since its listing, this makes sustainability metals a distinct industry model for the rest of the companies listed in the same sector.

3. Commercial and Professional Services Industry

Maharah's sustainability report shows a strong commitment to sustainability and covers a wide range of activities that reflect this commitment. However, the absence of a clear reference to the use of international standards such as GRI or SASB may reduce the level of transparency and credibility compared to reports that rely on such standards. The company can enhance its disclosures by adopting and using global disclosure standards, which will increase the reliability and comparison of reports internationally.

The non-publication of the Sustainability Report 2023 by Maharah Human Resources, despite approaching the end of 2024, raises some questions about the company's commitment to transparency and continuity in sustainability reports. Failure to publish the report promptly may erode investors' and other stakeholders' confidence in the company's commitment to sustainability. The lack of an ESG report for 2023 can be explained by the company's challenges in collecting or analysing data, or perhaps in implementing sustainability strategies. This may hurt the company's image and market position. In contrast, Sadr Logistics has not provided any sustainability disclosures before, reflecting a lack of clear commitment to transparency regarding sustainability practices. This can have negative impacts on a company's reputation and weaken investor and stakeholder confidence. In today's financial markets, reporting on ESG is an important part of a comprehensive assessment of corporate performance.

Overall in the business and professional services sector, the lack of continuity in the publication of reports or their total absence points to significant challenges in this sector, which calls for additional efforts to enhance transparency and commitment to sustainability. Companies in this sector need to further review their practices and disclosure to meet investors' and stakeholders' expectations.

4. Food Industry

Although both Almarai and Savola companies rely mainly on GRI standards to disclose their sustainability performance, pasture has been characterized by providing additional details on the use of standards and how to integrate them into their day-to-day operations, thus increasing transparency. Savola has also set 10 Sustainable

Development Goals (SDGs) as part of its strategy, reflecting its commitment to achieving these goals through its various initiatives. While the Almarai, on the other hand, did not clearly articulate the goals they focused on in the report, the report contained disclosures covering a greater number of sustainable development goals and set specific targets to achieve them. It is therefore clear that Almarai has demonstrated a strong commitment to achieving these goals and integrating them into their operational strategies.

5. Banking Industry

Both Al Rajhi Bank and the Development Bank provided comprehensive disclosures about ESG practices in their reports. Al Rajhi Bank's disclosures focused on the social and environmental impact of sustainable finance projects. The two reports reviewed indicate the use of international standards for ICMA's Green and Social Bond Guidance, which enhances transparency in disclosures. Al Rajhi Bank's disclosures provide accurate details about the use of proceeds and their allocation to specific projects, as well as figures and measurements to measure environmental and social impact. In its disclosures, Alinma Bank focused on developing a sustainable financing framework covering multiple aspects of sustainability. The Bank uses ESG due diligence assessment tools to assess and manage ESG-related risks. Alinma Bank disclosures demonstrate a commitment to use international standards such as ICMA, BRD, and Equator principles, enhancing the accuracy and reliability of disclosures.

Overall, both banks provided comprehensive and accurate disclosures about ESG, using international standards to enhance transparency and credibility, with some slight differences in how international standards are applied and developing evaluation tools for the benefit of Alinma Bank. Alinma Bank focuses more on developing ESG's due diligence assessment tools, enhancing the accuracy of risk management, and demonstrating greater complementarity in the application of standards.

6. Insurance Industry

Tawuniya provided comprehensive and multidimensional disclosures on ESG aspects. The report covers in detail environmental and social strategies and corporate governance, with a focus on reducing emissions, improving resource management, and social contribution. Disclosures were consistent with international GRI standards, enhancing the report's transparency and allowing it to be compared with international standards. The report also contained quantitative figures and measures reflecting the company's environmental and social performance, supporting stakeholders' decisions to rely on accurate and reliable data. While Malath's report showed a commitment to good governance and risk management, ESG sustainability disclosures were not as comprehensive as in Tawuniya's report. Disclosures were less detailed regarding

environmental and social aspects, and did not provide the same level of quantitative detail or use of international standards.

In addition to using GRI standards for sustainability disclosure, it has participated in international initiatives such as the United Nations Sustainable Insurance Principles (PSI). This enhances the credibility of disclosures and reflects the company's commitment to applying global best practices. In contrast, Malath's report noted adherence to international accounting standards such as IFRS, but did not explicitly address international sustainability standards such as GRI or SASB that can enhance the accuracy and transparency of disclosures. In general, Tawuniya is more advanced than a haven in sustainability disclosures and the use of international standards.

7. Telecommunications Industry

STC Report 2023 provides comprehensive and extensive disclosures, covering all aspects of ESG. The report highlights the deep commitment to reducing carbon emissions, increasing resource efficiency, and promoting diversity and inclusiveness in the working environment. The company's report also demonstrated a clear commitment to digital innovation and process improvement by using state-of-the-art technologies to enhance sustainability. Mobily's 2022 report also provides comprehensive disclosures but with a greater focus on operational areas and resource management. The report focuses on improving energy efficiency and environmental risk management, as well as social initiatives such as improving customer experience and enhancing inclusiveness. Innovation at Mobily is demonstrated by its commitment to improving environmental and social performance using modern technology, with a focus on supply chain sustainability and risk management.

STC used GRI and SASB standards, as well as the United Nations Global Compact (UNGC) and the Scientific Objectives Initiative (SBTi) targets to achieve net zero emissions by 2050. These standards enhance the report's transparency and allow comparison of performance on a global scale. On the one hand, Mobily has used the criteria of GRI, ISO 26000, and AA1000 for accountability. It also relied on ISO certificates such as ISO 22301 and ISO 31000. These standards support sustainability and demonstrate a commitment to risk management and social sustainability. The ESG report provided STC with comprehensive quantitative data covering environmental and social performance, such as carbon emission measurement, water and waste management, and gender equality. Mobily's report also contained good quantitative disclosures about energy management, improving resource efficiency, while providing data on the environmental impact of various initiatives. However, disclosures may be less detailed compared to STC in terms of quantitative coverage of some indicators. In short, both companies offer strong and comprehensive disclosures about sustainability, but STC may be slightly superior to comprehensiveness, innovation and detail in disclosures, as well as strict adherence to international standards such as SASB and

GRI. While Mobily provides good disclosures but with room for improvement in some quantitative and detailed aspects.

4.13.3. Findings

The analysis shows that companies' commitment to sustainability varies markedly based on the sector to which they belong, the size of the company, and its available resources. According to Liang and Renneboog's study⁷¹⁴ this variation can be explained by several key factors. One of the most notable is the size of the company, where large companies have the advantage of allocating additional resources to prepare and publish ESG disclosures and control reputational risks, resulting in better assessments compared to smaller companies that may face financial or regulatory challenges that prevent comprehensive disclosures.

Geographical location plays an essential role in this context, as companies operating in areas with strict regulatory requirements receive higher assessments⁷¹⁵ as a result of their compliance with the imposed disclosure procedures. Moreover, the industry is emerging as an influential factor, as normalising ESG ratings based on the nature of the industry can lead to streamlined results that mask companies' real efforts to improve their sustainability performance⁷¹⁶. Based on this, these factors can be used to explain the results of the sample of companies listed in the main market, as the analysis shows that the disparity in companies' commitment to voluntary disclosures of sustainability reflects the impact of size, industry type and stakeholders, enhancing our understanding of the factors affecting the quality and efficiency of disclosures in the Saudi context.

4.13.3.1. Industry Impact

Industries such as software and services, real estate management and development, healthcare equipment and services, longstanding consumers and clothing, consumer services, media and entertainment, have not provided any comprehensive disclosures about sustainability. Detections in these sectors are often superficial and general, limited to social responsibility initiatives or philanthropy, without providing clear performance indicators related to environmental or social aspects. This disparity can be attributed to the nature of these sectors where environmental sustainability may be less pronounced or direct compared to other sectors, such as energy or manufacturing. For example, software companies may consider their environmental impact to be limited, thereby neglecting aspects of environmental disclosure.

⁷¹⁴ Hao Liang and Luc Renneboog, 'Corporate Social Responsibility and Sustainable Finance: A Review of the Literature' (2020) European Corporate Governance Institute – Finance Working Paper No 701/2020, forthcoming in *Oxford Research Encyclopedia of Economics and Finance* <https://ink.library.smu.edu.sg/lkcsb_research/7001> accessed 16 August 2025.

⁷¹⁵ *ibid.*

⁷¹⁶ *ibid.*

This result supports the findings of a study conducted by Abu Hussain, Alsayegh, and Boshnak,⁷¹⁷ which examined the relationship between ESG disclosures and corporate performance in a sample of the top 100 non-financial companies included in Tadawul. Its study revealed clear sectoral differences, with non-manufacturing companies showing stronger relationships between ESG disclosure and performance measures, compared to manufacturing companies. It also noted that the size, age and level of liquidity of the company were factors influencing the extent to which the company's performance was linked to ESG practices. These results are consistent with the significant disparity in disclosure between different sectors revealed in this study, reflecting the need for differentiated regulation that takes into account each sector's specificity when developing regulatory frameworks for disclosure in the Saudi market.

4.13.3.2. Impact of Company Size and Resources

Large companies, especially those in which the state or a state company has a controlling stake, such as Saudi Aramco, tend to provide comprehensive and detailed disclosures about sustainability. These companies are often under greater control and have sufficient resources to develop and effectively implement advanced sustainability strategies. The quality of stakeholders and consumers if they are international such as obedience sector products and essential materials, the commitment to sustainability reporting and ESG performance is stronger because of the influence of stakeholders' supplier chains. In contrast, SMEs may face challenges in allocating resources for comprehensive sustainability reporting, resulting in less detailed disclosures or their complete absence.

4.13.3.3. Obligation of Mandatory Versus Voluntary Disclosures

Companies have shown considerable commitment to mandatory governance disclosures set out in the Corporate Governance Regulation. This obligation reflects the strength of mandatory legislation and its impact on companies' drive to comply and provide detailed and transparent reports. Conversely, the disclosures on social responsibility and sustainability, which came in an indicative rather than mandatory form, did not receive the same level of commitment. For example, the board report of Arab Sea Information System clearly indicated that it excluded any disclosures on the performance of the company's social responsibility since these disclosures were indicative and not mandatory. This discrepancy between obligatory and indicative disclosures reflects the importance of legislation to regulate sustainability disclosures.

⁷¹⁷ Maha Abu Hussain, Maha Alsayegh, and Helmi Boshnak, 'The Impact of Environmental, Social, and Governance Disclosure on the Performance of Saudi Arabian Companies: Evidence from the Top 100 Non-Financial Companies Listed on Tadawul' (2024) 16(17) Sustainability 7660.

4.13.3.4. Impact of Government Ownership

Companies in which the state or a state company has a control stake show higher performance and disclosures on ESG matters. This can be attributed to the greater oversight and accountability of these companies, as well as the high expectations of government entities for sustainability and transparency. Major companies such as Saudi Aramco, banks and STC tend to adopt international standards and provide comprehensive reporting, reflecting a strong commitment to sustainability practices not only as part of their social responsibility but also as part of their overall business strategy.

4.13.4. Comparison between the Performance of Companies in the Parallel Market “Nomu” and the Main Market of Saudi Tadawul:

By analysing the performance of companies in both the “Nomu” parallel market and the key market for trading Saudi Arabia, there is clearly a significant discrepancy in the extent to which governance and sustainability disclosures are adhered to.

4.13.4.1. Mandatory Corporate Governance Regulation

In the main market of Saudi Tadawul, the binding Corporate Governance Regulation has had a significant impact on enhancing corporate commitment to governance requirements. This commitment is evident in the annual reports of boards of directors that are obliged to disclose aspects of governance according to the regulation. Major companies listed in the Main market, such as Saudi Aramco and large banks, have shown a strong commitment to governance and sustainability standards due to this mandatory legislation. On the contrary, companies listed in the parallel market “Nomu” are not subject to the same binding regulatory requirements regarding governance and sustainability. As a result, many of these companies do not provide comprehensive reporting on ESG aspects, and disclosures are often limited to financial aspects and some non-binding social responsibilities.

A recent study of Almubarak et al ,⁷¹⁸ indicated that this impact is declining in the absence of legislation or when external crises, such as the COVID-19 pandemic, underscoring the importance of an effective regulatory framework in fostering a culture of sustainable disclosure and enhancing investor confidence.

⁷¹⁸ Wadhaah Almubarak, Mohammed Ammer, Kaouther Chebbi and Ayth Almubarak, ‘ESG and Financial Sustainability: The Role of Saudi Corporate Governance Reforms’ (2023) <<https://cma.gov.sa/en/ResearchAndReports/Documents/ESG-TheRoleofSaudiCorporateGovernanceReforms.pdf>> accessed 16 Aug 2025.

4.13.4.2. Impact of the Absence of Binding Legislation on ESG

Disclosures

Obviously, the lack of binding legislation on sustainability disclosures leads to significant disparities in the quality of such disclosures between companies. In the parallel “Nomu” market, where there is no clear legislative obligation, most companies avoid comprehensive sustainability reporting. Even in the major market, where large companies adhere to governance standards, there is still a discrepancy in companies' commitment to sustainability disclosure, suggesting that the absence of legal risks associated with non-disclosure of sustainability is an influential factor.

4.13.4.3. Discrepancies in Disclosures and Greenwashing Issue

The issue of greenwashing can arise due to a significant difference in the quality of corporate sustainability disclosures, which involves companies attempting to convince consumers that they are more sustainable than they actually are. Companies that make public and brief disclosures or focus solely on positive aspects such as charity without providing details of their environmental and social impacts, may be involved in greenwashing, through the so-called hush-washing, which is a tactic used by some companies to evade disclosure of their sustainability practices, leaving investors and stakeholders uncertain and without sufficient information to make informed decisions. This practice is one of the greenwashing images, which is attributable to legislation and censorship by the concerned authorities to prevent or at least limit it. Through these measures, transparency can be enhanced and the level of trust between companies and investors improved, ultimately leading to a more sustainable and reliable trading environment.

In summary, a comparison of companies' performance in the “Nomu” parallel market and the key market of Saudi Arabia trading shows that binding legislation plays a crucial role in promoting commitment to governance and sustainability disclosures. The absence of such legislation leads to a significant discrepancy in the quality of disclosures, and leaves room for greenwashing practices. Therefore, if the CMA aims to develop corporate disclosures and raise the level of transparency about ESG practices as set out in the objectives of Vision 2030 for the development of the financial sector, enacting binding legislation may be a necessary step that will improve the quality of disclosures and increase the confidence of investors and stakeholders in the company's practices

4.14. Conclusion

This chapter reviewed the legal and regulatory framework for disclosures of public companies listed in the Saudi capital market. The corporate laws, corporate governance rules and listing requirements were analysed in addition to the role of regulators such as the Capital Market Authority (CMA), the Central Bank of Saudi Arabia (SAMA)

and the Ministry of Commerce (MoC) in regulating and monitoring the compliance of listed companies with disclosure requirements. The chapter also addressed the challenges associated with the application of ESG disclosure criteria, analysing social, economic, legal and technical factors that may affect the quality of disclosures and the extent of companies' commitment to them, focusing on the discrepancy between voluntary and mandatory disclosure, the impact of the absence of binding legislation on the credibility of ESG reports, and the risks of greenwashing. The chapter provided an analytical study of samples of companies on the main and parallel market “Nomu”, comparing the extent to which companies in both markets adhered to disclosure criteria and identifying factors influencing the quality of reports submitted, such as company size, industry and government ownership.

The chapter's discussions concluded that the current regulatory framework for environmental, social and governance disclosures in Saudi Arabia still faces challenges in achieving compliance and transparency, especially with the absence of a mandatory comprehensive framework for disclosures and varying levels of adoption between companies. The results of the analysis also showed that large companies with larger financial resources and government ownership are more committed to disclosures than start-ups and small companies in the parallel market, reflecting the need for a more comprehensive regulatory framework that promotes compliance across all market sectors. This chapter contributes to answering the research question on how listing in the Saudi capital market facilitates ESG disclosure requirements under the rules-based governance model and analyses the economic, social and legal challenges associated with this model. This chapter also lays the foundation for subsequent discussions on how to improve the Saudi regulatory framework by leveraging the UK's experience, particularly the “comply or explain” approach, which provides greater flexibility in disclosures and allows companies to adapt to regulatory and economic variables. The forthcoming chapter will address how these lessons are applied in the context of the Saudi market, with the aim of balancing regulatory compliance with the required flexibility and addressing the challenges associated with the transition to a mandatory ESG disclosure approach to enhance sustainability in capital markets.

Chapter 5: Proposing an Effective Framework for ESG Disclosure for Saudi Capital Market

5.1. Introduction

Following the challenges identified in chapter 4, this chapter seeks to answer the study question about the possibility for the Saudi capital market to benefit from the UK corporate governance model in applying the concept of the dynamic materiality of ESG disclosures and the principle of “comply or explain” in any reforms the CMA intends to take with regard to environmental, social and governance disclosures. To address this question, the chapter reviews how the Saudi capital market benefits from the UK's experience in developing ESG disclosures, with the aim of improving the regulatory framework for disclosure and enhancing transparency and accountability. The chapter also discusses the concept of “dynamic materiality” defined by the World Economic Forum⁷¹⁹ as encompassing information not limited to indicators with direct financial impact, it extends to what is known as ‘pre-financial information’. Data that may be of environmental or social importance at present, without an immediate financial impact, it is expected to become financially relevant over time⁷²⁰. This dynamic nature of determining material information reflects the particular circumstances of each community and local economy, making determining what is considered material information to each country's social and economic context. Based on this background, the chapter suggests adding the concept of “dynamic materiality” to the disclosure of ESG in the Saudi capital market regulations, in line with the unique economic, social, and regulatory aspects of the market.

The chapter also reviews three main models for ESG disclosure: mandatory disclosure, voluntary disclosure, and a “comply or explain” approach, analysing the extent to which a single model or combination of these models can be adopted in the Saudi market to reduce the defects of any model. The UK experience is highlighted, with institutional shareholders playing a key role in ensuring compliance with disclosure requirements and promoting participatory governance in the financial market. In addition, the chapter discusses the limits of “legal transplant” in the transfer of UK disclosure practices to the Saudi market, and potential challenges that may hinder the application of this model. Finally, the chapter offers proposed solutions to the challenges facing ESG disclosure in Saudi Arabia, analysed in Chapter 4. These solutions include legislative and regulatory amendments inspired by the UK's

⁷¹⁹ World Economic Forum, *Embracing the New Age of Materiality: Harnessing the Pace of Change in ESG* (White Paper, in collaboration with Boston Consulting Group, March 2020).

⁷²⁰ *ibid.*

experience, along with technical and economic recommendations to promote companies' compliance with disclosure requirements without affecting the market attractiveness of investors.

5.2. Improving the Saudi Approach to ESG Disclosure

5.2.1. Saudi Approach to “Materiality”

The concept of materiality is a key element in the disclosure of financial and non-financial information in the financial markets, where regulations determine when disclosure is required to ensure transparency and investor protection, as explained through Chapter 3.⁷²¹ There is no specific definition of the concept of material information in the list of Saudi capital market Glossary of Defined Terms Used in the Regulations and Rules 2024,⁷²² similar to the definition of material in securities and exchange legislation for other global markets.⁷²³ To resolve this matter, the following sections aim to analyse the definition of materiality concept through various regulations, including the Corporate Governance Regulation (CG Regulation) for Listed Companies of 2023⁷²⁴ issued by the Saudi Capital Market Authority (CMA), as well as the Rules for Offering Securities and Continuing Obligations 2024.⁷²⁵ These regulations rely on different criteria to determine material information, which can lead to variation in how companies understand disclosure requirements. The analysis of these regulations therefore helps to clarify current trends in the disclosure of material information and to identify gaps that may affect the transparency of financial and non-financial reports. These rules will be reviewed according to the following sections.

5.2.1.1. Rules on the Offer of Securities and Continuing Obligations

Although the Rules do not provide a specific definition of material information, Article 64⁷²⁶ of the Rules provides a general standard specifying when disclosure is required, based on the issuer's assessment of the impact of such information on assets, liabilities, financial position, or the price of listed securities. The article is also based

⁷²¹ See sec 3.5.1. Nature of ESG's Financially Immaterial Disclosures 49-56.

⁷²² CMA, Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority 2024 <<https://cma.org.sa/en/RulesRegulations/Regulations/Pages/default.aspx>> accessed 22 Feb 2025.

⁷²³ For example, the U.S. Securities and Exchange Commission's definition of material: “A matter is “material” if there is a substantial likelihood that a reasonable person would consider it important”. US Securities and Exchange Commission, Staff Accounting Bulletin No 99 – Materiality (SEC, 12 August 1999) <<https://www.sec.gov/interps/account/sab99.htm>> accessed 8 February 2025.

⁷²⁴ CMA, Corporate Governance Regulations (as amended by Resolution of the Board of the Capital Market Authority, 18 January 2023) <<https://cma.org.sa/en/RulesRegulations/Regulations/Pages/default.aspx>> accessed 5 Feb 2025.

⁷²⁵ CMA, The Rules for Offering Securities and Continuing Obligations, (27 December 2017, as amended 7 October 2024) <<https://cma.org.sa/en/RulesRegulations/Regulations/Pages/details.aspx?code=5>> accessed: 5 Feb 2025.

⁷²⁶ CMA, The Rules for Offering Securities and Continuing Obligations 2024, art. 64 (C).

on the principle of ‘prudent investor’ in determining whether information is material, a criterion that requires specialised expertise that the average investor does not have,⁷²⁷ and is often more clearly and effectively applied by institutional investors. However, article 65⁷²⁸ of the Rules sets out specific quantitative criteria for the material information to be disclosed, regardless of the issuer's assessment of its substance. These criteria include any developments equal to or exceeding 10% of the net assets of the issuer, such as transactions for the sale or purchase of assets, recording of losses, or indebtedness outside the scope of the issuer's activity. This gives a clear impression of the keenness of the Saudi stock market to disclose any changes that may affect investors' perception of the company or reflect significant strategic and financial change.

In this context, the Saudi Stock Exchange (Tadawul) ESG Disclosure Guidelines⁷²⁹ provided a guiding view on the relevance of ESG disclosures and their impact on companies. According to this guide, the ESG report includes environmental, social and governance disclosures that can affect a company's ability to implement its strategy.⁷³⁰ While these factors are sometimes called ‘non-financial’ or ‘additional financial factors’, how a company manages these factors has undoubtedly financial implications.⁷³¹ This definition reflects a trend that recognizes that some information that may not be material financially in the short term, can become strategically influential in the long term, which is in line with the concept of ‘dynamic materiality’ adopted by some developed markets such as the UK.

However, the absence of mandatory disclosure of ESG issues in current regulations may lead to a difference in application between companies, as such disclosures depend heavily on each company's discretion, as the study sample results have revealed in Chapter 4.⁷³² Some companies may see environmental and social issues as having a fundamental impact on investors’ decisions, while others may consider them irrelevant, given the lack of clear regulatory guidance that determines when disclosures are necessary. Thus, the inclusion of the definition of Saudi ‘Tadawul’ in this context highlights the need for a more detailed framework for assessing the substance of ESG disclosures and linking them to the criteria of material information in the Saudi capital market. Therefore, with the globally increasing trend towards integrating sustainability standards into financial disclosures,⁷³³ a trading manual for ESG disclosures can be seen as a step in the right direction, but it is still only at a guiding stage, meaning that

⁷²⁷ Danielle Winchester, Sandra Huston and Michael Finke, ‘Investor Prudence and the Role of Financial Advice’ (2011) 65(4) *Journal of Financial Service Professionals* 43.

⁷²⁸ CMA, *The Rules for Offering Securities and Continuing Obligations 2024*, art 64 paras 1-3.

⁷²⁹ Saudi Stock Market Exchange, *The ESG Disclosure Guidelines*, <<https://www.saudiexchange.sa/wps/portal/saudiexchange/listing/issuer-guides/esg-guidelines>> accessed 15 Feb 2025.

⁷³⁰ *ibid.*

⁷³¹ *ibid.*

⁷³² See sec 4.13.3. Findings 186-190.

⁷³³ Ivan Gernego, Larysa Petrenko, Valentyna Lavrynenko and Mykhailo Dyba, ‘Trends and Focuses for ESG Investment Support’ (2024) 13(1) *European Journal of Sustainable Development* 167.

companies do not face a legal obligation to disclose this information. This raises questions about the extent to which companies can interpret their environmental and social performance according to their operating conditions without clear criteria, which may affect the quality of reports and create a gap in the level of transparency between listed companies.

5.2.1.2. Definition of Corporate Governance Regulation for Material Disclosures

Corporate Governance Regulation (CG Regulation) oblige listed companies to develop a disclosure policy in line with the disclosure requirements of the Saudi Companies Law and capital market regulations. Article 89 of the CG Regulation⁷³⁴ stipulates that this policy shall include methods of disclosure of financial and non-financial information about the company and its performance and ownership of its shares, so as to provide shareholders and stakeholders with access to information in an integrated manner. Although the article refers to the materiality of disclosure of non-financial information, it does not explicitly refer to ESG disclosures, leaving it to each company's discretion according to its operating circumstances and processes. This ambiguity reflects a challenge in determining what is considered 'material information', as current regulations do not provide clear criteria for how to assess the materiality of non-financial disclosures. While ongoing securities presentation rules and obligations require companies to disclose any information that may affect investors' decisions, the governance regulation does not set out a specific framework for how environmental and social information can be assessed for the financial and investment performance of the company.

In theory, the Saudi regulatory framework provides flexibility to accommodate future non-financial disclosures, especially if additional regulations or amendments are issued that reinforce the obligation to disclose sustainability strategies, but remain unclear like other global markets. In the UK as discussed in Chapter 3,⁷³⁵ the FCA has adopted a more sophisticated approach through the concept of 'dynamic materiality', which extends disclosure to non-financial issues that may become essential over time. Furthermore, the FCA has developed the FCA Handbook ESG, which sets mandatory rules and guidance for ESG disclosure, ensuring greater consistency and clarity in companies' reports.

While the Saudi Stock Market currently does not impose any legal obligations on ESG disclosures, assessing the material information of ESG issues depends on each company's estimate, resulting in a significant discrepancy in disclosure practices. Some companies may consider environmental and social issues to be of strategic important,

⁷³⁴ Corporate Governance Regulations 2023, art 89.

⁷³⁵ See sec 3.5.1.5. The UK View on Materiality 54-56.

while others do not, in the absence of clear criteria for determining the scope of disclosure and the impact of these factors on investors' decisions. In the absence of specific mandatory requirements, companies may find it difficult to determine whether to disclose information on environmental and social governance, especially since the impact of these factors may be insubstantial financially in the short term, but may become strategically important in the long term. This difference in interpretation of material information may lead to significant variation in disclosure practices among listed companies, affecting the level of transparency and standardization of disclosure standards in the Saudi stock market.

The Saudi stock market's lack of a clear regulatory framework for assessing the materiality of non-financial disclosures suggests the need to analyse the experiences of other markets, such as the UK model, to draw lessons on how to develop regulatory guidance to help clarify ESG disclosure requirements. The FCA Handbook on ESG highlights the importance of a combination of mandatory rules and guidelines, ensuring a balance between enhancing transparency and avoiding unnecessary regulatory burdens. In this context, the review of the Saudi regulatory framework to determine when sustainability issues are essential in line with the requirements of modern financial markets may contribute to the development of a more consistent disclosure environment that supports investor confidence and enhances the ability of the Saudi stock market to keep pace with global sustainability disclosure standards.

5.2.1.3. Challenges and Potential Solutions of Determining Materiality in ESG Disclosures

Saudi capital market Corporate Governance Regulation (CG Regulation) indicate that listed companies should disclose material information that may affect their financial or operational performance, including non-financial information.⁷³⁶ Nevertheless, sustainability disclosures remain voluntary, raising challenges about the current legal framework's ability to accommodate accelerated developments in ESG disclosure standards. The absence of an accurate definition of material information in this context may lead to a discrepancy in corporate disclosure practices, limiting the level of transparency in the market and affecting investors' ability to make decisions based on accurate information.

The Saudi capital market laws is based on the criterion of 'prudent investor' rule in determining the substance of the information to be disclosed.⁷³⁷ The materiality of information is assessed based on the perspective of a prudent investor who is supposed

⁷³⁶ Corporate Governance Regulations 2023, art 86 para 1.

⁷³⁷ CMA, Rules on the Offer of Securities and Continuing Obligations 2024, art 64(C).

to possess a basic understanding of the functioning of financial markets.⁷³⁸ This standard as Davis⁷³⁹ submits, aims to enhance transparency by ensuring that all information that may affect investment decisions is disclosed, reducing trading risks based on internal information. However, applying this standard to non-financial disclosures, such as ESG reports, poses significant challenges, especially in the Saudi market, where individual investors make up the majority of shareholders,⁷⁴⁰ as will be discussed in the following sections.

A prudent person's rule, as applied in more developed systems such as the UK⁷⁴¹ and the U.S.,⁷⁴² focuses on the behaviour of the investor himself, rather than relying solely on the nature of the disclosed information.⁷⁴³ The essence of this approach is that the investor or investment manager must act with care, skill, prudence and diligence of a wise man in similar circumstances.⁷⁴⁴ This means that disclosures are based on a deliberate process and not only on specific results, which creates considerable flexibility in identifying material information.⁷⁴⁵ However, Goldman⁷⁴⁶ argues that one of the main flaws in this approach is that its excessive flexibility makes it subject to different interpretations, especially when tested in the courts. As courts are not specialised investors, Del Guercio⁷⁴⁷ argues that courts tend to rely on the norms prevailing in financial markets, which may lead to a narrow interpretation of the concept of risk and security, and may exclude some recent practices in analysing non-financial risks, such as environmental and social governance issues. In this context, an additional challenge might arise in the Saudi market, as the majority of individual investors may not have the specialised financial knowledge to assess the impact of ESG factors on their investment decisions. This raises the question of the appropriateness of adopting the 'prudent investor' criterion as a basis for determining the material importance of ESG disclosures, especially since this criterion may be more effective with institutional investors such as investment funds, who are more familiar with these factors.

In contrast, developed markets, such as the UK, adopt a clearer standard by incorporating the concept of "Prudent Investment" into the mandatory rules.⁷⁴⁸ This

⁷³⁸ Philip Davis, 'Prudent Person Rules or Quantitative Restrictions? The Regulation of Long-term Institutional Investors' Portfolios' (2002) 1(2) *Journal of Pension Economics and Finance* 157.

⁷³⁹ *ibid.*

⁷⁴⁰ *CMA Annual Report 2023* <<https://cma.org.sa/en/ResearchAndReports/Reports/Pages/default.aspx>> accessed 25 Feb 2025.

⁷⁴¹ The Occupational Pension Schemes (Investment) Regulations 2005, SI 2005/3378, reg 4 s 6 <<https://www.legislation.gov.uk/ukxi/2005/3378/regulation/4>> accessed 17 February 2025.

⁷⁴² US Congress, House of Representatives, *Conference Report on HR 2, Employee Retirement Income Security Act of 1974*, HR Rep No 93-1280, 93rd Congress, 2nd session (1974) <<https://original-ufdc.uflib.ufl.edu/AA00024841/00002/1767x>> accessed 17 February 2025.

⁷⁴³ Davis (n 751) 194.

⁷⁴⁴ The Occupational Pension Schemes (Investment) Regulations 2005, SI 2005/3378, reg 4 ss (2)–(3).

⁷⁴⁵ Ruth Goldman, 'The Development of the 'Prudent Man' Concept in Relation to Pension Schemes' (2000) 5 *Pensions: An International Journal* 219.

⁷⁴⁶ *ibid.*

⁷⁴⁷ Diane Del Guercio, 'The Distorting Effect of the Prudent-Man Laws on Institutional Equity Investments' (1996) 40(1) *Journal of Financial Economics* 31.

⁷⁴⁸ The Occupational Pension Schemes (Investment) Regulations 2005, SI 2005/3378, reg 4 s 6.

model is to develop explicit regulatory guidelines that clarify when ESG issues should be disclosed based on their expected impact on financial performance, regardless of how much the individual investor perceives this information.⁷⁴⁹ For example, the FCA Handbook ESG⁷⁵⁰ provides a framework for determining when sustainability issues become essential, reducing disparities in disclosures and helping investors, both individuals and organisations, to more accurately assess sustainability-related risks.

One possible solution to enhancing disclosures is to establish minimum percentages of substantive transactions that warrant disclosure, as in some global systems. According to the OECD Corporate Governance Factbook 2021,⁷⁵¹ many countries are adopting this approach to ensure minimal disclosure of material information. For example, some financial markets require disclosure of any transactions that exceed a certain percentage of the company's total assets or revenues, to ensure that investors are provided with sufficient information when making their decisions. Although this approach may be effective in identifying material financial disclosures, it may not be sufficient for non-financial sustainability disclosures, given the difficulty of measuring the direct financial impact of certain environmental and social factors. Instead, it may be useful to adopt a more integrated approach that takes into account the financial and reputational risks associated with sustainability issues. The UK model can be utilised, with mandatory climate risk disclosure imposed in accordance with the standards of the Task Force on Climate Financial Disclosures (TCFD), which is transformed to IFRS 2,⁷⁵² providing clear guidance for companies on how to assess the substance of ESG issues in the context of their financial operations. This model, as claimed by Krueger et al,⁷⁵³ helps reduce the disparity of disclosures between listed companies, contributing to a higher level of transparency and giving investors more accurate information to make their investment decisions.

In addition, a phased approach to ESG disclosure can be developed, so that large companies are obliged to disclose some basic sustainability indicators, while allowing smaller companies to make disclosures voluntarily according to their operational capabilities. The UK has adopted a similar approach, as Companies Act 2006 (CA 2006)⁷⁵⁴ imposing mandatory disclosure on large companies according to the International Sustainability Standards Board (IFRS 2) standards, while giving smaller firms greater flexibility to adhere to these standards. This approach allows for

⁷⁴⁹ Goldman (n 758).

⁷⁵⁰ Financial Conduct Authority, FCA Handbook: ESG <<https://www.handbook.fca.org.uk/handbook/ESG/2/1.html>> accessed 17 February 2025.

⁷⁵¹ OECD, OECD Corporate Governance Factbook 2021 (2021) <<https://www.oecd.org/corporate/corporategovernance-factbook.htm>> accessed 15 February 2025.

⁷⁵² Task Force on Climate-related Financial Disclosures (TCFD), *Final Report* (FSB TCFD, 2023) <<https://www.fsb-tcf.org/>> accessed 17 February 2025.

⁷⁵³ Krueger and others (n 28) 5.

⁷⁵⁴ CA 2006, s 414C(7).

progressive application of disclosures, enabling companies to adapt to new requirements without unnecessary regulatory burdens.

Based on the foregoing, it is clear that determining the material significance of ESG disclosures in the Saudi market continues to face challenges related to the absence of a clear regulatory framework, and the high reliance on companies' appreciation of the level of materiality of non-financial information. Developing a clearer and more comprehensive regulatory framework that leverages the UK experience in determining dynamic materiality is one effective solution to enhance market transparency and integrate governance and sustainability standards in the Saudi stock market. By improving regulatory guidance, developing a phased approach to disclosure and strengthening legal accountability, the quality of disclosures can be improved, and a higher level of consistency and reliability can be achieved in listed companies' reports.

5.3. Enhancing Saudi ESG Disclosures Approach

5.3.1. The Voluntary Approach

The results of the analysed sample in Chapter 4⁷⁵⁵ showed that the level of voluntary disclosure of ESG issues among companies listed on the Saudi stock market remains limited and insufficient in many industries, reflecting weak internal and external incentives for such disclosures. These findings are consistent with a study by Syed et al,⁷⁵⁶ which found that some aspects of social and environmental performance are positively associated with corporate financial performance, but also revealed weak commitment by Saudi companies to social and environmental responsibility disclosures. The study explained that few companies report on their social responsibility, and these disclosures are often unregulated within financial reports, reflecting the absence of clear regulatory frameworks or incentives for such disclosures. It also noted that companies that prepare their reports in Arabic often do not include data on social or environmental performance, indicating that these issues have not yet become a priority in Saudi market disclosure practices.

This reality reflects a challenge in the effectiveness of voluntary disclosures, as companies tend not to prioritize ESG issues unless there is a legal obligation or regulatory risk that may lead to accountability. This is not a problem confined to the Saudi market, but a common phenomenon in many markets that rely on voluntary disclosures, according to the results of conducted studies by Chung et al,⁷⁵⁷ and Aghamolla and An.⁷⁵⁸ In this regard, the weak role of institutional shareholders in the

⁷⁵⁵ See sec 4.13.3. Findings 186-190.

⁷⁵⁶ Syed and others (n 39) 8.

⁷⁵⁷ Ricky Chung, Lyndie Bayne and Jacqueline Birt, 'Determinants of ESG Disclosure among Listed Firms under Voluntary and Mandatory ESG Disclosure Regimes in Hong Kong' (2024) 25(4) *Journal of Applied Accounting Research* 812.

⁷⁵⁸ Aghamolla and An (n 603) 127.

Saudi market is an additional factor limiting the development of disclosures, as their ownership of companies is still limited compared to individual investors, by about 41% of total traded assets in the Saudi Capital Market, according to the CMA annual report 2023.⁷⁵⁹ Thus, the institutional pressure to push companies to adopt stronger disclosure standards remains weak, as opposed to markets characterized by a strong presence of institutional investors capable of placing regulatory and financial pressure on companies to promote governance and sustainability practices.

Under voluntary disclosure requirements, companies rely on their own estimates of what to disclose, resulting in a significant discrepancy in the level of reporting and limiting the comparability of data between companies, which may affect investors' and stakeholders' ability to accurately assess environmental and social risks. This problem reflects a global challenge associated with the absence of a standard for ESG disclosures which this study addressed in Chapter 2.⁷⁶⁰ The World Economic Forum (WEF) noted that there are approximately 600 different frameworks and benchmarks used by companies, resulting in information discrepancies and difficulty in verifying them. Some companies rely on the Global Reporting Initiative (GRI) which provides guidance on sustainability reporting, while others resort to sustainability accounting standards (SASB) which focus on disclosures with direct financial impact, resulting in a fundamental difference in the quality of the data provided. As a result, investors and even investors have difficulty assessing environmental and social risks in a uniform manner, especially given the disparity between companies in choosing disclosure criteria. The absence of a binding regulatory framework weakens the reliability of reports and reduces their reliability in making accurate investment decisions, reinforcing the need for a more structured model that ensures a higher level of consistency and transparency in environmental and social disclosures.

5.3.2. Binding Rules Approach

In light of the challenges associated with the voluntary approach to disclosures, it becomes necessary to examine the effectiveness of the mandatory approach in improving transparency and strengthening companies' adherence to ESG standards. Saudi Arabia's governance approach relies on binding rules imposed by the CMA,⁷⁶¹ making it different from principle-based models such as the UK “comply or explain” approach. The CMA’s Corporate Governance Regulation (CG Regulation) is designed according to a mandatory approach that requires listed companies to comply fully with the rules governing governance practices, regardless of any justification provided by companies for non-compliance. As a result, companies that fail to comply with the rules will be held accountable and subject to regulatory penalties by the CMA. This binding model reflects a trend towards greater discipline and transparency in the Saudi stock

⁷⁵⁹ CMA Annual Report 2023 <<https://cma.org.sa/en/ResearchAndReports/Reports/Pages/default.aspx>> accessed 25 Feb 2025.

⁷⁶⁰ See sec 2.5.2. Challenges of Implementing ESG Principles in Business and Investment 29-35.

⁷⁶¹ CMA, Corporate Governance Regulation 2023.

market, where adherence to governance standards is not left to the companies' discretion, but is imposed by clear and enforceable regulations. The application of binding rules in governance is one of the factors that have contributed to enhancing confidence in the Saudi stock market, especially with the expansion of companies' inclusion and diversification of sources of finance under Vision 2030.⁷⁶²

The adoption of the CG Regulation with binding rules was not only a strictly regulatory step, but also part of a broader strategy aimed at improving the investment environment in the Saudi market and enhancing its position in global financial markets.⁷⁶³ This trend has been one of the key steps taken by the Saudi CMA to achieve global index accession standards such as MSCI⁷⁶⁴ and FTSE, as part of its efforts to apply international best practices, including the reform of the market regulatory framework to offer stronger protection to investors.⁷⁶⁵ According to the CMA,⁷⁶⁶ the CG Regulation was amended as part of these reforms, contributing to the inclusion of the Saudi market on the follow-up list of emerging market indices (MSCI) and (FTSE Russel) in 2017. This reality raises questions about the most effective model for promoting disclosure practices in Saudi Arabia. While the mandatory approach has proven successful in traditional aspects of governance, its application to environmental and social disclosures may require a reassessment of its relevance, especially given the challenges faced by companies in integrating sustainability standards into their operational processes. Chapter 4⁷⁶⁷ also showed that companies listed on the Saudi stock market face operational and technical challenges associated with disclosure requirements, including lack of specialised expertise, high compliance and disclosure costs, and the potential impact of these obligations on listing decisions. Some studies suggest that firms may avoid markets that impose stringent disclosure requirements, as in some European markets,⁷⁶⁸ which may lead smaller or less profitable companies to prefer less stringent regulatory environments.

Thus, the main challenge facing the Saudi CMA is to strike a balance between promoting environmental and social disclosures and governance and avoiding regulatory burdens that may result in companies reluctant to list or reduce their voluntary commitments to sustainability. As demonstrated in Chapter 4,⁷⁶⁹ the costs of complying with ESG requirements may be a determining factor in listing decisions,

⁷⁶² Abdullah Almoqbel, Mohammed Almuzaini and Saleh Alyahyan, 'Benefits of the Saudi Stock Market Joining Global Indexes' (2017), King Saud University <<https://faculty.ksu.edu.sa/sites/default/files/mwshrt.pdf>> accessed 18 Feb 2025.

⁷⁶³ *ibid.*

⁷⁶⁴ Morgan Stanley Capital International (MSCI), MSCI Saudi Arabia indexes. See: <<https://www.msci.com/msci-saudi-arabia-indexes>> accessed 18 Feb 2025.

⁷⁶⁵ Saudi Press Agency (SPA), 20 June 2017 <<https://www.spa.gov.sa/w432097>> accessed 18 February 2025.

⁷⁶⁶ *ibid.*

⁷⁶⁷ See sec 4.12.3. Technical Challenges and Companies' Desire to be Listed on the Tadawul Stock Market 138-139.

⁷⁶⁸ Bessler and others (n 663) 137.

⁷⁶⁹ See sec 4.12.3. Technical Challenges and Companies' Desire to be Listed on the Tadawul Stock Market 138-139.

reinforcing the need for a progressive disclosure model that takes into account differences between firms' size and financial resources, while maintaining an acceptable level of transparency and accountability. This is already the approach that has been applied regarding the mandatory rules of the Corporate Governance Regulation on SMEs listed on the Saudi Tadawul parallel market (Nomu). The rules of the CG Regulation as stated in Article 2⁷⁷⁰ apply to them voluntarily, giving these companies greater flexibility compared to those listed in the main market, which comply mandatorily with all CMA CG rules.

However, the breadth of the concept of ESG disclosures, as discussed in Chapter 2 of this study,⁷⁷¹ makes it complicated to impose uniform mandatory standards for all companies. Sustainability standards vary according to industries and sectors, which means that requiring all companies to disclose according to a standardized model may not be suitable for all cases. For example, the energy sector may have different priorities in environmental disclosure compared to the financial services sector or the industrial sector. Therefore, a more flexible approach that takes into account sector differences and corporate size may be more effective, rather than imposing strict mandatory regulations that are inconsistent with the nature of all listed companies' activities. Accordingly, the challenge for policymakers in the Saudi stock market lies not only in the need to compel disclosures, but also in how to balance compliance with flexibility.

5.3.3. Comply or Explain Approach

While full compliance by listed companies with governance law can be a positive indicator in the eyes of the market, from a corporate governance perspective, it may not always be the best approach for all companies subject to code conditions.⁷⁷² Departing from some of the Code's provisions allows companies to be given sufficient space to manage themselves more effectively.⁷⁷³ The “comply or explain” approach therefore gives public companies the flexibility to prepare reports, allowing them, where appropriate, to provide explanations rather than strict compliance with specific management standards. This approach is useful for taking into account corporate differences in their sizes, sectors and circumstances, and it is therefore difficult to apply a “one size fits all”⁷⁷⁴ approach. However, this approach carries certain risks for environmental, social and cultural governance. One of the main risks is that companies may benefit from being able to provide explanations to avoid full disclosure of ESG information. This may ignore a duty to disclose important information or involve an

⁷⁷⁰ Corporate Governance Regulations 2023. art 2(b).

⁷⁷¹ See sec 2.2. Definitions of ESG Pillars 15-23.

⁷⁷² European Parliament, ‘Resolution of 29 March 2012 on a Corporate Governance Framework for European Companies’ (2011/2181(INI)).

⁷⁷³ *ibid.*

⁷⁷⁴ Shuangge Wen, *Shareholder Primacy and Corporate Governance: Legal Aspects, Practices and Future Directions* (Routledge, 2013) 128.

attempt to hide sensitive information from stakeholders and regulators.⁷⁷⁵ There is also the possibility that companies will fail to provide sufficient or false explanations, reducing the effectiveness of detection.⁷⁷⁶ In the UK, regulatory reports have shown that the lack of oversight powers of the FRC or any other supervisory authority makes it difficult to assess the companies' commitment to governance principles. Kingman Audit 2018⁷⁷⁷ noted that many companies use a “comply or explain” approach to provide inaccurate or insufficient justification for non-compliance, resulting in poor disclosure of environmental and social management issues. Vague and insufficient explanations from companies reduce transparency and open the door to “greenwashing”, where companies provide misleading information about their commitment to sustainability practices.

The success of the “comply or explain” approach requires an effective contribution from institutional investors who play a pivotal role in overseeing companies and evaluating the quality of their disclosures. Chapter 3⁷⁷⁸ addresses this role, explaining that UK institutional investors investing on behalf of savers,⁷⁷⁹ such as pension funds and investment fund managers, have a direct impact on corporate policies, helping to improve governance practices and enhance transparency. In contrast, the situation in the Saudi market varies, with individual investors controlling a large proportion of the ownership of listed companies, while institutional investors' ownership remains limited compared to advanced financial markets, as discussed in the results of the study.⁷⁸⁰ As a result, there is insufficient pressure from institutional shareholders to urge companies to provide accurate and transparent explanations for non-compliance. This means that if the “comply or explain” approach is applied in the Saudi market; it may be difficult to ensure the quality of disclosures without effective supervision by institutional investors.

The FRC noted in its 2021⁷⁸¹ report on improving the quality of “comply or explain” reporting that high-quality interpretations of non-compliance were rare, with only four high-quality cases of interpretation found out of the 74, while the remaining cases of explanations were inadequate or not given at all,⁷⁸² indicating that there is

⁷⁷⁵ George Hadjikyprianou, ‘The Principle of ‘Comply or Explain’ Underpinning the UK Corporate Governance Regulation: Is There a Need for a Change?’ (2015) 7(81) *Corporate Law: Corporate Governance Law Journal*.

⁷⁷⁶ *ibid.*

⁷⁷⁷ John Kingman, *Independent Review of the Financial Reporting Council (Kingman Audit)*, *Final Report* (18 December 2018) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/765622/frc-independent-review.pdf> accessed 19 February 2025.

⁷⁷⁸ See sec 3.8.12. UK's Principle-Based Approach to Corporate Governance 89-93.

⁷⁷⁹ Financial Reporting Council (FRC), UK Stewardship Code archive <<https://www.frc.org.uk/library/standards-codes-policy/stewardship/archive/>> access: 19 Feb 2025.

⁷⁸⁰ See sec 5.2.1.3. Challenges and Potential Solutions of Determining Materiality in ESG Disclosures 195-198.

⁷⁸¹ Financial Reporting Council, *Improving the Quality of ‘Comply or Explain’ Reporting* (FRC, 2021) 6 <https://media.frc.org.uk/documents/Improving_the_Quality_of_Comply_or_Explain_Reporting.pdf> accessed 25 Feb 2025.

⁷⁸² CFA Institute, ‘Survey of CFA Institute Members on Latest ESG Matters’ (2021) <<https://www.cfainstitute.org/>> accessed 28 March 2024.

considerable room for improvement in this aspect of reporting. The 2021 FRC report suggests that there should be stricter oversight by regulators of the quality of explanations and disclosures provided by companies.⁷⁸³ This oversight can include a regular review of disclosures, and provides greater guidance for companies that help clarify how to provide justified and appropriate explanations. This would enhance the credibility of disclosures and ensure that companies do not use the flexibility offered by the “comply or explain” approach to evading transparency.

Thus, the main challenge facing the Saudi CMA is to strike a balance between promoting ESG disclosures and avoiding regulatory burdens that may result in companies reluctant to include or reduce their voluntary sustainability commitments. As addressed in chapter 4,⁷⁸⁴ the costs of complying with environmentally sound management requirements may be critical for decision-making on listing, reinforcing the need for a progressive disclosure model that takes into account differences between companies' size and financial resources, while maintaining an acceptable level of transparency and accountability. This is already the approach applied to SMEs listed in the Saudi parallel market “Nomu”, where the CG Regulation rules voluntarily apply to Nomu companies,⁷⁸⁵ giving them greater flexibility compared to those listed in the main market, which compulsorily complies with all CMA CG rules.

5.3.4. Recommended Approach to ESG Disclosures in the Saudi Capital Market

Analysis of different forms of disclosure shows that each approach has its advantages and challenges, and the effectiveness of any disclosure system depends on each market's regulatory and economic context. In Saudi Arabia, voluntary disclosures remain insufficient to ensure a high level of transparency, as the results of a sample study that highlighted the weak commitment of companies on the Saudi stock market to voluntary disclosures and the absence of a clear mechanism to ensure their quality. In contrast, the mandatory approach, while able to promote compliance, may face application difficulties due to the breadth of the ESG concept and its differing standards between sectors, making the development of a uniform mandatory framework a complex regulatory challenge. Accordingly, adopting a “comply or explain” model, with effective regulatory control over the quality of disclosures, appears to be the most balanced option for the Saudi market. This approach gives companies flexibility in disclosure, but at the same time requires legislative supervision to ensure that it is not exploited to evade transparency. Given the weak influence of institutional investors in the Saudi market, relying on their role in monitoring disclosures may not be sufficient,

⁷⁸³ Financial Reporting Council, Improving the Quality of ‘Comply or Explain’ Reporting (FRC, 2021) 6<https://media.frc.org.uk/documents/Improving_the_Quality_of_Comply_or_Explain_Reporting.pdf> accessed 25 Feb 2025.

⁷⁸⁴ See sec 4.12.3. Technical Challenges and Companies' Desire to be Listed on the Tadawul Stock Market 138-139.

⁷⁸⁵ Corporate Governance Regulations 2023, art 2(b).

necessitating the CMA's intervention by establishing clear standards for the quality of explanations, and applying regulatory mechanisms to ensure that the explanations provided are justified and objective and not merely a means of circumventing the required disclosures.

Also, the concept of disclosure of material information in the Saudi stock market is based on the principle of a prudent investor, who has sufficient ability and knowledge to assess this information. ESG disclosures also require a certain level of specialized understanding, which may not be available to the majority of individual investors who make up the largest proportion of the Saudi stock market. Thus, leaving such disclosures without regulatory control could lead to a discrepancy in the quality of the information provided, reducing its reliability and limiting its ability to effectively guide investors' decisions. Similar to the UK experience, which, while embracing the principle of “comply or explain”, has mandated the disclosure of certain environmental and social aspects through Companies Act 2006 (CA 2006),⁷⁸⁶ Saudi Arabia can take a similar approach. Mandatory disclosure of national priority environmental issues, such as those related to Saudi Green Initiative and Saudi Arabia's plans to reach zero emissions neutrality by 2060,⁷⁸⁷ as well as mandatory disclosure of social policies related to job resettlement, can be imposed as an essential part of corporate social responsibility in Saudi Arabia. Just as reducing environmental emissions is a national goal, enhancing citizens' participation in the labour market is a fundamental social goal that companies need to disclose to ensure a balance in the labour market. The proposed approach therefore combines regulatory rigour in national priority environmental and social aspects with flexibility in other aspects, with effective oversight mechanisms that ensure the credibility of the disclosures made. Through this approach, transparency and accountability can be enhanced in the Saudi market, while reducing unnecessary regulatory burdens, enhancing the market's attractiveness to investors and contributing to national sustainability targets.

5.3.5. Greenwashing Risk in the Context of “Comply or Explain”

Approach

In the context of adopting a “comply or explain” approach to ESG disclosures in the Saudi capital market, serious concerns about the possibility of greenwashing arise, as some companies may take advantage of the flexibility offered by this approach to provide formal disclosures without genuine adherence to sustainability standards.⁷⁸⁸ Allowing companies to choose between compliance or interpretation may lead to inaccurate or misleading explanations about their compliance with environmental and

⁷⁸⁶ CA 2006, s 414C(7).

⁷⁸⁷ Saudi Vision 2030, Saudi Green Initiative, (Launched in 2021) <<https://www.vision2030.gov.sa/en/explore/projects/saudi-green-initiative>> accessed 2 Mar 2025.

⁷⁸⁸ B Ingman, ‘How Weak and Misguided Enforcement is Greenlighting Greenwashing’ (2023) 38(4) *Journal of International Banking Law and Regulation* 6.

social standards, which may create an opaque environment that impedes the achievement of these disclosures' objectives. In the absence of clear standards and strict regulatory mechanisms, some companies may amplify their environmental and social obligations to attract investors, making greenwashing a threat to the credibility of the Saudi stock market and posing additional challenges for regulators to ensure accurate disclosures.

This challenge is linked to a growing global interest in sustainable finance, with many companies seeking to improve their environmental and social image for investors.⁷⁸⁹ However, some of these companies resort to greenwashing, a concept that refers to making exaggerated or misleading claims about environmental and social practices in order to achieve commercial gains without real changes being implemented.⁷⁹⁰ In other words, some organizations may deliberately market themselves as committed to sustainable practices, while their actual activities remain inconsistent with sustainability principles, misleading investors and stakeholders seeking responsible investments.⁷⁹¹ A notable example is green bonds, which, while an important financing tool to support environmental projects, are frequently questioned about their actual conformity with sustainability standards.⁷⁹²

A recent study conducted by Ingman⁷⁹³ confirmed that the lack of clarity of tariffs and criteria for sustainable financing increases concerns about greenwashing, as this phenomenon remains one of the main obstacles to the expansion of sustainable financial products. The absence of uniform standards and rigorous implementation mechanisms of ESG principles increases the risk of greenwashing. For this reason, regulatory efforts, such as; CFA Handbook ESG Guidance⁷⁹⁴ and European Bank Authority's (EBA) Final Guidelines on the management of ESG risks 2025⁷⁹⁵, are aimed at enhancing transparency in this area and guiding investors towards responsible and reliable investment options.

Despite these efforts, differing experiences and capabilities between companies remain one of the most significant challenges to the application of standardized disclosure standards, with research indicating that lack of knowledge and technical ability to prepare ESG reports remains a major impediment to some companies. In the

⁷⁸⁹ Yang Z and others, 'Greenwashing Behaviours: Causes, Taxonomy and Consequences Based on a Systematic Literature Review' (2020) 21(5) *Journal of business economics and management* 1486.

⁷⁹⁰ Silvio de Freitas Netto, Marcos Sobral, Ana Ribeiro and Gleibson da L Soares, 'Concepts and Forms of Greenwashing: A Systematic Review' (2020) 32 *Environmental Sciences Europe* 19.

⁷⁹¹ Béatrice Parguel, Florence Benoît-Moreau and Fabrice Larceneux, 'How Sustainability Ratings Might Deter 'Greenwashing': A Closer Look at Ethical Corporate Communication' (2011) 102 *Journal of Business Ethics* 15.

⁷⁹² International Capital Markets Association (ICMA), 'Green Bond Principles (GBP)' (June 2022) <<https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/>> accessed 2 Mar 2025.

⁷⁹³ Ingman (n 801) 203.

⁷⁹⁴ CFA Handbook ESG <<https://www.handbook.fca.org.uk/handbook/ESG/1/?view=chapter>> accessed 2 Mar 2025.

⁷⁹⁵ European Banking Authority (EBA), *Final Guidelines on the Management of ESG Risks* (January 2025) <<https://www.eba.europa.eu/activities/single-rulebook/sustainable-finance/guidelines-management-esg-risks?version=2024#activity-versions>> accessed 2 Mar 2025.

absence of effective implementation, companies can make false claims about sustainability without facing clear legal penalties, which means that investors and stakeholders are responsible for paying the cost of such misconduct.⁷⁹⁶ For example, when executives are not held accountable for their greenwashing decisions, shareholders bear losses resulting from any negative impact on a company's reputation and financial performance.⁷⁹⁷ These misconduct practices may lead to financial crises and governance scandals,⁷⁹⁸ reinforcing the need for stricter regulatory mechanisms to ensure the credibility of ESG disclosures. Policymakers should therefore strengthen regulations that impose greater transparency on companies, with executives held individually accountable for any misleading practices.⁷⁹⁹ International experience provides examples of how to address this problem. A recent study conducted by Leung, Wan and Wong,⁸⁰⁰ on the Hong Kong Stock Exchange showed that companies involved in greenwashing faced negative repercussions, becoming less able to reissue green bonds due to a loss of investor confidence, affecting their reputation and financial performance. This suggests that enhanced transparency can lead to self-censorship mechanisms, whereby markets and investors themselves hold uncommitted companies accountable, requiring a supportive regulatory environment that encourages the adoption of stricter standards in ESG disclosures.

In order to ensure the effective application of the “comply or explain” approach in Saudi Arabia, and to address the problem of greenwashing to enhance the credibility of ESG disclosures in the Saudi market, it is necessary to adopt regulatory solutions that ensure transparency and prevent companies from providing misinformation about their sustainable practices. A key solution is to issue a local Saudi ESG disclosure standard, inspired by international best practices such as International Sustainability Standards Board (ISSB)⁸⁰¹ and Global Reporting Initiative (GRI)⁸⁰² standards. This standard should be adapted to the Saudi economic and regulatory context, ensuring clear corporate disclosure requirements and reducing confusion about the data to be

⁷⁹⁶ Ingman (n 801) 203.

⁷⁹⁷ *ibid.*

⁷⁹⁸ Sue Jaffer and Nicholas Morris, ‘Lessons from the Financial Crisis and Other Banking Scandals’ (2019) 36 *Law Context: A Socio-Legal Journal* 47; Jed Rakoff, ‘The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?’ (2014) 9 *The New York Review* 7.

⁷⁹⁹ Ingman (n 801) 203; Zhen Yu, Xiuling Li and Lang Yu, ‘Green Financial Policies and Corporate ESG Reporting “Greenwashing”: Empirical Evidence from Chinese Listed Companies’ (2023) SSRN 4446265.

⁸⁰⁰ Victor Leung, Wilson Wan and Joe Wong, ‘The Shade of Green: Greenwashing in The Corporate Green Bond Markets’ (2023) Hong Kong Institute for Monetary and Financial Research (HKIMR) Research Paper WP No. 01/2023, <http://dx.doi.org/10.2139/ssrn.4342360>.

⁸⁰¹ International Sustainability Standards Board (ISSB), ‘The ISSB builds on the work of market-led investor-focused reporting initiatives, including the Climate Disclosure Standards Board (CDSB), the Task Force for Climate-related Financial Disclosures (TCFD), the Value Reporting Foundation’s Integrated Reporting Framework and industry-based SASB Standards, as well as the World Economic Forum’s Stakeholder Capitalism Metrics’ <<https://www.ifrs.org/groups/international-sustainability-standards-board/>> accessed 2 March 2025.

⁸⁰² Global Reporting Initiatives (GRI), ‘GRI (Global Reporting Initiative) is the independent, international organization that helps businesses and other organizations take responsibility for their impacts, by providing them with the global common language to communicate those impacts’ <<https://www.globalreporting.org/about-gri/>> accessed 2 March 2025.

disclosed. Moreover, a unified Saudi standard will help investors make accurate comparisons between companies' performance in terms of their commitment to sustainability, helping them make their investment decisions.

In addition, the Saudi CMA in the endeavour to reduce greenwash risk can enhance the credibility of ESG disclosures by applying mandatory external audit to reports, similar to the external audit of financial reports. Under this procedure, companies listed in the Saudi stock market are required to conduct an independent audit by certified audit institutions to ensure the accuracy of the information provided. External audit reduces the likelihood of misleading investors through inaccurate or exaggerated data,⁸⁰³ as the external auditor is highly respected within the framework of corporate governance, given its independence compared to the internal audit.⁸⁰⁴ The external auditor is appointed by shareholders and not by management, which means it is an independent entity or certified audit company appointed in accordance with legal requirements to audit the entity's financial statements and to give an objective opinion on their accuracy and transparency, as defined by OECD.⁸⁰⁵ Theoretically, the role of the external auditor is widely recognized as indispensable for ensuring effective corporate governance, directly contributing to enhancing corporate accountability and transparency, thus helping to reduce the agency's problems resulting from conflicts of interest between management and shareholders.⁸⁰⁶ This role has contributed to enhancing shareholders' and other stakeholders' confidence in the financial statements,⁸⁰⁷ which could be extended to ESG reports if mandatory external audit of such disclosures is adopted.

Applying this solution in the Saudi market will ensure that companies not only provide formal reports on their sustainability, but will verify the accuracy and reliability of these reports by independent entities, which will reduce greenwashing, establish confidence in the companies' adherence to ESG standards, and drive towards a more sustainable and transparent investment environment. This approach is also in line with the Kingdom's Vision 2030, which focuses on enhancing corporate governance and increasing transparency in the financial market,⁸⁰⁸ making Saudi Arabia a more attractive investment destination at the regional and international levels.

⁸⁰³ James Alabede, 'The Role, Compromise and Problems of the External Auditor in Corporate Governance' (2012) 3(9) *Research Journal of Finance and Accounting* 114.

⁸⁰⁴ *ibid.*

⁸⁰⁵ OECD, *Glossary of Statistical Terms* (2008) 195, s.v. 'External Auditors'.

⁸⁰⁶ Alabede (n 816).

⁸⁰⁷ *ibid.*

⁸⁰⁸ Financial Sector Development Program, <<https://www.vision2030.gov.sa/en/vision-2030/vrp/financial-sector-development-program/>> accessed 19 March 2025.

5.4. Legal Transplant Limits: Challenges of Applying the UK Model for Disclosure in the Saudi Market

The adoption of the “comply or explain” model conveyed from the UK experience raises potential limitations about its relevance to the Saudi Arabia's legal, economic and social context, especially given the challenges that may arise from the transfer of laws and regulatory practices between States. The legal transplant methodology has been widely criticized by jurists and legal practitioners. Some jurists argue that the ability of the importer's law to adapt to the receiving society is influenced by several factors,⁸⁰⁹ and should, therefore, be viewed with caution.⁸¹⁰ Among the factors influencing the adaptation of the law transferred in the country of transplantation, for example, is the existence of a local need and demands for the law, and the response of the lawmakers to that demand. Added to these factors is the flexibility of the rules - the extent to which the rules are mandatory - which allows recipients in the “transplant country” to adapt its rules to the specific needs of their communities,⁸¹¹ or else they fear that the transferred law will impede local economic development rather than reinforce it,⁸¹² or even repel the act of law implanted with the purpose for which it was set.⁸¹³

In this context, Montesquieu⁸¹⁴ argued that political and civil laws must be the case of each nation, so that the laws must be adapted in such a way as to suit the people for whom they are made, that it is very unlikely that the people of a nation fit the laws of another country. Montesquieu also supposes that it would be a great historical coincidence if the laws of one country were appropriate for the people of another. It is understood from Montesquieu's opinion that he believes that the law cannot be stripped from its social and economic context for a country, so the habits of society, the identity of its members, and its sources of economic income are an integral part of the formation of the legal system in it. Thus, the process of legal farming is a form of unrealistic optimism. Thus, the success of a new legal model requires alignment with the unique characteristics of the State to which it is transferred, which requires consideration of how to balance the utilisation of international experiences with the requirements of the domestic environment. Scholars, such as Berkowitz, Pistor and Richard⁸¹⁵ also support Montesquieu's view, arguing that despite globalization and the great convergence of

⁸⁰⁹ Ian Ramsay and Petra Mahy, ‘Legal Transplant and Adaptation in a Colonial Setting: Company Law in British Malaya’ (2014) *Singapore Journal of Legal Studies* 123.

⁸¹⁰ Pierre Legrand, ‘The Impossibility of Legal Transplant’ (1997) 4(2) *Maastricht Journal of European and Comparative Law* 111.

⁸¹¹ Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp and Mark West, ‘Evolution of Corporate Law: A Cross Country Comparison’ (2002) 23(4) *University of Pennsylvania Journal of International Law* 791.

⁸¹² Rob McQueen, ‘Company Law as Imperialism’ (1995) 5(2) *Australian Journal of Corporate Law* 187; Rob McQueen, *A Social History of Company Law, Great Britain and the Australian Colonies 1854–1920* (1st edn, Routledge 2016). *Supra* note 7; cf Lipton, *supra* note 7.

⁸¹³ Umakanth Varottil, ‘The Evolution of Corporate Law in Post-Colonial India: From Transplant to Autochthony’ (2016) 31 *Am. U. Int'l L. Rev.* 253.

⁸¹⁴ Charles de Montesquieu, *The Spirit of Laws* (Charles Nugent tr, Halcyon Press Ltd 2010) 1.

⁸¹⁵ Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard, ‘The Transplant Effect’ (2003) 51 *American Journal of Comparative Law* 163.

societies in the world today, however, convergence has often been confined to the law of books, while the performance and effectiveness of legal institutions still differ fundamentally from one country to another. Differences in institutional structure, legal culture and society's adherence to laws are factors that may render the application of imported laws ineffective if they are not adequately adapted.

On the contrary, there are scholars' opinions that stand in a middle position on the methodology of legal implantation. There is no doubt that the element of relativism imposed by the special relationship of the law to its social and cultural environment must be taken into account when applying the comparative method and before the process of transmitting the laws.⁸¹⁶ However, the claim by some scholars that legal transplants are impossible is an overstatement of cultural diversity. Because it contradicts the evidence of history, and it contradicts the modern trends towards legal integration in some regions of the world.⁸¹⁷ In other words, although countries are diverse and have different cultures, there are common needs among people that enable them to benefit from each other's experiences without prejudice to their identity and their social, economic, and political interests. In this context, Jhering's opinions were and still are one of the most important opinions in favour of transferring laws and benefiting from the experiences of countries with each other. Jhering in 1852⁸¹⁸ warned that if science was still hesitant about putting the idea of transnationalism next to the idea of nationality and its equality, it would never be able to understand the world in which it lived. He believes that the life of nations is not isolated side by side, but rather is like the life of individuals within the borders of one state, a common life; for mutual communication, giving, and borrowing.⁸¹⁹ In this sense, the important challenge for legal decision makers lies in how to adapt these laws to the recipient State's regulatory, economic and cultural characteristics.

In a study by Berkowitz, Pistor and Richard⁸²⁰ the determinants of effective legal institutions were analysed using data from 49 countries. The study showed that the way in which the law was first implanted and received is a more important influence than the provision of law from countries belonging to the same legal family -common law or civil law-. Countries that have taken steps to smooth the transfer of foreign laws to adapt the implanted law, and/or members of the community are already familiar with the basic principles of the implanted law, have more effective receptivity than countries that have received foreign laws without any similar preliminary steps. Adaptation is defined as “the ability of the country to make meaning of the imported law. Adaptation does not necessarily require a significant change of the implanted law, but an informed

⁸¹⁶ George Mousourakis, 'Legal Transplants and Legal Development: A Jurisprudential and Comparative Law Approach' (2013) 54(3) *Acta Juridica Hungarica*, 219.

⁸¹⁷ *ibid.*

⁸¹⁸ Konrad Zweigert and Kurt Siehr, 'Jhering's Influence on the Development of Comparative Legal Method' (1971) 19(2) *The American Journal of Comparative Law* 215.

⁸¹⁹ *ibid.*

⁸²⁰ Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard, 'Economic Development, Legality, and The Transplant Effect' (2003) 47(1) *European Economic Review* 165.

decision must be made about alternative rules”.⁸²¹ Berkowitz et al ’ argument is that in order for the law to be effective, citizens should have an incentive to implement it, and even require institutions to enforce and develop it. The conviction of legal intermediaries responsible for developing the law – e.g. judges and lawyers - in the transferred law makes them able to increase the quality of the law in a way that responds to the need in the context of their countries and societies.⁸²² In fact, the result of this study can be understood that the process of legal implantation and the transfer of foreign laws should be adapted in the local community in order to benefit from it.

The acceptance of imported laws by individuals and local communities may take a considerable period; because it is associated with a shift in traditional ideas and customs or a shift in economic policies in the country where the law is being transferred. Therefore, if a country sees that it needs to make qualitative shifts in the organization of a matter, it should study and compare in some detail the aspects of foreign laws and local laws in order to avoid conflict between the conditions of the two countries, which may lead to community members not accepting the imported law, and not believing in the importance of commitment to and development of it, to become a value-added part of the legislative system of their state. Therefore, this perception should be built by individuals that intolerant of their identity and refusal to seek help from foreign laws and consider them as a threat to the authenticity of their societies may delay their catch-up with the developments taking place in the world around them.

Based on these considerations, the adoption of the “comply or explain” model of ESG disclosures in Saudi Arabia, inspired by the UK experience, poses many challenges associated with the legal transplant methodology. In this spirit, the following sections will discuss in detail the challenges that may arise as a result of this transfer, while offering possible solutions to overcome them, ensuring a balance between enhancing disclosures and ensuring their relevance to the Saudi reality.

5.5. Proposed Solutions to Overcome ESG Disclosure Challenges

Although analysis of different regulatory models has shown that the “comply or explain” approach with the addition of strict regulatory control may be best suited to the Saudi market, its application is not without challenges. There are still legal and regulatory obstacles related to the harmonization of Saudi laws with international standards, as well as social and economic challenges affecting the extent to which companies and investors accept this approach. Furthermore, the technical and operational aspects of ESG performance measurement mechanisms make it difficult to ensure accuracy and consistency of disclosures across different sectors.

In this context, questions are raised as to the appropriateness of adopting international standards on ESG disclosures in the Saudi environment without modifying

⁸²¹ Berkowitz, (n 828) 207.

⁸²² *ibid.*

them according to domestic specificities, which is linked to the concept of legal transplant. While this methodology is important in strengthening national legislation based on other States' experiences, it faces significant constraints that should be considered,⁸²³ in particular the cultural and social challenges that render certain laws inspired by foreign regulations incompatible with the local social and cultural context, which may lead to ineffective application.⁸²⁴ International standards for ESG disclosures are often based on stakeholders' expectations in developed countries, where institutional investors and civil society play a prominent role in shaping disclosure requirements.

In contrast, these social, cultural, and environmental factors of different states, may not have the same effect in the Saudi market, which may lead to a gap in application and compliance with the international standards. In addition, disparities in legal and economic systems may be an obstacle to adopting these standards without aligning them, necessitating a more adaptive approach that takes into account local dimensions of governance and sustainability. Thus, overcoming the challenges of legal transplantation requires the development of a balanced regulatory framework that benefits from international best practices, while ensuring that it is compatible with the needs of the Saudi market and the realities of its business environment. Accordingly, this section discusses those challenges in some detail and proposes solutions derived from successful international experiences, taking into account the specific characteristics of the Saudi market, with a view to minimizing the potential negative effects of the legal transplant methodology and ensuring a smooth and effective experience in applying the proposed “comply or explain” model of ESG disclosures.

5.5.1. Aligning ESG Disclosure Standards with the Economic and Cultural Specificities of Saudi Arabia

Recognition and respect for cultural and economic diversity among States is essential when drafting legislation and policies on ESG disclosures. When laws are in line with local values and customs, compliance with them is more effective, with individuals and companies viewed as legitimate and fair legislation. In contrast, imposing standards disproportionate to the local context may lead to resistance and non-compliance, limiting their effectiveness. For example, a study by Shi and Veenstra⁸²⁵ confirmed that the impact of CSR performance on financial performance depends largely on the culture of the country in which the company operates. A recent study by Wasiuzzaman, Ibrahim and Kawi,⁸²⁶ also showed that ESG disclosure may have a significant negative impact on energy companies' profitability, reflecting the need to

⁸²³ Legrand (n 823) 207.

⁸²⁴ Ramsay and Mahy (n 822) 207.

⁸²⁵ Shi and Veenstra (n 150) 33.

⁸²⁶ Shaista Wasiuzzaman, Salihu Ibrahim and Farahiyah Kawi, ‘Environmental, Social and Governance (ESG) Disclosure and Firm Performance: Does National Culture Matter?’ (2022), *Meditari Accountancy Research* 1239.

take into account cultural dimensions when seeking to develop a single global standard for ESG. The researchers⁸²⁷ show in the study that regulators must balance the costs and benefits of establishing a global standard for disclosure, so that it is effective and acceptable according to each country's economic and social circumstances. The social aspect also plays a key role in shaping companies' response to disclosure requirements, necessitating the need to integrate communities' cultural orientations when developing sustainability strategies. Companies are expected to consider their society's national culture when analysing data and choosing strategies to gain an understanding of the factors that impact environmental and social disclosure practices. This is necessary since disclosure of information on environmental and social governance in some States may be driven by social and political pressures, while in others it may be seen as merely a non-substantive regulatory requirement. The researchers⁸²⁸ added that the need to establish a global standard for ESG disclosure aims to enhance comparability among companies in different markets, but that the application of these standards remains limited if each country's cultural and social dimension is not taken into account in developing these standards.

At the corporate strategy level, Kotler⁸²⁹ called for the concept of “glocalization”, which encourages companies to “think globally and work locally”, which means aligning brands with local preferences while leveraging international best practices. This approach helps companies enhance consumer and investor confidence, contributing to creating an enabling environment to improve voluntary compliance with ESG disclosure standards. This approach strikes a balance between strategic, tactical and operational trends, giving global brands the ability to adapt to local needs and enhance their market share.⁸³⁰ According to this concept, reconciling local culture with globalization contributes to rebuilding the relationship between global companies and local communities, where consumers prefer brands that respect their national roots as they integrate into international markets.⁸³¹

At the international level, the Paris Agreement on climate change⁸³² stressed the importance of taking national differences into account in the implementation of sustainability policies. Article 2 (2) of the Agreement⁸³³ states that sustainability objectives must be implemented in a manner that reflects the principle of equity and common but differentiated responsibilities according to each State's different national capacities. This suggests that environmental commitments should take into considerations different States' economic and social characteristics, allowing greater

⁸²⁷ *ibid.*

⁸²⁸ *ibid.*

⁸²⁹ Philip Kotler, Kevin Keller, Mairead Brady, Malcolm Goodman and Torben Hansen, *Marketing Management* (European edn, Pearson Prentice Hall 2009).

⁸³⁰ Luigi Dumitrescu and Simona Vinerean, ‘The Glocal Strategy of Global Brands’ (2010) 5(3) *Studies in Business & Economics* 147.

⁸³¹ *ibid.*

⁸³² Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) UN Doc FCCC/CP/2015/L.9/Rev.1.

⁸³³ *ibid.*

flexibility in the application of policies to ensure that sustainability goals are achieved without adversely affecting the domestic economy. This can be achieved by supporting developing countries with resources and technology to help them adapt to sustainability requirements in a manner consistent with their economic and social priorities. Article 9 of the Agreement states that developed countries should provide finance and technology to developing countries to support climate change mitigation and adaptation efforts, and encourages other States to provide such support voluntarily.

In the Saudi context, developing tiered disclosure policies is an appropriate approach to ensure a balance between sustainability and economic development. Saudi Arabia can begin by imposing mandatory standards on certain priority sectors, such as the energy sector, in line with Vision 2030 and its international commitments such as Saudi Green Initiative and plans to reduce carbon emissions by 2060⁸³⁴. At the same time, some flexibility can be allowed with regard to other social and economic aspects, giving companies sufficient space to gradually adapt to environmental and social disclosure criteria. The success of any regulatory framework for ESG disclosures depends on its adaptation to the State's economic and cultural characteristics. In Saudi Arabia, where the oil sector is a fundamental pillar of the economy, adopting stringent disclosure standards without looking at economic impacts may lead to undesirable results. Thus, a phased approach to disclosures, focusing on the most affected sectors and giving companies sufficient time to adapt, would be more effective than imposing broad commitments at once.

5.5.2. Stakeholders and Community Values

The role of stakeholders, particularly institutional investors, is central to influencing corporate policies on environmental, social and governance disclosures, contributing to a higher level of corporate oversight to ensure that they adhere to sustainable practices consistent with each country's social and economic values⁸³⁵. As discussed in previous chapter,⁸³⁶ institutional investors in developed financial markets, such as the UK, have a significant impact as a result of their large ownership of listed companies' stocks, giving them the ability to pressure boards to ensure their commitment to environmental and social disclosures. This role was addressed in Chapter 3,⁸³⁷ where the importance of institutional investors' stewardship in strengthening institutional governance was noted, particularly after the 2008 financial crisis, when this category emerged as an informal oversight tool to track companies' performance and ensure their adoption of

⁸³⁴ Saudi Vision 2030, Saudi Green Initiative Project (2021) <https://www.vision2030.gov.sa/en/explore/projects/saudi-green-initiative> accessed 3 March 2025.

⁸³⁵ René Orij, 'Corporate Social Disclosures in the Context of National Cultures and Stakeholder Theory' (2010) 23(7) *Accounting, Auditing and Accountability Journal* 868.

⁸³⁶ See sec 3.8.15. Institutional Investors and Stewardship Role 99-104.

⁸³⁷ *ibid.*

responsible practices.⁸³⁸ This role contributes to enhanced accountability, ensuring that companies' commitment to disclosures is not merely formal compliance with global standards, but adopts effective sustainability policies that directly affect their financial performance and the sustainability of their business operations.

In this context, stakeholders' collaboration with companies ensures that sustainable practices are implemented in a manner that takes into account the needs, priorities and values of communities. As noted by Khelif, Guidara and Souissi,⁸³⁹ companies operating in societies with collective cultures are more committed to stakeholder requirements than those operating in individual societies that are primarily concerned with investors' interests only. In collective societies, managers seek to maintain strong relationships with different stakeholder groups through more transparent disclosure⁸⁴⁰. According to this study, the level of disclosure in companies operating in these environments is higher than in individual societies, where the social pressures that motivate companies to effectively disclose decrease.

As Starks⁸⁴¹ pointed out, institutional investors may incorporate ESG information into their investment decisions from two different perspectives: first, on the financial consequences that corporate activities may have for investment risk and cash flow, known as value, where investment decisions aim to improve long-term financial performance by reducing risks associated with environmental and social issues. The second perspective is linked to the value aspect, where investors consider their ethical and social preferences in their investment decisions even if they are not directly related to financial performance, to ensure that their investments are consistent with the principles they believe in or are in line with their institutional mandates. In the UK, the Stewardship Code 2026 plays a key role in guiding institutional investors' actions, obliging them to take proactive positions in the oversight of corporate performance, especially regarding ESG disclosures.⁸⁴² This shows how institutional investors can be a driving force for positive change within financial markets, directly influencing companies' sustainability decisions by incentivizing them to provide accurate and transparent disclosures and imposing accounting procedures when failing to comply.

By contrast, the investment landscape in the Saudi market varies, with individual ownership controlling a large proportion of listed companies,⁸⁴³ limiting the effective

⁸³⁸ María Gallén and Carlos Peraita, 'The Effects of National Culture on Corporate Social Responsibility Disclosure: A Cross-country Comparison' (2018) 50(27) *Applied Economics* 2967.

⁸³⁹ Hichem Khelif, Achraf Guidara and Mohsen Souissi, 'Corporate Social and Environmental Disclosure and Corporate Performance' (2015a) 5(1) *Journal of Accounting in Emerging Economies* 51; Hichem Khelif, Khaled Hussainey and Imen Achek, 'The Effect of National Culture on the Association between Profitability and Corporate Social and Environmental Disclosure: A Meta-Analysis' (2015b) 23(3) *Meditari Accountancy Research* 296.

⁸⁴⁰ *ibid.*

⁸⁴¹ Starks (n 31) 6.

⁸⁴² See sec 3.8.17. The Current Situation of Institutional Investors Stewardship 105-106.

⁸⁴³ CMA, Annual Report 2023 <<https://cma.org.sa/en/ResearchAndReports/Reports/Pages/default.aspx>> accessed 25 Feb 2025.

influence of institutional investors in censoring companies' environmental and social disclosures policies. This challenge was mentioned in Chapter 3,⁸⁴⁴ where the role of institutional investors in the UK was analysed, noting that the inactive role of institutional investors could result in weak control over the quality of disclosures. This challenge opens up the possibility for some companies to make inaccurate or incomplete disclosures, leading to risks associated with the phenomenon of “greenwashing”, where companies may promote a formal commitment to environmental and social standards without implementing real strategies that support sustainability. As noted in this Chapter⁸⁴⁵ Saudi capital market regulations adopt a “prudent investor” standard for the material information of disclosures, which may not be available in an individual investor. The stakeholder theory that has been expressed,⁸⁴⁶ believes that the absence of strong institutional investors advocating the interests of the broader base of stakeholders, including society and the economy, may reduce the pressure on companies to adhere to disclosure standards, making regulatory oversight by government agencies more important to offset this lack of market control.

The Saudi Public Investment Fund (PIF) plays a pivotal role in promoting environmental, social and governance disclosures through its sustainable investment strategies, which are in line with Vision 2030 and Saudi Arabia's commitment to achieving carbon neutrality by 2060.⁸⁴⁷ As discussed in chapter 4, the development of governance frameworks that promote the principles of transparency and accountability is an essential step in improving the quality of disclosures. Based on its role as one of Saudi Arabia's largest institutional investors, the PIF imposes clear standards for environmental and social disclosures as part of its responsible investment policies,⁸⁴⁸ motivating companies to improve the quality of their reporting and adopt more realistic sustainability practices.

The PIF's influence reinforces the fact that it invests 70%⁸⁴⁹ of its assets within Saudi Arabia, making it a major investment force that can impose sustainability standards on Saudi companies. Due to this large proportion of domestic investments, the companies listed in the Saudi market seek to attract the PIF as a strategic investor, giving it greater ability to guide the standards of environmental and social disclosure and accountability within the companies in which it invests. This makes it not only an investor, but an informal regulator that pushes for improved levels of voluntary

⁸⁴⁴ See sec 3.8.17. The Current Situation of Institutional Investors Stewardship 105-106.

⁸⁴⁵ See sec 5.2.1.3. Challenges and Potential Solutions of Determining Materiality in ESG Disclosures 195-198.

⁸⁴⁶ See sec 3.6.4. Stakeholders Theory 62-64.

⁸⁴⁷ The Public Investment Fund, PIF Green Finance Framework Preamble <<https://www.pif.gov.sa/en/investors/green-finance-framework/>> accessed 1 Mar 2025.

⁸⁴⁸ *ibid.*

⁸⁴⁹ PIF, Annual Report 2023 <<https://www.pif.gov.sa/en/investors/annual-reports/>> accessed 1 Mar 2025.

disclosure and enhanced compliance with ESG standards in line with national trends and Vision 2030.

In furtherance of this trend, the PIF launched the “Green Finance Framework”,⁸⁵⁰ which continues its leading role in sustainable enterprise development in Saudi Arabia. This framework aims to channel financial resources towards sustainable environmental and social investments, contributing to financing projects that support the transition towards renewable energy, water resources management and achieving net zero emissions by 2050.⁸⁵¹ The framework is based on a set of fundamental principles, such as aligning investments with global environmental standards, promoting transparency in disclosures and developing responsible investment policies that ensure a positive impact on the economy and society. To achieve these goals, the PIF has developed several initiatives within the Green Finance Framework,⁸⁵² most notably, designing a net zero transition plan to support the Kingdom's ambition to achieve carbon neutrality by 2060, developing a responsible investment policy that obliges companies in its portfolio to achieve higher performance in environmental and social disclosures, issuance of green bonds to finance environmental projects, such as renewable energy and emissions management, and developing a voluntary carbon stock exchange platform to encourage companies to reduce their carbon footprint in line with global sustainability standards. The PIF supports these goals through innovative financing mechanisms,⁸⁵³ such as green bond issuance, the establishment of a voluntary carbon stock exchange platform and collaboration with domestic and international investors to promote a culture of responsible investment.

However, this role should not be limited to the PIF alone, but other institutional investors in the Saudi market, such as retirement funds and asset managers, should adopt a similar approach in promoting compliance with environmental and social disclosure standards. The adoption by investment institutions of PIF's green finance model would create a multiplier effect in the market, as listed companies realise that compliance with these standards is no longer merely a regulatory requirement or a desire from a single investor, but a key requirement to attract financing and institutional investments. The adoption of this approach by institutional investors contributes to a dual impact: on the one hand, it ensures that ESG disclosures are not just a formal obligation, but a fundamental criterion that determines companies' attractiveness to domestic and international investors. On the other hand, it contributes to building a stable investment environment, where compliance with ESG disclosure standards becomes a competitive advantage that enhances the companies' market value and earns them investor confidence. As discussed in Chapter 3,⁸⁵⁴ strengthening institutional investors' oversight is an effective tool to ensure voluntary compliance with

⁸⁵⁰ The Public Investment Fund, PIF Green Finance Framework (2024) <<https://www.pif.gov.sa/en/investors/green-finance-framework/>> accessed 1 Mar 2025.

⁸⁵¹ *ibid.*

⁸⁵² *ibid.*

⁸⁵³ *ibid.*

⁸⁵⁴ See sec 3.8.11.2. Effective Shareholders' Oversight of Companies Explanations, 93-95.

sustainability practices and strengthen corporate governance in accordance with international standards. However, extending the initiatives to all institutional investors in the Saudi capital market will enhance their impact, improving the level of voluntary disclosure and effective commitment to environmental and social governance practices, becoming a well-established benchmark in the domestic investment environment.

Although the PIF is an ideal model for institutional investors in embracing sustainability strategies and green investments, its nature as a sovereign fund gives it greater incentive to strengthen its role in meeting Vision 2030 targets. In contrast, other institutional investors may not enjoy the same incentive, especially in the absence of a regulatory framework that obliges them to adopt similar practices. Unlike the UK Stewardship Code 2026,⁸⁵⁵ which obliges institutional investors to periodically report on their regulatory role on the companies in which they invest, the Saudi market does not have a similar framework imposing this type of obligation. This regulatory vacuum may lead to uneven levels of adherence to environmental and social disclosure standards, which may weaken the expected positive impact of this approach on the sustainability of Saudi Arabia's financial market.

In order to avoid this challenge, consideration could be given to the development of a Saudi stewardship code to be adopted along the lines of the UK experience, establishing a flexible framework that directs institutional investors to strengthen oversight of listed companies, without being fully mandatory, but rather through the adoption of the comply or explain model. This code can incentivize institutional investors, such as pension funds and investment funds, to adopt responsible investment practices, and disclose how they integrate environmental and social governance standards into their investment strategies, enhancing transparency and creating a regulatory environment more consistent with the Saudi market's aspirations for sustainability. Furthermore, the CMA can play a role in activating this code by offering incentives to companies and institutional investors who adhere to it, such as facilitating access to sustainable financing tools or granting them regulatory concessions. The PIF's collaboration with CMA can also contribute to the development of evaluation mechanisms that help measure institutional investors' adherence to these standards, fostering a culture of sustainable investment and encouraging other market actors to emulate the sovereign fund model of financing sustainable projects.

5.5.3. Technical Challenges and Potential Solutions

Saudi Arabia's stock market and its regulatory rules provide a clear example of the many technical challenges companies face when deciding to disclose their sustainable and ethical practices through ESG reports.⁸⁵⁶ One of these technical challenges is the

⁸⁵⁵ See sec 3.8.12. Stakeholders Role as an Informal Enforcement Tool in the UK, 95-96.

⁸⁵⁶ Saudi Stock Exchange Company (Tadawul), Listing Rules (2023) <<https://cma.org.sa/RulesRegulations/Consulting/Docu>> accessed 2 March 2025.

lack of expertise and experts with sustainability risks and ESG reports, as well as high listing costs and continuous obligations.⁸⁵⁷ These higher costs and commitments may have negative consequences for the Kingdom's Vision 2030 goals of developing the financial sector⁸⁵⁸ in expansion and increasing the number of companies listed in the Saudi stock market (Tadawul).

Saudi Arabia's experience in imposing a corporate governance regulation and binding disclosure of governance practices and conflicts of interest has not exceeded seven years since the adoption of a corporate governance regulation listed by the Saudi CMA in 2017.⁸⁵⁹ ESG practice disclosure requirements are additional requirements for companies regarding governance. Given the lack of expertise and the novelty of Saudi Arabia's experience in governance and reporting, the option here is to use skilled foreign expertise in those aspects. However, it may also increase financial costs⁸⁶⁰ and burdens on listed companies to prepare this type of report, especially for medium-sized companies that will face a real financial challenge to report on the status of compliance with ESG standards.⁸⁶¹ This challenge can be addressed by providing advice and guidance by the CMA, as well as by holding workshops that explain this type of report and its relevance to listed companies that wish to obtain funding from investors and are increasingly interested in aspects of ethical and responsible investment.

With regard to the problem of the cost of responsible investment, Murphy and McGrath⁸⁶² argue that when the cost of complying with ESG standards exceeds the potential regulatory penalty, companies may choose to incur the penalty and risk their reputation whenever costs are saved. High costs of adhering to environmental and social standards may result in companies' reluctance to list, or voluntarily delist their market listing, where financial and technical burdens are higher than the benefits they receive from market offering. This is confirmed by a study by Marosi and Massoud⁸⁶³ which examined the reasons behind the increasing demand of foreign companies to delist their registration with the United States Securities and Exchange Commission (SEC) despite the difficult procedures for deregistration from the exchange of foreign companies. The scholars claim that the voluntary cancellation of the registration of foreign companies in the United States is due to two main reasons. The first concerns change in the cost of governance for regulatory compliance, which in the context of the United States

⁸⁵⁷ Xinlai Liu and others, 'Blockchain-Enabled ESG Reporting Framework for Sustainable Supply Chain' in Steffen Scholz, Robert Howlett and Rossi Setchi (eds), *Sustainable Design and Manufacturing 2020* (Smart Innovation, Systems and Technologies vol 200, Springer 2020) 200.

⁸⁵⁸ Financial Sector Development Program <<https://www.vision2030.gov.sa/en/vision-2030/vrp/financial-sector-development-program/>> accessed 19 Mar 2025.

⁸⁵⁹ CMA, Announcements, 'The Capital Market Authority Approves the Corporate Government Regulations' 15 Feb 2017 <<https://cma.org.sa/en/MediaCenter/PR/Pages/NewCGR.aspx>> accessed 13 Mar 2025.

⁸⁶⁰ Wenzhi Ding, Ross Levine, Chen Lin and Wensi Xie, 'Competition Laws, Norms and Corporate Social Responsibility' (NBER Working Paper No 27493, 2020) DOI 10.3386/w27493.

⁸⁶¹ *ibid.*

⁸⁶² Daniel Murphy and Dianne McGrath, 'ESG Reporting – Class Actions, Deterrence, and Avoidance' (2013) *Sustainability Accounting, Management and Policy Journal* 216.

⁸⁶³ Andras Marosi and Nadia Massoud, 'You Can Enter but You Cannot Leave. . .': U.S. Securities Markets and Foreign Firms' (2008) 63(5) *Journal of Finance* 2477.

involves the direct effects of Sarbanes-Oxley Act 2002 (SOX) adoption,⁸⁶⁴ which is not similar to the governance requirements of their country of origin, especially when these requirements of their origin country are weak.⁸⁶⁵ When the company is deregistered, foreign companies will no longer need to produce US-approved financial reports, nor will they be subject to SOX's governance and disclosure regulations. The second reason for the cancellation of the registration of foreign companies is due to the economic incentives that companies receive from their listing on the stock exchange. These incentives vary according to each company's ability to afford and benefit from the joint listing costs, depending on their size, expected growth opportunities, and market liquidity.⁸⁶⁶

The aforementioned studies may serve as an alert to all stock exchange monitors, including the Saudi Capital Market Authority, to study corporate behaviour and measure the cost of preparing sustainability reports to see whether this will significantly affect the market's attractiveness for listing local and international companies. Since companies may bear some costs as a result of long-term economic returns, such as profits from a good reputation, linking companies' level of commitment to sustainability to certain material incentives such as tax relief, government duty exemption, and other incentives. Given the objectives of Vision 2030 mentioned at the beginning of this section relating to increasing the number of listings in the Saudi Tadawul, medium-sized companies aspiring to obtain liquidity and generate returns, increased organizational burdens and costs may affect those companies' listing attraction and the medium-sized listed companies may even proceed to voluntary cancellation of listing once the return on profit does not correspond to the size of the costs and liabilities you incur to stay in the market.

In this context, providing tax incentives can be an effective solution to alleviating the financial burden associated with compliance with ESG standards, making the adoption of sustainability practices more economically attractive. According to the Sprinkle and Maines study,⁸⁶⁷ cash contributions by companies to support sustainability and social responsibility projects can reduce taxable income, reducing the actual cost of such contributions. For example, contributions to environmental initiatives or non-profit organizations may be tax deductible up to 10% of taxable income, meaning that companies can recover a portion of these costs by reducing their tax liabilities. The study shows that these tax incentives not only ease the companies' financial burdens, but also enhance their reputation, increasing their ability to attract investors and customers interested in sustainability. Assuming a 35% corporate tax rate, if a company donates \$2 million to environmental or social initiatives, the actual net cost would be only \$ 1.3 million after deducting tax incentives.⁸⁶⁸ Thus, tax incentives can be seen as an effective tool to support the companies' shift towards more committed sustainability

⁸⁶⁴ Sarbanes–Oxley Act 2002 (US).

⁸⁶⁵ Murphy and McGrath (n 875).

⁸⁶⁶ *ibid.*

⁸⁶⁷ Sprinkle and Maines (n 666) 137.

⁸⁶⁸ *ibid.*

practices, without posing a significant financial burden, striking a balance between regulatory compliance and long-term financial benefits. Therefore, adopting government policies that support this approach can encourage more companies to invest in sustainability without worrying about the cost involved, thereby contributing to a business environment more committed to ESG principles.

5.6. Conclusion

This chapter addressed the possibility of the Saudi capital market benefiting from the UK's experience in developing ESG disclosures, with the aim of enhancing transparency and accountability and improving the regulatory framework for disclosures in the Saudi market. The concept of “dynamic materiality” has been highlighted as a more flexible alternative to traditional disclosure requirements that focus solely on financial significance, as this concept allows disclosure information to be evaluated according to changing economic, social and environmental factors, which makes it more compatible with the nature of sustainability disclosures. The chapter also reviewed three main forms of ESG disclosure: mandatory disclosure, voluntary disclosure, and a “comply or explain” approach, and the advantages and disadvantages of each model were discussed, with a focus on the United Kingdom's “comply or explain” experience to enhance flexibility in disclosure. Based on this analysis, the chapter suggested that the “comply or explain” approach should be the most appropriate option for the Saudi market, supported by regulatory control mechanisms to ensure accuracy and reliability of disclosures, reducing greenwashing risks and enhancing investor and stakeholder confidence.

In addition, the chapter discussed the limits of legal transplant, stating that the adoption of disclosure practices from the UK to the Saudi market should take into account Saudi Arabia's economic and social characteristics, requiring regulatory adjustments commensurate with the domestic market environment. The chapter provided solutions to address the challenges associated with ESG disclosure in Saudi Arabia, which include legal adaptation to international standards, developing effective regulatory tools, motivating institutional shareholders to play a more effective role in ensuring compliance with disclosure standards, and providing tax incentives to companies that perform well in ESG practices to reduce financial burdens related to disclosures on listed public companies. Through these analyses and proposals, this chapter is a pivotal contribution to defining the best approach to ESG disclosure in the Saudi market, ensuring a balance between flexibility and regulatory commitment, enhancing the sustainability of financial markets, and supporting Vision 2030's objectives in promoting transparency and sustainability in the financial sector.

Chapter 6: Conclusion and Way Forward

6.1. Overview of the Thesis

This thesis focuses on examining the effectiveness of different regulatory frameworks in supporting ESG disclosures, with a comparative analysis between the UK's principle-based governance model and Saudi Arabia's rule-based governance model. The study is based on the premise that the dynamic nature of environmental and social disclosures requires a flexible regulatory framework, allowing companies to adjust their disclosures according to economic and regulatory variables. In this vein, the thesis seeks to assess the compatibility of the current Saudi approach with global trends in ESG disclosure, and to explore the possibility of leveraging the UK's experience in adopting a more adaptive model. This thesis argues that Saudi Arabia's adoption of a more flexible disclosure model, inspired by the “dynamic materiality” and the “comply or explain” approach, will improve the quality of environmental and social disclosures and enable companies to adapt to global developments while maintaining a balance between regulatory flexibility and effective oversight.

The thesis addresses the problem of incompatibility between current regulations for disclosure in the Saudi capital market and dynamic disclosure requirements. The Saudi model relies on strict regulation in some areas, while leaving environmental, social and governance disclosures voluntary, resulting in uneven compliance between listed companies. In contrast, the UK model has a more flexible approach through the principle of “comply or explain”, allowing companies to make disclosures in line with their own circumstances, while ensuring regulatory oversight that promotes transparency and accountability. Accordingly, the study answered the key research question of the extent to which the Saudi capital market could benefit from the British corporate governance model in applying the concept of the dynamic materiality of ESG disclosures and the principle of “comply or explain” in any reforms the CMA intends to take with regard to ESG disclosures. Reaching the answer to the key question asks that the study answer a range of sub-questions, which focused on the issue of the impact of differing disclosure requirements between traditional governance and ESG disclosures on public companies' compliance and transparency, and how a corporate governance framework can enhance the effectiveness of ESG disclosures, focusing on the UK model and approach to dynamic materiality. Finally, the chapters addressed the legal, social and economic challenges that the Saudi Capital Market Authority may face when implementing mandatory ESG disclosures.

By answering these questions, this study aims to analyse the shortcomings of the current framework for the disclosure of ESG in the Saudi capital market and explore the benefits and risks of adopting the principle of “comply or explain” in the Saudi context. The study also aims to assess the portability of the UK's experience to the Saudi market, taking into account economic, social and legal differences, so that it can

contribute to proposing legislative and regulatory solutions to enhance transparency and accountability in environmental and social disclosures.

According to the study methodology, this study adopts the doctrinal methodology as a basic framework for analysing the legal and regulatory frameworks associated with ESG disclosures, by examining relevant laws and regulations in the UK and Saudi Arabia. This analysis helps determine the compatibility of current legislation with the principles of transparency and sustainability, and reveals legal gaps that may impede improved quality disclosures. It also contributes to assessing the need for legislative amendments to ensure a more effective regulatory framework in promoting sustainability. Besides jurisprudence analysis, the study used the comparative approach using legal transplant to compare the UK governance model with that of governance in Saudi Arabia. This approach aims to assess the extent to which certain elements of the UK model, such as the principle “comply or explain” and the concept of dynamic materiality, can be embraced in ESG disclosures reforms in the Saudi market. It also provides an analysis of how successful regulatory practices can be adapted in different legal environments, taking into account economic, social and cultural factors that may affect the success of such legal adjustment.

In addition, the study used qualitative analysis methodology to analyse the ESG disclosures of a sample of companies listed in the Saudi Tadawul market, both in the Main market and the parallel market “Nomu”. This analysis aims to assess the level of compliance with ESG requirements, and to detect influential factors such as company size, industry type, and government ownership, on the quality of disclosures. It also helps identify corporate challenges in adhering to sustainability standards, and the impact of the absence of a dynamic regulatory framework at the disclosure level. By combining jurisprudence analysis, legal comparison, and qualitative analysis, this thesis provides a comprehensive view on how to improve the ESG disclosure framework in the Saudi market, drawing on international best practices such as in the UK, and taking into account domestic challenges to ensure effective implementation of ESG disclosure reforms.

6.2. Summaries of the Study Chapters

The study was divided into six chapters, with chapter I dedicated to the background and methodology of the study, which will help to obtain answers to the study's questions. Chapter 2 of this study has answered the study's question on the extent of the challenge posed by the difference between traditional corporate governance disclosure requirements and ESG disclosure requirements of public companies in terms of compliance and transparency. To gain an answer to this question, the chapter reviewed the theoretical and regulatory foundations of ESG disclosures, focusing on how disclosure standards evolve that are aligned with different countries' local and international contexts. It also discussed the difference between traditional requirements for governance disclosure and ESG disclosure requirements, and provided an analysis

of how these differences affect public companies' compliance and transparency. The chapter also addresses regulatory challenges arising from the integration of environmental and social standards into the traditional disclosures of companies on financial markets. Discussions in this chapter have shown that the shift towards the concept of the dynamic materiality of ESG issues continues to face legal and governance challenges. This analysis helped to develop a framework for understanding the challenges that subsequent chapters will discuss, especially with regard to how different regulatory frameworks affect the effectiveness of disclosures in the context of Saudi Arabia.

After reviewing the evolution of ESG disclosure standards and associated challenges, chapter 3 focused on the relationship between corporate governance and the effectiveness of ESG disclosure, highlighting the UK's principles-based governance model. Chapter 3 answered the study's question about the contribution of a principled governance approach to enhancing the effectiveness of environmental, social and governance disclosures. The chapter also discussed the concept of dynamic materiality and how it contributes to providing greater understanding and flexibility to determine the type of disclosures. The chapter also discussed the role of institutional investors and stakeholders in promoting transparency and ensuring compliance with disclosure requirements. The analysis showed that incorporating the concept of dynamic materiality into legislation might be more suited to changing disclosure requirements than to a strict rule-based approach. These findings later provided a strong theoretical basis in discussing the possibility of the Saudi capital market benefiting from this model.

Chapter 4 aimed to answer a large part of the study's key question of the role of listing in the Saudi capital market, based on the rule-based governance model, in contributing to facilitating ESG disclosure requirements for listed companies, given the economic, social and legal challenges associated with this transition. To provide an answer to this question, this chapter focused on the regulatory framework for the listing of public companies in the Saudi stock market “Tadawul”, analysing the role of the Capital Market Authority (CMA) in the oversight of these companies. The chapter also discussed the economic, social and legal challenges facing the Saudi market when trying to adopt mandatory disclosure standards about ESG performance for listed companies, especially with the rule-based governance model applied in corporate disclosures listed in Saudi Arabia. The chapter reviewed and analysed ESG disclosures of a sample of companies listed in the main market and the parallel market “Numo”, providing a comprehensive assessment of the level of compliance and differences between companies in terms of quality of disclosure. This chapter revealed that the lack of mandatory disclosures in the Saudi market has led to a significant disparity in the quality of disclosure among listed companies, highlighting the need to strengthen the regulatory framework. The results also showed that government ownership, company size, and the nature of the industrial sector play a key role in the extent of companies' commitment to ESG disclosure. These findings were used in Chapter 5 to make

proposals on how to improve Saudi's approach to disclosure, drawing on the UK's experience.

Finally, aiming to contribute to the legal literature on the Saudi capital market, chapter 5 sought to analyse how the Saudi market can benefit from the UK's experience in developing ESG disclosures, by incorporating the concept of dynamic materiality and adopting a “comply or explain” approach. The chapter also discussed the advantages and disadvantages of different forms of disclosure, and reviewed the challenges associated with applying a more flexible legal framework based on principles rather than rules as currently applied to listed companies' disclosures. The chapter also provided solutions to the challenges identified in chapter 4 relating to the Saudi context. This chapter concluded that the concept of dynamic materiality could be applied in the Saudi capital market, while proposing a “comply or explain” approach as the best option for regulating ESG disclosures with regulatory oversight mechanisms in place to avoid greenwashing risks. The chapter also made recommendations to address the legal, technical and economic challenges associated with a mandatory disclosure approach to ESG practices, paving the way for final discussions and conclusions in chapter 6 of this study.

6.3 Results and Arguments

The central argument of the study is that the rules-based disclosure approach in the Saudi market is inconsistent with the changing dynamic nature of ESG requirements, compared to the UK's principle-based model, which helps provide sufficient flexibility to move to this type of disclosure taking into account its nature and application in different local contexts. This thesis drew a set of findings highlighting the deficiencies in Saudi Arabia's regulatory framework for ESG disclosures as follows.

6.3.1. Need for a Flexible Regulatory Framework for ESG Disclosure

The study revealed that the current Saudi model relies mainly on strict rules in some respects, while leaving ESG disclosures fully voluntary, resulting in a discrepancy in the quality of corporate disclosures listed in relation to ESG matters, raising greenwashing concerns, and the lack of achievement of Vision 2030 targets in upgrading the Saudi financial market with ESG global rating agencies. In contrast, the UK's “comply or explain” approach provides greater flexibility, obliging companies to explain their noncompliance to any aspect of the ESG disclosures principles, thus enhancing transparency without imposing rigid obligations that are not appropriate with different business environments.

6.3.2. Role of Dynamic Materiality in Improving Disclosures

The study results showed that the absence of a uniform concept of dynamic materiality in Saudi capital market legislation limits companies' ability to provide disclosures appropriate with economic and social developments. Current regulations determine the materiality of disclosures from a financial perspective, without looking at ongoing developments in ESG requirements. In contrast, the UK has adopted a more dynamic approach, allowing flexible disclosures that reflect economic and regulatory developments. The study thus supports the argument that the inclusion of the dynamic materiality concept in the Saudi market will contribute to clarifying the scope of ESG disclosures and their suitability to investors' and stakeholders' expectations.

6.3.3. Analysis of Disclosures in the Saudi Stock Exchange

By analysing a sample of companies listed in the parallel market “Nomu” and the main market in Tadawul, the study revealed that large companies often voluntarily disclose ESG practices to enhance their image to international investors, while small companies lack motivation or the ability to advance disclosure. Therefore, the results of the study sample analysis showed that large mining and energy companies exporting their products abroad are more committed to reporting on their ESG performance than companies dealing with local stakeholders. The results also showed that ESG disclosures in the Saudi market lacked a uniform standard for aspects of environmental, social and governance sustainability, which could lead to greenwashing risks.

6.3.4. Benefit from the UK’s Experience

The study confirms that the UK's principled approach provides a more appropriate framework for adopting ESG disclosure practices in Saudi Arabia, with some necessary adjustments to match the behaviour of market companies as detected from the study sample findings. While adopting a “comply or explain” model may be useful, it requires effective oversight mechanisms to ensure that companies' explanations for non-compliance are adequate.

6.3.5. Need to Strengthen the Oversight Role of Institutional Investors

The study found that UK institutional investors play an important oversight role in monitoring ESG disclosures, while this role remains limited in the Saudi market, with the exception of the Public Investment Fund's (PIF) very recent initiatives on green investment. The study therefore supports the argument that strengthening institutional investors' oversight, such as the PIF, banks, and asset managers, of ESG disclosures can provide non-regulatory oversight in support of regulatory oversight, thus increasing transparency and accountability in the Saudi market.

6.3.6. Legal and Social Challenges to the Implementation of Reforms

The results showed that there are legal and regulatory challenges obstacle the adoption of a regulatory framework to disclose ESG in Saudi Arabia. For example, the need for legislative amendments that clearly define disclosure requirements, while ensuring that they do not conflict with the Saudi Arabia's environment, social values, and economic features. Furthermore, technical challenges include the lack of standardized measurement mechanisms to disclose ESG in the Saudi market, which can lead to uneven quality of reports.

Based on these findings, the study supports the central argument that the Saudi regulatory framework needs substantial adjustments to keep pace with global developments in ESG disclosure practices, and to ease the contribution of the companies and private sector in integrating ESG matters in their long-term strategies, which helps to achieve the Vision 2030 goal in improving the sustainability practice among the financial sector. The study suggests that Saudi Arabia's best approach is to adopt a “comply or explain” principle, but with regulatory control to prevent greenwashing and ensure quality disclosures. The study also recommends the adoption of the concept of dynamic materiality to determine the important information, similar to the UK experience, rather than merely traditional disclosures of financial materiality. Finally, this chapter proposes solutions to address legal and regulatory challenges based on previous discussions of this study chapters, which contributes to improving the level of disclosures and enhancing transparency and accountability in the Saudi capital market, in line with Vision 2030 goals.

6.4. Summaries of Implementation Recommendations

At the end of the analysis of the different models of corporate governance and their compatibility with the requirements of ESG disclosures of in the Saudi market, this study concluded a set of recommendations aimed at improving the level of transparency and accountability in ESG disclosures. These recommendations address legislative and regulatory aspects, as well as the role of institutional investors and SMEs as follows:

6.4.1. Mandatory Legislation to ESG Disclosures in Accordance with the "Comply or Explain" Approach

As binding regulations on corporate governance have strengthened companies' adherence to regulatory standards, it is necessary to adopt a regulatory framework for sustainability disclosure in line with the “comply or explain” approach. Main and parallel market companies can be obliged to provide ESG disclosures, while giving them flexibility to explain the reasons for non-compliance or explain their alternatives to achieve sustainability goals. This framework can be based on a local Saudi standard that conforms to international best practices such as ISSB and GRI standards, but

adapted to the nature of the Saudi market, balancing transparency and accountability on the one hand, and the nature of Saudi domestic economy and values on the other.

6.4.2. Strengthening the Oversight and Enforcement of ESG Reports

To ensure companies' adherence to disclosures, regulatory oversight should be strengthened, with companies required to external audit their reporting on ESG performance. This will contribute to reducing greenwashing practices, and encourage companies to provide accurate and comprehensive reporting on sustainability and ESG practices.

6.4.3. Support for SMEs

To encourage compliance with SME disclosure standards, financial incentives provided to SMEs' might help to enhance sustainability reporting capabilities. These incentives can include tax cuts on costs associated with ESG reporting, reducing financial burdens that may hinder small-medium size enterprises compliance with these requirements. And apply gradual implementation for ESG reporting, starting with large size companies, and rising the

6.4.4. Strengthening the Role of Institutional Investors

Due to their pivotal role in improving transparency in financial markets, regulators should strengthen institutional investors' oversight of environmental and social disclosures. This can be achieved by obliging institutional investors to report periodically on how they integrate ESG factors into their investment decisions, as in the case of the UK Stewardship Code. In this context, Saudi Arabia's PIF can play a leading role in setting clear disclosure criteria, making it a role model for other institutional investors. The commitment of these major funds to adopt sustainable disclosure practices will motivate other financial institutions to follow the same approach, thus enhancing the level of transparency and compliance in the Saudi market.

6.5. Original Contributions and Opportunities for Future Research

This thesis represents a unique contribution to the study of environmental, social and governance (ESG) disclosures from a comparative legal perspective, with a focus on the possibility of improving the Saudi model by leveraging the UK's experience. The study highlights shortcomings in the Saudi rule-based model and suggests a more flexible approach of compliance based on the principles of “comply or explain”, while strengthening regulatory control mechanisms to ensure effective compliance. The thesis also stresses the importance of incorporating the concept of dynamic materiality into

Saudi legislation, which is essential to ensure the flexibility of environmental, social and governance disclosures and their response to economic and regulatory changes.

The thesis' methodology utilises a comparative approach to apply the theory of “legal transplant”, providing a more comprehensive understanding of how regulatory practices intertwine between different markets, taking into account each country's legal, economic and social context. The study also employs a qualitative analysis of a sample of companies listed in the parallel market “Nomu” and the Main market in Saudi Tadawul, providing empirical data that supports arguments about the challenges facing current disclosures. Furthermore, the thesis contributes to enhancing the use of the doctrinal methodology in the study of ESG disclosure, by analysing the current legislative framework and comparing it with international best practices. In practice, the thesis provides recommendations to decision makers at the Saudi Capital Market Authority (CMA) on how to improve the regulatory framework for disclosures, considering the UK experience and Saudi market requirements. It also proposes regulatory solutions to address greenwashing risks, enhance the transparency of corporate disclosures, as well as reconsider the role of institutional investors, such as the Public Investment Fund (PIF), in overseeing companies' adherence to ESG standards to ensure the effectiveness and sustainability of disclosures.

6.5.1. Original Opportunities for Future Research

As regulatory and economic changes continue, more studies are needed to rise understanding of how to strike a balance between regulatory compliance, enhancing investor confidence, and pushing companies towards genuine and transparent sustainability practices. The study opens up new research areas that can enrich the debate on developing a flexible and sustainable regulatory framework for ESG disclosure in Saudi Arabia as follows.

First, while this study focused on comparing the Saudi market with its UK counterpart, research into Gulf Cooperation Council (GCC) financial markets models can give a greater understanding of best practices and the possibility of standardising the disclosure of ESG practices among the countries of the region, given the cultural, social and economic similarity between GCC countries. Second, given the importance of institutional investors in enhancing transparency and accountability in financial markets and assessing ESG's level of performance, future research can explore how institutional investors in Saudi Arabia, such as the Public Investment Fund (PIF), can play a greater role in driving companies to disclose ESG in a more committed and transparent manner. The possibility of activating the oversight role of institutional investors mandatorily can also be analysed to disclose their expectations and aspirations on sustainable investment, as applied in the UK, and its impact on improving ESG disclosure practices in Saudi Arabia. Finally, while this study addressed the risks of greenwashing, more detailed research is still needed on the extent of greenwashing among companies listed in the Saudi market, and its impact on investor and regulator

confidence. A content analysis of corporate reports can be conducted to determine the impact of “greenwashing” on shareholders' rights, and the extent to which legal accountability according to capital market regulations is possible for investors who have deceived ESG performance reports is not real, enhancing shareholder rights in Saudi capital market legislation, and giving greater confidence to invest in green investments.

6.6 Final Remarks

This study represents an essential contribution to understanding the relationship between governance models and environmental, social and governance (ESG) disclosures in the context of financial markets, by comparing Saudi Arabia's rules-based model to the UK's principles-based model. Through this analysis, the study highlighted the importance of dynamic materiality concept to determine ESG information as a framework more adapted to economic and regulatory variables, allowing greater transparency and more flexible compliance with ESG disclosures. The findings of this study through the proposal to adopt a “comply or explain” approach, while enhancing the role of regulators in monitoring the quality of disclosures, can improve the level of transparency and accountability, and enhance investors' confidence on the Saudi investment environment of the Saudi capital market. Enhancing institutional shareholder participation and implement oversight mechanisms can also contribute to reducing “greenwashing” practices and ensuring the credibility of listed companies' ESG reports. Achieving Saudi Vision 2030's ambitious goals and enhancing the position of the Saudi capital market as an attractive financial centre for local and foreign investments requires ongoing reforms in regulatory frameworks, which this study hopes has contributed to in a practical and feasible manner.

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