

# The Concept of Corporations In Saudi Law and Its Relationship With Islamic Law

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## Summary:

Saudi laws must be derived from Islamic law. However, Islamic law has a flexible methodology that allows it to deal with any form of business entity. Today there is no difference between the countries around the world about the general concept of the corporation because countries have copied the system of the corporation from each other since the sixteenth century.

## Keywords:

*law, Saudi Law, Sharia law, Islamic law, Corporation*

## 1. Introduction

The legal system of Saudi Arabia is based on Islamic law, called "Sharia law," which is derived from the Qu'ran and the Sunnah, and includes among its sources the Islamic scholarly consensus developed after Muhammad's death. The Qu'ran and the Sunnah were declared to be the constitution of the country. Hence, business in Saudi Arabia is governed by Sharia, and commercial jurisdiction belongs to the Supreme Judicial Council which is composed of Sharia-trained judges. This research draws a comprehensive overview of business entities in general. It explains, in particular, the nature and types of joint-stock companies under Saudi Commercial Law and which must comply with Sharia law principles.

## 2. Business Entities in Saudi Arabia

In general, business entities in Saudi Arabia are divided into two main categories, the first is establishments and the second is companies. The total of the Commercial Register for both categories amounted to 1,201,363 which establishments have 91% of them. Although both types are considered commercial entities and commercial courts have jurisdiction to hear disputes concerning both sectors, there are radical differences between them, such as companies owned by two or more people who contribute by money or work, except for one-person companies, while establishments are owned by one person who is personally responsible for his establishment. Another difference is that the companies have a financial liability that is independent

of the investors' liability. So, the investor's responsibility is limited to the amount that he has contributed to the company, except with general and limited partnership, while establishments do not have an independent financial liability, but in return, the financial liability is linked to the owner. Another difference is that the companies are independent entities separate from the partners so that the companies can obtain financing or loans. On the other hand, there is no separation of financial liability between the establishments and the owner. Therefore, the owner of the establishment is given the loan or financing in a personal capacity.

## 3. Definition of the corporation in Islamic Law

The corporation is under the second category which is companies. So, it is important to highlight this type by clarifying its definition in Islamic law and Saudi law because a definition has the potential to provide clarity and work like a compass, providing a lost reader with several potential directions from which to proceed. Therefore, the definitions are the fundamental pillars of research. The following will explain the definition and concepts of companies in Islamic law and then in Saudi law.

Many old sharia law's books address this particular area as a chapter under the Transactions book, and they discussed the concept of companies and their rules and kinds. There are some differences between them according to different schools. There are four schools under Islamic sunnah which are Hanafi, Maliki, Shafi'i, and Hanbali. All these schools arose shortly after the death of the Prophet and his companions. The Hanafi school was founded by Abu Hanifa an-Nu'man. It is followed by Muslims in different countries such as the Levant, Central Asia, Afghanistan, Pakistan, and India. The Maliki school was founded by Malik ibn Anas. It is followed by Muslims in different countries such as North Africa, West Africa, the United Arab Emirates. The Shafi'i

school was founded by Muhammad ibn Idris ash-Shafi'i. It is followed by Muslims in different countries such as Egypt, and Yemen. The Hanbali school was founded by Ahmad ibn Hanbal. It is followed by Muslims in different countries such as Saudi Arabia.

All these schools agree on basic issues in Islam and disagree in some details based on their different understandings of the Quran and Sunnah. This difference of understanding is reflected in many issues, including the definition of the concept of the company. Hanbali school defined the company as subscribing between two or more persons in a benefit or interest or a subscription in an act. While Hanafi school defined it as the contract between participants in profit and loss. Maliki school defined it as a contract between two or more people who have money to trade together or who will work together with profit divides between them. While Shaafa school defined it as two or more persons who own a particular thing and have an undivided interest in that thing.

It can be seen that the scholars of the four schools took two paths in defining the term company. The first path defines the company as a type of contract, and this path represents the majority of Hanafi and Maliki's scholars. The second path makes the concept of the company broad and places under it many transactions; so, when there is participation between two or more persons in something, it is considered a company, and this path represents the majority of Shafi and Hanbali's scholars.

Although the Saudi courts generally adhere to the Hanbali school, they depart from this origin primarily based on the jurisprudence of the judges in achieving the best understanding of the Quran and Sauna which could "Ijtihad."

#### **4. Division of the Corporation in Saudi Business Law**

As noted earlier, Saudi laws must be derived from Islamic law. In this context, we illustrate the definition of the company in Saudi law and other Arab laws. As a quick overview of the definition of companies in Arabic country laws, it can be found that all these definitions are identical or convergent and contain the same elements. For example, both the Egyptian Civil Code and the Syrian Civil Code define the "company as a contract under which two or more persons undertake to participate in a financial project by

contributing a share in the form of money or work and share profit or loss resulting therefrom."

In this context, the UAE Companies Law defines the company as "a contract under which two or more persons undertake to participate in an economic project aimed at making profits by contributing a share in the form of money or work and share profit or loss resulting therefrom." It is noted that the Egyptian and Syrian Civil Code used the term "financial project" while the UAE Companies Law used an economic project and added that the company target to profit.

The company definition under Saudi Companies Law is not very different from other Arab countries. Article 2 of the Companies Law defined the company as "A company [is defined as] a contract under which two or more persons undertake to participate in an enterprise for profit, by contributing a share in the form of money, work, or both, and share profit or loss resulting therefrom." It may be noted that definition is the same definition in the previous companies' law. Although the current companies law contains types of companies that do not meet this definition. This is illustrated by the fact that the definition states that a contract must be between two people or more while the regulation authorizes that a company may be established by one person with limited liability as in article 145 and authorizes a joint stock company of one person in certain cases as in article 55.

Today there is no difference between the countries around the world about the general concept of the corporation because countries have copied the system of the corporation from each other since the sixteenth century; therefore, all definitions are close.

The Saudi Companies Law defined the corporation as "a capital company whose capital shall be divided into negotiable shares of equal value. The stock corporation alone shall be liable for the debts and obligation arising as a result of performing its business operation."

All regulations are issued in Arabic because Arabic is the official language of the Kingdom. It is noted that the relevant regulations use the word "sharikat musahama" to express the corporation, but in the official translation, it often uses (joint stock company), and in some cases uses (corporation) or (joint corporation). In case of differentiation between the close or public corporation it often uses (listed company) and (unlisted company). The US uses a corporation more than a joint-stock company. The label "corporation" originally comes from one trait of

this business structure - treatment of the firm as a legitimate individual ("body corporate") able to own property and deal with outsiders. The name "joint-stock company" originates from another part "of this business form - ownership of the firm by investors of capital who receive transferable shares in the firm".

## 5. Characteristics of Corporations

Corporations are distinguished from other commercial entities by some characteristics that are often considered as advantages and will mention four of them.

1- The nature of the relationship between the shareholder and the corporation.

On the opposite of general partnership, the corporation is not dissolved in case of the death of one of its shareholders. Therefore, the French jurist Georges Ripert term believes that the term "partner" cannot be used instead of "shareholder" because the link between the shareholder and the company is the possession of a negotiable bond rather than the company contract.

In the same context, the Saudi corporate system reinforces this principle. According to Article 53, the name of the company must be the name of a legal person indicating the company's activity. The law prohibits the company name from being a natural person or referring to a natural person except in certain cases.

2. Minimum Number of shareholders:

The previous Companies Law stipulates that the minimum number of shareholders in the corporation shall not be less than five shareholders, whether they are natural or legal persons. The current Companies Law does not specify the minimum shareholders, but in general terms following the definition of companies, the company must consist of two people or more. Notwithstanding Article (2) of these Regulations, the state, public natural persons, and companies owned in whole by the Government and companies whose capital is not less than five million Saudi Riyals can incorporate a corporation composed of one person, and such person shall enjoy the powers of shareholder assemblies, including the Constituent Assembly.

3. Distinct Legal Entity:

A corporation is viewed as an entity separate from its shareholders because every shareholder in his

individual capacity cannot bind the company at all. He can enter into a contract with the corporation and can be an employee in it as well. Even if the shareholder owns the entire corporation, he cannot be held liable for the acts of the corporation.

Besides, the company has the right to own the property, lands, patents, et cetera in any way it likes. The company may also be held liable for the debts and obligations arising as a result of performing its business operation.

The corporation can sue outsiders to obtain shareholders' rights. Furthermore, it can institute an action for liability against members of its board of directors for wrongful acts that cause damage to the assembly of shareholders. The general assembly ultimately has the power to decide whether to institute legal action. To do so, the general assembly must appoint an individual or group to pursue the action on behalf of the corporation. However, if the corporation is bankrupt at the time of the action, then the right to institute the action rests with the receiver and upon corporate dissolution the liquidator shall pursue the action at the direction of the general assembly.

4. Perpetual Succession:

In general, a corporation has everlasting life quite independent of the life of its shareholders. The death, bankruptcy, or exit of any shareholder has no effect on the life of a company. Even if all the shareholders die, the ownership of the shares is transferred directly to their heirs. However, the law has identified certain cases to end the life of the corporation. Article 16 provides specific reasons leading to the dissolution of all types of companies stipulated under the Companies Law. The reasons are as follows:

- a. Expiration of the company's term, unless extended in accordance with the provisions of the law.
- b. When the object for which it was established is realized, or when it becomes impossible to realize such object.
- c. Agreement of the partners to dissolve the company before the expiry of its term.
- d. Merger of the company into another.
- e. If a decisive judgment is issued to dissolve or invalidate it at the request of one of the parties

concerned and for serious reasons justify such a step.

These previous cases apply to all types of companies, including the joint stock company, and there are two additional cases of a termination relating to the corporation.

First: When all shares of a corporation devolve to a single shareholder not fulfilling the conditions set forth in Article 55 of the Law, which were previously referred. So shareholders shall amend the company's status in accordance with the provisions by increasing the number of shareholders or transform the company into a limited liability company of one person within one year. Otherwise, the company shall be terminated by the force of law.

Second: The corporation shall be deemed terminated by the operation of law when it incurs losses amounting to half of the paid-in capital at any time during the fiscal year, and the extraordinary general assembly fails to meet during 45 days after calling to meet or if the assembly convenes but fails to issue a decision on the matter. The corporation may also be terminated if it decides to increase the capital in accordance with this article but the shares issued are not fully subscribed to within 90 days from the assembly's decision to increase the capita.

## 6. Separation of the Ownership and Management

One of the most important differences between the joint stock company and other companies is the separation of the ownership from the management. Many public corporations are owned by a million or more people who live in scattered locations nationwide. Accordingly, it is impossible for the owners to be intimately familiar with all of the details about their business, and it becomes quite challenging to manage it wisely. Although the law gives any shareholder the right to attend general or special assembly meetings, participate in the deliberations, and vote on resolutions, only a few numbers of shareholders attend the company's annual meetings and vote on some important issues such as the election of board members.

However, many of the directors and officers, especially in close corporations or family close corporations, are shareholders, but this does not

eliminate the idea of separating ownership from management because the involvement of the shareholder in managing the company is as an employee and not as an owner. So Article 69 gives any shareholder the right to nominate himself for membership of the board of directors, within the percentage of his ownership in the capital

## 7. Limited Liability for Shareholders

Limited liability implies that shareholders of a joint stock company are not personally liable for any financial obligation such as torts committed by the corporation or its debts incurred. If the corporation fails, the damage to the shareholder is limited to the amount he paid to invest in the company. In other words, the damage is limited to his shares only. The limited liability feature is one of the most important advantages of investing in the corporation. While a shareholder can engage wholly in the growth of a corporation, his or her liability is restricted to the amount of his investment in the company, even if it goes bankrupt afterward and has remaining debt obligations.

Perhaps in this context, we face the problem that originated in Islamic law that the rights of others are reserved and no one should refrain from giving money on the basis that there is limited liability. The Koran supports this idea in general, as God says,

( وَلَا تَأْكُلُوا أَمْوَالَكُم بَيْنَكُم بِالْبَاطِلِ وَتُدْلُوا بِهَا إِلَى الْحُكَّامِ لِتَأْكُلُوا فَرِيقًا مِّنْ أَمْوَالِ النَّاسِ بِالْإِثْمِ وَأَنْتُمْ تَعْلَمُونَ )

meaning, "And do not swallow up your property among yourselves by false means, nor seek to gain access thereby to the judges, so that you may swallow up a part of the property of men wrongfully while you know" (2:188). Accordingly, there is no one in the old jurisprudential heritage putting forward the idea of limited liability. So, if debts and losses exceed the capital, partners or shareholders will be responsible, similar to the general partnership.

It can be said, this verse is general, and we can find in the words of the Prophet proof of the principle of limited liability. The Prophet said, "The Muslims will be held to their conditions, except the conditions that make the lawful unlawful, or the unlawful lawful." As a practical application of limited liability, we can say that when the creditor entered into the contract with the company, he was aware that this company has limited liability, and that in the case of loss of the company or the inability to pay the debt, his claim is

limited to the company's funds and does not extend to natural persons, whether they are shareholders or partners. So any party engaging in business with a joint-stock company or a limited liability company accepts this condition implicitly. In fact, there is a lack of clarity in the Saudi commercial courts regarding this issue. Therefore, many Saudi courts today resort to holding the board of directors of corporations or managers in limited liability companies responsible for losses or debts when they exceed the capital based on negligence. The idea of limited liability should be applied together with the principle of Piercing the Corporate Veil to create a balance.

## 8. Types of corporations in Saudi law

According to the previous Companies Law, corporations are divided into three types: a listed joint-stock company, an unlisted joint-stock company, and a limited partnership in shares. A limited partnership consists of two different sets of partners. At least one partner in the limited partnership is a partner in solidarity who is personally responsible for debts of the company. At least four shareholding partners may opt for limited liability wherein their liability is limited to their capital investments. In the current Companies Law, corporations are divided into two types. Type I are unlisted corporations and termed closed joint-stock companies, although the law does not use this name. Type II are listed corporations that are listed on the Saudi Stock Exchange.

### 8.1 Unlisted corporations

Unlisted corporations are companies that are not listed in the capital market stock exchange and are under the direct supervision of the Ministry of Commerce.

In contrast to the current Companies Law, there was a procedural division of unlisted shareholding companies, which was reflected in the reports issued during the period of the previous Companies Law. As for the current reports based on the new law, there are no divisions or types under unlisted corporations. But it can be said that there is a new type of corporation, which is a professional corporation. The new law of professional companies was issued on 09/24/2019. It provides that the professional company takes the form of one

of the four companies provided in the law, one of them being a corporation.

Thus, it can be said that non-listed companies are divided into two types: unlisted commercial corporations and unlisted professional corporations. The Ministry of Commerce is responsible for following up on unlisted corporations before their life, during their life, and until their termination. With the jurisdiction of the Ministry of Commerce to oversee unlisted corporations, however, there are other supervisory bodies over corporations, depending on the nature of the company's activity. For example, foreign corporations are supervised by the General Authority for Investment, and corporations such as banks or insurance corporations are supervised by the Saudi Arabian Monetary authority.

According to the report issued by the Ministry of Commerce in 2017, the number of unlisted corporations is 1405. That is 2.02% of all other companies.

### 8.2 Listed corporations

Listed corporations are companies listed in the Saudi Capital Market Stock Exchange. According to the annual report in 2017 issued by the Capital Market Authority, the number of listed corporations are 179. However, according to the website of the Saudi Stock Exchange, Tadawul, the number of listed companies is more than 200, perhaps because a number of companies joined the Saudi Stock Market after the report. According to the Saudi Stock Market, listed corporations are divided into two types of markets: The Main Market and the Nomu - Parallel Market.

Type I: Main Market:

Approximately 195 listed corporations are listed under the Main Market. It has several stringent requirements compared to the other market. The minimum market cap is 300 million riyals. The number of shareholders should be at least 200. There are also stringent standard disclosure requirements. Companies are obligated to disclose their financial statements every fiscal year, as they must submit their financial report within 3 months after the end of the fiscal year. They are also

obliged to disclose quarterly data within thirty days from the end of the period.

Type II: Nomu - Parallel Market:

The Nomu – Parallel is another means for companies to be listed on the Saudi Stock Market. However, only qualified investors may invest in the Nomu – Parallel Market. It provides yet another platform on which to sell securities and increase diversification.

According to Tadawul there are only 10 listed corporations under this market.

There are lighter requirements than the Main Market for joining the Parallel Market. The minimum market cap is 10 million riyals. The number of public shareholders should be at least 50. In terms of disclosure, the corporation must disclose their financial statements every fiscal year, as they must submit their financial report within 3 months after the end of the fiscal year. They are also obliged to disclose quarterly data within 45 days from the end of the period.

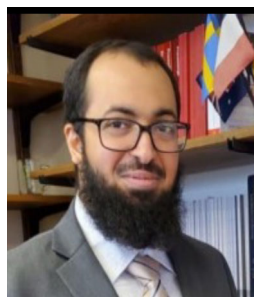
The Capital Market Authority is responsible for overseeing listed corporations in general. Therefore, the CMA issued the Corporate Governance Regulations in order to regulate the listed corporations. This regulation explains what is mentioned in the Companies Law. It also includes more stringent and detailed requirements due to the nature and sensitivity of listed companies. In the same time, the Ministry of Commerce oversees some aspects of the listed companies, creating some inconsistency, which will be clarified in Chapter IV. There are also other supervisory bodies depending on the activity of the corporation, like unlisted companies.

The supervisory bodies deal directly with the boards of directors of listed and unlisted corporations as they are representatives their corporations and their spokespersons, therefore, this is a burden on the board of directors because they are responsible to the Ministry of Commerce and the Capital Market Authority as representatives of the corporation and as members of the Board who have obligations and duties stipulated in the Law. In the next section, the composition and duties of the board will be clarified.

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