

CORPORATE GOVERNANCE IN EMERGING MARKETS THE CASE OF EGYPT

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ABSTRACT

There are many studies about corporate governance in emerging markets, however, very few about Egypt. The term corporate governance doesn't have an equivalent in the Arabic language. Finally, the word, "hawkama" was adopted but it is often misunderstood because the word brings about connotations of government.

In 2006, the Ministry of Investments with the cooperation of the Egyptian General Authority for Investment and Free Zones and with the support of the Egyptian Stock Market, Egypt issued for the first time "Egypt Code of Corporate Governance: Guidelines and Standards."

In this paper we chose a sample of 30 listed companies and reviewed their annual reports in order to determine to what degree Egyptian firms adopted the governance code. The results have indicated that Egyptian companies are still not committed to the application of the new proposed rules.

Introduction

Corporate governance has become an essential tool for improving corporate performance and advancing the development of market-oriented democracies. Good governance practices maintain the integrity of business transactions and in doing so strengthen the rule of law and democratic governance.

Governance issues rose in importance in the 1990s as competition for finance among businesses increased following the deregulation of markets and the liberalization of international trade and investment.

The shareholders' role in governance is to appoint the directors and the auditors to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the boards include setting the company's strategic aims, providing the leadership to put them into effect, supervising management of the business and reporting to shareholders on their stewardship.

Interest in corporate governance has increased and as a result many other definitions have come out. One of the major changes in the definition is taking a broader view. In 1995, Monks and Minow defined it as "the relationship among various participants [chief executive officer,

management, shareholder, employees] in determining the direction and performance of corporations.” (Monks and Minow, 1995).

The Emerging Markets

Economic theory suggests that greater disclosure of corporate governance lowers information asymmetry and estimation risk. Corporate governance disclosures-legal or regulatory and voluntary- should improve financial performance, reduce risk and raise investor confidence. Corporate governance infuses the democratic values of fairness, accountability, responsibility, and transparency into the corporation. It maintains the integrity of business transactions.

A well-run corporation generates value for investors and lenders as well as for its employees, customers, and society as a whole. Good governance contributes to a healthy business climate that encourages domestic and foreign investment, in turn creating jobs and increasing the welfare of a country’s citizens.

In the political domain, the shift to better private governance accelerates the move toward more democratic public governance. Corruption, for instance, withers in a transparent environment, since it is much more difficult to conceal bribes when companies keep proper books and directors exercise good judgment. Corporate governance is fundamental to changing the relationship between business and the state in many emerging markets. By injecting transparency into the relationship, corporate governance helps to remove cronyism and favoritism, instead facilitating an open exchange between the private sector and the government.

The following table summarizes the benefits of corporate governance in emerging markets. (Table 1).

Benefits to Companies and Investors	Benefits to Society
<ul style="list-style-type: none"> • Enhances company performance • Protects investors’ rights • Mitigates risk • Lowers cost of capital • Increases liquidity • Build shareholders relationship • Strengthens company reputation • Improves strategy • Grows and preserves shareholders value 	<ul style="list-style-type: none"> • Promotes efficiency and reduces waste • Stabilizes financial markets • Promotes competitiveness • Fights corruption • Encourages investment and sustainable growth • Develops capital markets • Fosters transparent relations between business and the state • Supports public confidence in the market system • Stimulates productivity and innovation

The Role of International Organizations

The World Bank, and the Organization for Economic Co-Operation and Development (OECD) have set some Governance's Principles, which many emerging markets used as a basis for developing their own guidelines and rules.

On June 21, 1999, the World Bank and the OECD signed a Memorandum of Understanding to sponsor the Global Corporate Governance Forum. The main aim of the forum is to help middle and low-income countries improve their corporate standards of governance by fostering the spirit of enterprise and accountability, promoting fairness, transparency, and responsibility (Iskender and Chamlou, 1999). In consultation with other organizations, the World Bank has also developed a template for the assessment of corporate governance regimes in developing countries. This template is to allow an evaluation of strengths and weaknesses in different markets.

Furthermore, the International Finance Corporation (IFC), being a member of the World Bank Group, has also promoted better corporate governance by requiring that the firms in which it invests, practice sound corporate governance and by insisting on proper internal controls and reporting.

Corporate Governance in Egypt

The Egyptian Stock Market (EGX)

Egypt's stock exchange has two locations: Cairo and Alexandria. The two locations are governed by the same chairman and board of directors. The Alexandria Stock Exchange was officially established in 1888, followed by Cairo in 1903. The two exchanges were very active in the 1940's and the Egyptian Stock Market ranked fifth in the world. Nevertheless, the central planning and socialist policies adopted in the mid 1950's led to a drastic reduction in activity on the stock exchange until the early 1990's.

Since 1996, international organizations such as Standard & Poor's, Morgan Stanley, Bloomberg, and others have added Egypt to their emerging countries indexes.

The Market's Structure

As in many countries around the world, Egypt underwent two diagnostic exercises by joint missions of the World Bank and IMF in 2001 and 2004 to test the alignment of Egypt's corporate governance system in relationship to internationally accepted corporate governance norms.

In 2001, six areas warranted attention of the government and the private sects: first, disclosure and ownerships and control structures; second: disclosure of financial and non-financial information; third: training and capacity building of regulators and the private sector; fourth: roles and effectiveness of shareholder's meetings; fifth: practices of boards of directors; and, sixth: professional conduct of auditors.

The second test came in 2004 when the World Bank and IMF updated this assessment of the application of the corporate governance in Egypt in comparison with the 2001 findings. The main results came to three: building a center for directors that can develop a code of corporate governance that define the role, duties and functions of the board, and create a director training program; focused enforcement of the new listing rules and disclosure provisions, with continued emphasis on a review of content; and implementation of legislative reform to bring the policy framework into greater compliance with the OECD principles.

Following these observations, the Egyptian government acted immediately. The government formed the Egyptian Institute of Directors (EIOD). The institute in cooperation with the stock market developed a new governance code.

Egypt Code of Corporate Governance

In 2006, the first Egyptian Code of Corporate Governance (ECCG) was issued by the Ministry of Investment and the General Authority for Investment and Free Zones (GAFI). The document indicated that these standards should be considered in addition to the corporate-related provisions stated under various laws – especially the law on shareholder’s joint stock companies, partnerships, and limited liability companies issued by virtue of law #159/1981, the Capital Market Law issued by virtue of law #95/1992 and the executive regulations and decrees regarding their implementation.

These guidelines and standards are neither mandatory nor legally binding; rather, they promote responsible and transparent behavior in managing corporations according to international best practices and means that strike equilibrium between various party interests.

The code addresses 7 major topics:

- The General Assembly
- Board of Directors
- Internal Audit
- External Audit
- Audit Committee
- Disclosure of Social Policies
- Avoiding Conflict of Interest

Methodology

This study is based on a checklist based on the variables mentioned in the Egyptian Code of Corporate Governance. It is the intention to study the companies’ disclosures and to see whether the companies have discussed these variables mentioned in the previous section. The issue isn’t how detailed/comprehensive the disclosures, but whether mentioned at all or not.

The study examines a sample of 30 companies selected randomly from the listed companies in the Egyptian Stock Market.

The Results

The previous table shares some interesting observations. All companies mentioned that they have board of directors; however, they are chosen by major shareholders where each group selected a number of board members based on their percentage of ownership in the company (Table 2).

The Egyptian companies use the title non-executive member on many occasions rather than independent board member; however a non-executive board member doesn't necessarily mean an independent one.

Only about half of the companies mentioned the audit committee and who the members are. Very few mentioned the structure of the committee. The same is true with compensation committees.

It was very disappointing to see only two firms discussing the internal audit issue and the business risk. One of the two companies indicated that the chief internal auditor reports to the managing director, which is not consistent with the corporate governance best practices where he/she should report directly to the board of directors.

Each company has an external auditor, but nothing was mentioned about the relationship between the external auditor, the audit committee, and the board.

The Code's Elements and the Results

Board of Directors	Number of companies
Size	30
Independent members/non-executive	30
Qualification	18
Duration of service	4
Compensation policy	2
Committees	
a. Audit committee	16
b. Compensation committee	7
Structure of the audit committee	12
Internal control	2
External auditor	30
Relationships with audit committee	3
Notes about conflict of interest	6
Social disclosures	
Human resources	30
Environment	30
Community service	30
Healthcare	10

Table 2

Conclusion

The purpose of this study is exploratory in its nature. Its main aim is to examine the level of implementing the new code of corporate governance by a sample of the Egyptian companies.

The main findings suggest low rates of corporate governance disclosures and a very high rate of some social responsibility disclosures.

The low level of corporate governance disclosures in Egypt can be explained by the novelty of the concept in Egypt, the capital structure in many organizations, and the role of banks in financing and being represented in the board.

Corporate governance has become a major issue in development, since it relates directly to the establishment of long-term productivity and sustained growth. The future of all emerging markets including Egypt depends on improving governance within and around corporations.

While the Egyptian laws cover a lot of areas that could fall under the title “governance,” major changes must occur and the stock market must take a more active role in implementing and requiring standards and guidelines developed by the code.

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