



**Faculty of Commerce
Alexandria University**

**CORPORATE GOVERNANCE QUALITY, VOLUNTARY DISCLOSURE AND FIRM VALUATION OF
EGYPTIAN LISTED FIRMS**

BY: SALAH ZAKI

The Supervisor Professors:

Dr. Ismail Gomaa PhD

**Professor of Accounting – Faculty of Commerce
Alexandria University
EMBA Program Director**

Dr. Mohamed El Bannan PhD

**Department of Accounting - Faculty of Commerce
Cairo University**

The Examining Committee:

**Dr. Sami Radi PhD
Faculty of Commerce Vice Dean
For Societal Affairs
Tanta University**

**Dr. Kamal Al Dahrawy PhD
Professor of Accounting
Alexandria University**

I propose to the Major Professor and to the Committee Members a study of the following topic to be conducted in partial fulfillment of the requirements for the degree of Master of Business Administration in Corporate Governance Quality, Voluntary Disclosure and Firm Evaluation of Egyptian Listed Firms.

SEPTEMBER 2009

Acknowledgment

To the Almighty God **“ALLAH”** who have granted me all these graces to fulfill this work and who supported me in all my life. To him I extend my heartfelt thanks.

I would like to express my sincere appreciation to **Professor Dr. Ismail Gomaa**, EMBA Program Director, and Alexandria University for his unwavering support; I also like to extend my gratitude to **Professor Dr. Mohamed Al-Fayoumi** who helped to initiate the EMBA Program and **Professor Dr. Ali Messallam** –the former EMBA Program Directors-. It is my pleasure to express my deepest thanks to the supervising **Professor Dr. Mohamed El Bannan** for his continuous encouragement, valuable enthusiastic discussions and professional advice and guidance throughout this project.

I will be forever grateful for my **Parents**, who did all their best for my well being and from whom I have learnt the dedication, determination and professionalism and would thank my **Wife** for her support and encouragement throughout the time of my study. I say thank you to my best friend –my son- **Youssef** who shared many nights of studying with me for his encouragement.

I would like to thank all my lecturing **Professors** and staff members at EMBA Program at Alexandria University as well as **Dr. Mohamed Hememi** and his staff at American Chamber of commerce in Cairo; I also should give very special thanks and dedications to my EMBA class mates for their valuable discussions and wonderful friendship.

To all of you, thank you so much.

Salah Zaki

salah@salahzaki.com

Cairo, Saturday, September 12 2009

Contents

	Page
Abstract	4
1. Introduction	5
2. Literature Review	7
2.1 Voluntary Disclosure	8
2.2 Corporate Governance Quality	8
2.2.1 Definition of Corporate Governance	9
2.2.2 Benefits of Corporate Governance	10
2.3 Egyptian Economic Environment	11
2.4 Egyptian Corporate Governance Initiatives	16
3. Conceptual Framework and Hypotheses Development	23
4. Research Design	27
4.1 Sample Selection	28
4.1.1 Characteristics of The Final Sample	28
4.2 Model Specification and Variable Definitions	30
4.2.1 Corporate Governance and Voluntary Disclosure	31
4.2.2 Corporate Governance and Firm Valuation	39
4.3 Study Limitations	41
5. Empirical Results	41
5.1 Corporate Governance and Voluntary Disclosure	41
5.1.1 Descriptive Statistics	41
5.1.2 OLS Regression Estimation	48
5.1.3 Univariate Analysis	49
5.2 Corporate Governance and Firm Valuation	56
5.2.1 Descriptive Statistics	56
5.2.2 OLS Regression Estimation	56
5.2.3 Univariate Analysis	57
6. Additional Analysis	61
6.1 Disclosure on The Internet	61
6.2 Corporate Governance and CSR Holistic Nexus	62
7. Conclusion and Recommendations	64
8. Appendices and Tables	66
9. References	84

CORPORATE GOVERNANCE QUALITY, VOLUNTARY DISCLOSURE AND FIRM VALUATION OF EGYPTIAN LISTED FIRMS

ABSTRACT

This study examines the relation between the quality of corporate governance mechanisms, the extent of voluntary disclosure and firm valuation in Egyptian listed firms. We use a sample of 100 most actively traded firms in the Egyptian stock market as of December 31, 2007. Using OLS regression and t-tests, results suggest that voluntary disclosure is influenced by governance index in general, but more specifically with the foreign ownership, ownership concentration, and director independence governance components. It is also related to audit quality and firm size. Additional analysis shows that ownership structure & investor rights disclosure by Egyptian firms is influenced by the proportion of ownership held by institutional investors. Institutional investors, along with foreign ownership, are also suggested to significantly influence the level of financial transparency and information disclosure. The level of board and management structure and process disclosure is influenced by foreign ownership. In terms of firm characteristics, the level of financial transparency and information disclosure is influenced by firm size and audit quality, whereas board and management structure and process is influenced by industry type (manufacturing versus non-manufacturing) and firm size.

Ownership structure and investor rights disclosures are mostly affected by higher director independence, higher institutional ownership, and lower ownership concentration. Financial transparency and information disclosures are affected by institutional investor ownership, director independence, and foreign ownership. This category has the highest overall mean disclosure level among all three S&P transparency and disclosure categories for Egyptian firms. Board and management structure and process disclosures are affected by director independence. This category has the lowest overall mean disclosure level among all three S&P T&D categories for Egyptian firms. Overall, the results point to a large divergence in the disclosure practices of Egyptian listed firms, in the governance components that elicit the disclosure response, and in the governance causes by S&P disclosure category. Egyptian firms score highest on financial transparency and information disclosures and lowest on board & management structure & process.

CORPORATE GOVERNANCE QUALITY, VOLUNTARY DISCLOSURE AND FIRM VALUATION OF EGYPTIAN LISTED FIRMS

1. INTRODUCTION

The paper examines the relations between corporate governance quality, voluntary disclosure and firm valuation. The Egyptian economic reform starting in the 1990s, in addition to recent economic events such as the global financial crisis, fuel the need for close investigation of corporate governance and transparency issues in the Egyptian market. Report on the Observance of Standards and Codes (ROSC) of The World Bank find that that transparency generally is not a characteristic of the Egyptian stock market and that voluntary disclosure specifically is not predominant among Egyptian preparers of public financial statements (ROSC 2002). Transparency is a major factor in resource allocation decisions and the lack thereof raises uncertainty with respect to firm future cash flow generation potential, hence raising a non-transparent firm's cost of capital (Botosan 1997) and reducing the range of acceptable investment opportunities. Further, voluntary disclosure could help improve financial information reliability (Skinner 1995) leading to more informed investment decision making and more efficient resource allocation, especially that the demand for financial disclosures arises from information asymmetry and agency conflicts (Healy and Palepu 2000).

One factor suggested in prior literature that may determine the extent of voluntary disclosure is the quality of corporate governance mechanisms in place to ensure optimum managerial decisions and resource allocation (Karamanou and Vafeas 2005; Cheng and Courtenay 2006; Fan et al. 2007; Lim et al. 2007). We model the relation between the extent of voluntary disclosure and firm corporate governance quality using a sample of the 100 most actively traded firms listed on the Egyptian stock exchange as of December 31, 2007. To measure the quality of firm corporate governance mechanisms, we use measure firm performance on five governance components: foreign ownership, director independence, unitary leadership, ownership concentration, and institutional ownership. On the other hand, we measure the level of firm voluntary disclosure using the Standard and Poor's (S&P) 2006 transparency and disclosure (T&D) framework. We evaluate a company's score on each of the above measured using relevant hand-collected data from firm annual reports and websites.

We examine the relation between quality corporate governance and voluntary disclosures in an Egyptian setting. Prior research (Karamanou and Vafeas 2005, Lim et al. 2007) shows that the quality (attributes) of a company's corporate governance affects its disclosure decisions. Companies with more effective corporate governance (e.g., independent directors) tend to have a higher level of voluntary disclosure (Cheng and Courtenay 2006). Other factors affecting companies' voluntary disclosure decisions are firm size, ownership concentration, industry classification, management compensation and investment growth set (Lim et al., 2007).

Study results suggest that voluntary disclosure is influenced by governance in general, but more specifically with the foreign ownership, ownership concentration, and director independence governance components. It is also related to audit quality and firm size. The diversity of ownership base creates pressure on firm management to make additional disclosure to satisfy demands of the various stakeholders. Significant foreign ownership also creates pressure to disclose information of interest to foreign investors, e.g., accounting practices. Finally, director

independence creates an internal culture of transparency within the firm, thus encouraging the provision of additional information.

Ownership structure & investor rights disclosures by Egyptian firms are influenced by the proportion of ownership held by institutional investors. Institutional investors, along with foreign ownership, are also suggested to significantly influence the level of financial transparency and information disclosure. The level of board and management structure and process disclosure is influenced by foreign ownership. In terms of firm characteristics, the level of financial transparency and information disclosure is influenced by firm size and audit quality, whereas board and management structure and process is influenced by industry type (manufacturing versus non-manufacturing) and firm size.

Ownership structure and investor rights disclosures are mostly affected by higher director independence, higher institutional ownership, and lower ownership concentration. Financial transparency and information disclosures are affected by institutional investor ownership, director independence, and foreign ownership. This category has the highest overall mean disclosure level among all three S&P transparency and disclosure categories for Egyptian firms. Board and management structure and process disclosures are affected by director independence. This category has the lowest overall mean disclosure level among all three S&P T&D categories for Egyptian firms. Overall, the results point to a large divergence in the disclosure practices of Egyptian listed firms, in the governance components that elicit the disclosure response, and in the governance causes by S&P disclosure category. Egyptian firms score highest on financial transparency and information disclosures and lowest on board & management structure & process.

On the other hand, study results suggest that firm valuation (measured by firm-level Tobin's q) is a function of unitary leadership, leverage, and industry-level Tobin's q . The results could be explained in the context of the dynamics of the Egyptian capital markets. The positive sign on the unitary leadership coefficient could indicate market participants placing more weight on the personality of the firm leader, especially if this person was the firm founder, in which case the occupation of both leadership positions -Chief Executive Officer (CEO) and Chairman Of The Board (COB)- by the same powerful person would lend more confidence to firm future decisions and thus market expectations with respect to the growth in the stream of future cash flows generated by this firm. Examples of similar phenomenon in the Egyptian stock market are not in short supply. The individuality of decision making process and the close ties between firm life and founder's life at many Egyptian firms may justify this interpretation of the results.

Further, the positive relation shown between firm-level Tobin's q and leverage may explained by the fact that Egypt is a country where bank-based financing is the norm for many firms. Higher leverage ratio may be perceived by many market participants as bringing greater ability to the firm for undertaking projects and expanding. Additionally, a firm announcement of its intention to obtain financing through debt instruments sends a signal to the market of managerial confidence in the favorability of investment outcomes. Moreover, the tax savings from debt financing costs creates a situation where debt financing is "good news". Due to these reasons, debt financing could signal growth potential of sustainable earnings of firms to market participants.

Finally, the positive relation between firm Tobin's q and industry Tobin's q could be due to the fact that some economic sectors enjoy temporal abnormal stock returns due to market

imperfections, e.g., construction and building materials. Firms that are members of an industry that enjoys abnormal returns; they would share in the future cash flow expectations. Therefore, it may reasonably be expected that changes in industry-level Tobin's q be matched by firm-level Tobin's q . Overall, the results may be interpreted from the perspective of Egyptian cultural values, which raises the role of secrecy and individualism (Hofstede, 1980), and therefore results in low overall disclosure performance by most individual firms.

We consider this research one of the few studies that examine the relation between corporate governance and voluntary disclosure by Egyptian listed firms. We expect results of this study to be of interest to stock exchange regulators, professional investors, among others. In particular, results should provide stimulus for regulatory and law-making bodies to create regulations aiming at improving the effectiveness of corporate governance mechanisms for Egyptian firms, which potentially increases the attractiveness of the Egyptian stock exchange as a low-risk investment venue.

2. LITERATURE REVIEW

“The directors of [joint stock] companies, however, being managers rather of other people's money than of their own, it cannot be well expected that they should watch over it with the same anxious vigilance [as owners]...Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.” Economist Adam Smith (1776).

For centuries, the above quote represented an advance warning and if Adam Smith was telling of shape of things to come in the twenty century as big scandals aroused the public suspicion. Information asymmetry is a major economic problem which has been discussed by 2001 Nobel Laureate George Karloff's 1970 paper "The Market for Lemons" and the asymmetric of information since then has been known as the "Lemons Problem". The Lemons Problem is important in capital market, as good firms would be more willing to use voluntary disclosure along with quality corporate governance in order to gain more benefits as well as higher share prices. Demand for financial reporting and disclosure arises from information asymmetry and agency conflicts between managers and outside investors (Healy and Palepu 2000).

“Boards Fail – Again”, a 2008 piece in Business Week, claimed that “board failures ...represent ...a signal failure of the broad corporate governance movement that gained momentum at the beginning of this decade”. A 2009 OECD report concluded “that the financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements.” A 2009 article in Management Today entitled “Corporate Apocalypse” claimed similarly “today's doctrines of shareholder primacy and managerial self-interest have brought many companies to the brink of self-destruction. As a representative of the Council of Institutional Investors said in a November 2008 interview, the financial crisis “represent(ed) a massive failure of oversight at all levels” and argued “corporate governance should be part of any regulatory overhaul coming down the pike.”

2.1 Voluntary Disclosure

According to Leuz and Verrecchia (2000) that there is an association between economic theory and contemporary accounting thought which implies greater disclosure should lower information asymmetry's costs. Corporate disclosure is critical for the functioning of an efficient capital market; it can also be directed to stakeholders other than investors, however, there has been relatively little research on these types of voluntary disclosures. Additionally, some firms engage in voluntary communication, such as management forecasts, analysts' presentations and conference calls, press releases, internet sites, and other corporate reports. Also, there are disclosures about firms by information intermediaries, such as financial analysts, industry experts, and the financial press (Healy and Palepu 2000). There are sound reasons for disclosures in term of economic benefits. The literature (e.g., Foster 1986) shows that market forces rather than regulatory based forces are more likely to be the cause of disclosures (Monash Business Review Volume 4 Issue 2 – July 2008).

Voluntary disclosure which disclose some information in excess of requirements by Securities Regulatory Committee represent free choice on the part of company managements to provide accounting and other information deemed relevant to the decision needs of users of their annual reports (Meek et al 1995). Skinner(1995) the paper investigates voluntary disclosure of listed companies in NASDAQ and the findings is that voluntary disclosure could help to improve the reliability of financial information and there is no significant relationship between voluntary disclosure and firm performance.

Fan et al. (2007) find that the indicators of earnings quality changes violently and there is not regular trend in three years. Then it is believed that there is no significant statistic relationship between disclosure and indicators of earning quality. The same thing to the indicators of corporate governance happened in three years. The ownership type has a regular relation to the disclosure variable, although the ownership concentration has weak positive relation to disclosure.

Botosan (1997) also found an association between the cost of equity capital and voluntary disclosure level for firms with a low analyst following. She finds no association between these variables for firms with a high analyst following. The association between the quality of disclosure and the costs of issuing debt was examined by Sengupta (1998). Foster (1986) suggests that issues other than regulatory mandates persuade the supply of financial statements; also voluntary disclosure is an efficient means of transferring inside information to stakeholders. Voluntary disclosure can be used to improve the credibility of financial reporting and also to mitigate the misevaluation problem (Healey and Palepu 1993).

2.2 Corporate Governance Quality

The impact of improvements in corporate governance quality on traditional measures of real economic activity— Gross Domestic Products (GDP) growth, productivity growth, and the ratio of investment to GDP— is positive, significant, and quantitatively relevant, and the growth effect is particularly pronounced for industries that are most dependent on external finance. The improvements in corporate governance quality affect the aggregate economic activities positively and significantly; and disclosure and transparency are necessary, albeit not sufficient, conditions of good corporate governance, since the extent of information asymmetries among managers and

stakeholders pointed out by the corporate governance literature are likely to be less severe with enhanced transparency and disclosure (De Nicolò et al. 2006).

A number of studies examine the economic consequences of voluntary disclosure. These studies argue that there are potentially three types of capital market affects for firms that make extensive voluntary disclosures: improved liquidity for their stock in the capital market, reductions in their cost of capital, and increased following by financial analysts (Healy and Palepu 2000). The quality or “informativeness” of disclosures can also lead to broader coverage by analysts and a lower overall cost of borrowing (Lang and Lundholm 1996).

Corporate Governance can be traced back to the United States during the period between 1880 and 1930 when there was a process to formulate the “Outsider/Arm-Length” form of ownership and then was published Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) “Policy Statement on Corporate Governance” on 1993 followed by the Sox Act on 2002. By 2008, there are more and more countries are rushing join the elite of countries who have well established Corporate Governance codes and lead by example and Egypt is trying to make amends with international investors by setting up well defined Corporate Governance Codes.

Italian and French boards are considered medium-sized, although still quite inefficient due to the lack of outsiders. Germany is unusual because it tends to have a wide variety of stakeholders represented in the upper (supervisory) board, such as employees, industrial banks and suppliers. In November 2004, a commission convened by The Confederation of German Employers' Associations (Bundesvereinigung der Deutschen Arbeitgeberverbände BDA) and The Federation of German Industries (Bundesverband der Deutschen Industrie BDI), concluded that the German co-determination system had become a hindrance to German companies operating internationally and a barrier to inward investment. It recommended changes to the laws, which were last revised in 1976. Under this proposal, individual companies would be free to choose a system of employee representation, taken from three options, ranging from retention of the current system to a looser consultation system separate from the supervisory board.

The most active boards are in the UK and US, in part due to the enforcement of corporate law. In the UK, the Cadbury Report and subsequent codes of good governance have had a great deal of influence in designing efficient boards. In the US, the Sarbanes-Oxley Act of 2002 has also introduced pressure for a higher percentage of outsiders on boards.

2.2.1 Definition of Corporate Governance

Good corporate governance clearly means different things to different managers; it ranges from being a well-run company to being big and successful, from making reliable products to the virtue of having been around for a long time. Governance has been given several definitions according to the intended purpose of definition. Corporate governance lacks any accepted theoretical base or commonly accepted paradigm as yet (Carver, 2000; Tricker, 2000; Parum, 2005; Larcker, Richardson and Tuna, 2007; Harris and Raviv, 2008).

Appendix 2 suggests that through different models, researchers have tried to examine the subject from different perspectives of financier or other stakeholders. Despite various challenges from different models, agency theory remains the most frequently used theoretical approach followed in corporate governance research (Spira, 2003).

“Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer and Vishny, 1997, 737].

"Corporate governance is a field in economics that investigates how to secure/motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational designs, and legislation. This is often limited to the question of improving financial performance, for example, how the corporate owners can secure/motivate the corporate managers to deliver a competitive rate of return" (Mathiesen, 2002).

"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance" (OECD 1999). OECD's definition is consistent with the one presented by the Cadbury Report [1992, 15].

“Some commentators take too narrow a view, and say it (corporate governance) is the fancy term for the way in which directors and auditors handle their responsibilities towards shareholders. Others use the expression as if it were synonymous with shareholder democracy. Corporate governance is a topic recently conceived, as yet ill-defined, and consequently blurred at the edges...corporate governance as a subject, as an objective, or as a regime to be followed for the good of shareholders, employees, customers, bankers and indeed for the reputation and standing of our nation and its economy” (Maw et al. 1994, 1).

The Organization for Economic Co-Operation and Development (OECD) has laid out a set of basic principles that should guide the functioning of corporate governance systems in almost every country and these principles are shown on Appendix 1.

2.2.2 Benefits of Corporate Governance

<i>Benefits to Society</i>	<i>Benefits to Companies and Investors</i>
Encourages investment and sustainable growth.	Enhances company performance.
Fights corruption.	Lowers cost of capital.
Promotes competitiveness.	Strengthens company reputation.
Stimulates productivity and innovation.	Improves strategy.
Promotes efficiency and reduces waste.	Builds stakeholder relationships.
Stabilizes financial markets.	Grows and preserves shareholder value.
Develops capital markets.	Protects investors' rights.
Fosters transparent relations between business and the state.	Mitigates risk.
Supports public confidence in the market system.	Increases liquidity.

Prior studies on corporate governance tend to focus on one attribute of governance, e.g., board independence, as opposed to studying a set of governance attributes intended to protect stakeholders' claims to firms' resources. A limitation of this research is that some governance attributes may complement each other in protecting stakeholders' claims whereas other governance attributes may serve as substitutes. As a result, inferences drawn from studying one

attribute of governance may be limited. In 2002, S&P developed a framework for evaluating corporate governance that is based on four governance components; ownership structure and influence, financial stakeholders rights and relations, financial transparency and disclosure, and board and management structure and process (Standard & Poor's, 2002). Many of the individual governance mechanisms studied in the prior academic literature can be classified into one of these four governance components.

Swiss Finance Institute finds that neither higher levels of code compliance nor improvements in governance quality have a (positive) impact on stock price performance compared to low levels of compliance and a reduction in the level of compliance. The results add further evidence to the perception that self-regulatory corporate governance reform initiatives relying on mandatory disclosure without independent monitoring and legal enforcement are ineffective and do not positively influence shareholder value.

Good corporate governance can mean generally better relationship with all stakeholders. "This helps improve social and labor relationships and aspects such as environmental protection" (Claessens and Fan 2003, 14). Weak corporate governance has been singled out as the leading cause for recent high-profile cases of corporate fraud, and found that firm credit ratings are: (1) negatively associated with the number of blockholders that own at least a 5% ownership in the firm; (2) positively related to weaker shareholder rights in terms of takeover defenses; (3) positively related to the degree of financial transparency; and (4) positively related to over-all board independence, board stock ownership and board expertise and negatively related to CEO power on the board. (Ashbaugh-Skaife 2005).

The Board has a complementary mix of skills that provide the desired depth and experience and as the old saying goes: "If you don't know where you are going, any road will get you there." This is the problem too many boards have. They have no clear criteria to use in determining how to allocate their precious time together. Rather, they focus on whatever issues management feels are most pressing and on what they have traditionally done.

Additionally, because boards are unclear about their role, directors' complaints about lack of strategic involvement, while heartfelt, are unclear and vague. How do they want to be involved in strategy? What contribution to strategic decisions do they have the knowledge to make? Where the line should be drawn between the board and management on strategic matters? How can the board provide effective oversight of the company's strategic direction and progress within the limits of time and knowledge? All are important questions that are too rarely addressed (FT Mastering Corporate Governance 2005).

There is difficulty in measuring the extent of voluntary disclosure. Researchers have used several proxies for this variable, including management forecasts (see Miller and Piotroski 2000), and metrics based on The Association for Investment Management and Research (AIMR) database (see Lang and Lundholm 1993, 1997, Healy et al. 1999, Botosan 1997, and Miller 1999).

2.3 Egyptian Economic Environment

For a developing country, like Egypt, the level of economic activity hinges upon investor confidence in the prevailing investment environment. Egypt has embarked on an ambitious economic reform plan since the early 1990s. The Egyptian capital markets were revived in the 1992. Today, the Egyptian Exchange (EGX) is the largest exchange in North Africa. In March 2008, over 400 companies were listed on the EGX, with a total market capitalization of USD 130

billion. Since 2004, EGX showed an annual growth of 77 percent in market capitalization. Out of the total population of 77 million, about 1.6 million Egyptians, or 2 percent of the population, are shareholders. EGX is almost completely open to foreign ownership. In the case of individuals, mutual funds and international funds, no taxes are levied on dividends, capital gains and interest on bonds. Profits of Egyptian corporations from investing in securities are subject to a capital gains tax rate of 20 percent.

A new index, NILEX, was established in early 2007 for small- and medium-sized firms, as part of the EGX. This is the first mid and small cap market in the Middle East and North Africa region. The Capital Market Authority (CMA) was established in 1979 with the objective of organizing and developing the Egyptian capital market and serving as its primary regulator. The EGX 30 Index is a free-float capitalization weighted index of the 30 most highly capitalized and liquid stocks traded on the Egyptian Exchange. EGX 30 constituents are reviewed and changed twice a year (end of January and end of July). The index was developed with a base level of 1000 as of January 1st 1998 and previously named CASE 30 Index.

To ensure the success of the reform plan, the government has decided to adopt a modified version of International Accounting Standards (IAS). The first IAS-based Egyptian Accounting Standards (EAS) were passed by a Ministerial Decree in 1997, followed by two major revisions in 2002 and 2006. These IAS-based standards aims at enhancing the transparency and usefulness of financial statements, bolstering investor confidence in the credibility of Egyptian financial reporting, and increasing the level of investment in the economy. Despite the important role financial accounting standards play in achieving the overall economic reform plan and ensuring efficient resource allocation in the economy, the EAS effectiveness were never empirically evaluated (El Bannan 2009).

In July 2002, new listing rules went into effect that increased disclosure and corporate governance requirements for listed firms, and CASE has renewed its commitment to enforce the listing rules. As a result, a net of 99 companies had been de-listed for failing to observe the new listing rules by end-September 2003. Awareness of corporate governance has increased significantly due to a number of banking and corporate scandals and the role of the press in uncovering scandals. (WB ROSC 2004)

Since 2004, Egypt has made significant strides in improving its business climate and in attracting foreign investment. However, there remains an unfinished reform agenda, especially in the financial sector. During the Country Assistance Strategy (CAS) review period (1997–2007), the International Finance Corporation's (IFC) strategy has been to support the private sector and build an efficient financial sector. IFC operations —investment as well as advisory— were broadly consistent with that strategy. Collaboration between IFC and the International Bank for Reconstruction and Development (IBRD) in Egypt has been good. Challenges ahead include the continued need for regulatory reforms, quality enhancement in advisory services, power sector reforms, increased levels of investment, inadequacies in infrastructure, and financial sector reforms.

Egypt has remained a medium-risk country during the review period. Overall, the investment climate in the country has improved, based on both the Institutional Investor Country Credit Risk Ratings and the Heritage Foundation Index. According to the 2007 investment climate assessment update, businesses identified macroeconomic instability, anticompetitive practices, and corruption as the top three constraints (Appendix 3). The improvement in investment climate

also comes through, when the investment climate assessments from 2007 and 2005 are compared, especially with regard to tax issues. Egypt's nonbank financial institutions are underdeveloped. They are composed of a stock exchange—sizeable in terms of market capitalization but having small trading volumes—with a low turnover ratio and a relatively small contractual savings sector including insurance, funded pensions, and mutual funds and underdeveloped mortgage and ancillary financial institutions. Combined insurance and private pension funds under management amounted only to 8 percent of GDP in June 2004 (IEG World Bank 2008).

The Egyptian stock market has developed very rapidly over the last few years; nonetheless, it has attracted only a very limited amount of research in the finance and economics literature on Egypt Stock Market. Few researches and studies examined the relation between corporate governance and disclosures practices of Egyptian firms. (Dahawy November 2007) examined corporate governance disclosure items developed by the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) and found that:

Many company officials appear to believe that the generic description of corporate procedures and process in the laws of Egypt is sufficient to explain their company's specific procedures and process. Historic business factors may explain a significant part of the low disclosure rates in Egypt. Before the reforms of the 1990s, enterprises in Egypt placed a high value on confidentiality and did not engage in extensive corporate reporting. Lack of awareness is the cause of low rates of corporate governance disclosure in Egypt, and then significant improvements may be gained from training and education programs, such as those provided by the Egyptian Institute of Directors (EIoD).

Another survey revealed one of the key deficiencies in Egyptian corporations which are those of boards in general and the Chairman/CEO issue. In 67.90% of the companies surveyed, there is no separation between the Chairman and CEO; however, The Egyptian code of corporate governance calls for the separation between the two functions. This recommendation is not required by the law or even by the listing rules of EGX. If the Chairman is at the same time the CEO, then this requires a strong dynamic board to balance the situation. Otherwise, the board will not be able to "control" the CEO properly (Gamal El-Din 2008).

In a recent interview (early 2009) with Mr. John D. Sullivan, Center for International Private Enterprise (CIPE) Executive Director, about the current financial crisis he noted the following comments: "...In this regard, corporate governance is one tool available to us that can help manage financial risks, and it is clear that in many ways we have not done enough to put in place good governance procedures in the financial sector."

"...Alternatively, those countries in the Middle East that are less dependent on oil, are less affected by the immediate financial crisis. However, as the financial crisis leads into real economy are results in reduced demand, it becomes an economic downturn. Some countries in the region, notably Egypt, are taking aggressive steps to cope with slowdown in growth in the real economy."

However, we should not be complacent as the crisis creeps to our real economy and affects FDI in Egypt either through direct investments into large projects or through investment in the Egyptian Stock Exchange which needs a great deal of attention, as Egypt is lying very low in all Global Competitiveness Report tables.

On regional level, there have been some tremendous improvements in the region regarding the real understanding of Corporate Governance as well as putting regulations and the right infrastructure in place and in this regard we should mention Tunisia, Lebanon, Turkey and the Gulf Countries.

There are several laws governing the economic environment in Egypt main laws governing the legal framework that regulate business environment in Egypt and could influence disclosure and corporate governance in Egypt. These laws are summarized in Appendix 4. Egypt has signed multilateral and several bilateral agreements as shown in Appendix 5 to promote and develop competitiveness of the Egyptian exports, enhance trade, and improve the balance of Trade. These agreements offer Egypt access to the world's largest markets, and give investors in Egypt a manufacturing base for exports. The agreements will also accelerate the improvement of trade and investment practices.

Table 1: Macroeconomic and Financial Statistics for the Egyptian Economy and Capital Markets
(Source: Central Bank of Egypt, Central Agency for Public Mobilization and Statistics and Egypt Portal Website)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Market Capitalization (LE Mill.)	11,324	21,965	29,743	61,503	70,873	94,843	119,734	110,317	118,673	150,214	172,865	337,059	377,070	601,826	813,341
Market Capitalization (% of GDP)	6.47	10.77	12.96	23.94	24.66	30.83	35.29	30.64	31.40	35.89	35.60	62.60	61.00	82.30	90.70
Nominal Value of Shares (LE Mill.)	8,926	9,476	12,552	14,964	23,172	40,897	69,535	76,737	89,127	99,029	96,527	108,209	109,165	121,072	137,974
Number of Listed Firms	672	718	680	661	702	960	1,036	1,072	1,136	1,123	803	770	656	544	380
Annual Trading Value (LE Mill)	N/A	N/A	4,669	19,333	21,208	29,061	51,193	35,124	35,479	29,548	32,422	83,715	254,609	246,252	556,804
Annual Volume of Traded Shares (Thousand Shares)	N/A	N/A	130,505	280,719	399,271	759,914	1,219,065	1,059,731	1,081,031	1,066,548	2,109,477	3,244,377	7,011,660	11,242,486	23,591,784
International Investors' Transactions (LE Mill)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	10,050	7,986	13,000	45,298	147,10	135.70	327,80
EGX 30 Index	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	472.10	775.90	4,828.70	4,772.80	7,803.40	9,827.30
Egyptian L.E. exchange rate per US\$ (June 30)	3.39	3.40	3.39	3.39	3.39	3.40	3.45	3.6844	4.4272	5.1229	6.1665	6.0193	5.75	5.71	5.51
Egyptian L.E. exchange rate per US\$ (Dec. 31)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	5.5385
Interest Rate (%) (June 30)	16.60	12.25	12.00	13.20	13.20	12.84	13.11	13.57	14.10	13.45	13.27	13.35	12.50	12.60	12
Consumer Price Index (%) (Dec. 31)	11.90	8.90	9.50	3.90	2.30	3.20	2.20	2.40	3.00	5.50	17.40	3.10	12.30	6.90	18.30
Unemployment Rate (% , Dec. 31)	11.10	11.10	11.26	8.37	8.21	8.12	8.98	9.20	10.20	11.00	10.30	11.20	10.60	8.94	8.70