



Assessment of Corporate Governance in Egypt

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Abstract

This paper aims at evaluating corporate governance rules, laws and standards in Egypt. It starts with a discussion on the concept and importance of corporate governance, followed by a review of the various aspects of the capital market, including the structure of the stock market, the legal and supervisory framework, registration requirements, and the ownership structure. The paper then assesses Egypt's corporate governance standards in accordance with the five OECD principles, namely, shareholders' rights, equitable treatment of shareholders, stakeholders' role in corporate governance, disclosure and transparency, and responsibilities of the board of directors.

The analysis shows that corporate governance standards in Egypt have improved significantly, as reflected in the overall assessment of all five OECD principles. The degree of progress, however, varies from one principle to another. Finally, the paper points out that Egyptian companies are still far from properly implementing corporate governance principles.

ملخص

تهدف هذه الورقة إلى تقييم القواعد والقوانين والمعايير المنظمة لحوكمة الشركات في مصر. وتبدأ الورقة بمناقشة مفهوم حوكمة الشركات وأهميته، ثم تتناول الجوانب المختلفة لسوق المال، من حيث هيكل البورصة، والإطار القانوني والرقابي الذي يحكم سوق الأوراق المالية، ومتطلبات التسجيل والقيود في جداول البورصة، وهيكل ملكية الأوراق المالية. ثم تنتقل بعد ذلك إلى تقييم تطور قواعد الحوكمة في مصر وفقا لمعايير حوكمة الشركات الخمس التي وضعتها منظمة التعاون الاقتصادي والتنمية عام ١٩٩٩، وهي: حقوق المساهمين، المعاملة المتساوية للمساهمين، دور أصحاب المصالح أو الأطراف المرتبطة بالشركة، الإفصاح والشفافية، ومسؤوليات مجلس الإدارة.

وقد خلصت الورقة إلى أن سوق المال في مصر قد شهد تطورا ملحوظا في مجال إرساء قواعد حوكمة الشركات، مما ترتب عليه بشكل عام تحسن في التقييم الإجمالي للمعايير الخمس للحوكمة، وإن كانت درجة التحسن قد اختلفت من معيار لآخر. كما أوضحت الورقة أيضا أنه على الرغم من تحسن الإطار القانوني والمؤسسي لحوكمة الشركات في مصر، إلا أن الممارسات العملية للشركات مازالت إلى حد كبير بعيدة عن التطبيق السليم للمبادئ الموضوعية.

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Highlights

- Corporate governance refers to the rules, laws and standards that define the relationship between the company's management and its shareholders and stakeholders or related parties, namely the bondholders, workers, suppliers, creditors and consumers.
- This report – which was conducted by the Egyptian Center for Economic Studies in cooperation with the Ministry of Foreign Trade, the Capital Market Authority and the Cairo and Alexandria Stock Exchanges – aims to evaluate the laws and rules that ensure the proper application of corporate governance in Egypt. The evaluation was based on the institutional development of corporate governance standards in Egypt in comparison with the five OECD principles issued by the Organization of Economic Cooperation and Development in 1999.
- Review of the laws governing the capital market in Egypt showed that the legal framework that regulates corporate governance rules and principles in Egypt is based on the French civil law of companies. There is no direct effect of Islamic Shari'a (legislation) on such rules. On the other hand, the Anglo-American law affects the central depository and registry law and the draft capital market law, which is due to be referred to the People's Assembly (Parliament) for discussion.
- The Capital Market Authority (CMA) is the main party responsible for capital market regulation and supervision with the help of the Cairo and Alexandria Stock Exchanges (CASE) and the Egyptian Clearance and Central Depositing Company. Other non-profit or self-regulatory institutions play supporting roles in this respect.
- In Egypt, there is one stock market with two premises for trading: Cairo and Alexandria, which include four listing tables. The number of listed companies rose from 656 in 1992 to 1,151 in December 2002. The market value rose from 8 percent of Gross Domestic Product (GDP) in 1992 to 32 percent in 2002. Trading value/market capital rose from 3.4 percent in 1992 to 21 percent in 2002.

- Developments in the Capital Market and the Cairo and Alexandria Stock Exchanges indicate that the period from September 2001 to March 2003 witnessed considerable improvement in instituting corporate governance rules in Egypt. This resulted in a general improvement in the overall assessment of these rules. The evaluation showed improvement in the five principles of corporate governance, with varying degrees of improvement from one principle to another. According to the assessment, the five principles of corporate governance in Egypt may be classified in descending order based on their degree of conformity with the international principles as follows: stakeholders' role in corporate governance, equitable treatment of shareholders, shareholder's rights, disclosure and transparency, and responsibilities of the board of director. It is possible to refer to some procedures that led to such an overall improvement in the assessment, including the issuance of new rules for listing and disclosure that are in harmony with the international principles, which are related to the company's profitability, number of shareholders and minimum limit of share capital. The rules of disclosure were also developed and companies were obliged to form auditing committees and to appoint an officer responsible for relations with investors. The procedures also include the establishment of a settlements guarantee fund, allowing the registered owner to vote on behalf of the beneficiary owner and per the former's instructions, and allowing voting through ordinary and electronic mail.

- The report concluded that there are certain rules that need more improvement such as protecting minority shareholders' rights, providing strict control to ensure that the board of directors performs its responsibilities, emphasizing the importance of disclosure in all the details of the ownership structure, as well as completing the legal framework and strengthening the supervisory institutions' capacities. The report also showed that there is still a need for improving the application of these standards among Egyptian companies.

Introduction: The Concept of Corporate Governance and Its Importance

Generally speaking, the concept of corporate governance refers to the rules, laws and standards that define the relationship between a company's management on one hand and its shareholders and stakeholders, namely the bondholders, workers, suppliers, creditors and consumers, on the other hand. More strictly, the term "corporate governance" provides answers to many questions including: How can the owners make sure that the management does not misuse their money? How can they make sure that the management acts towards maximizing the company's share value and profitability in the long run? How much does the management care about the basic interests of the society such as health and environment? And lastly, how can shareholders and stakeholders effectively supervise the management?

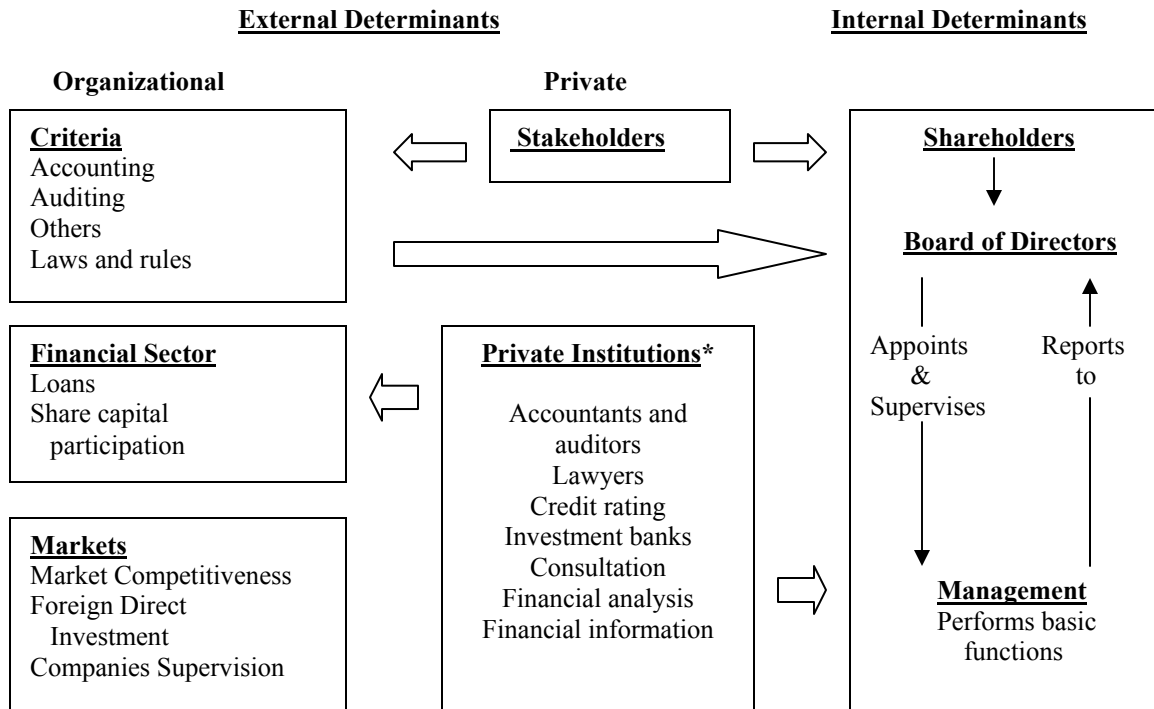
The term corporate governance raises some ambiguity for three main reasons related to the modernity of the term itself. The first reason is that the roots of the concept of corporate governance and many of the issues linked with it go back to the beginning of the 19th century and were dealt with by some organization and management theories as well as the "enterprise theory." The term itself started to be used in the English language and its concepts began to crystallize only two or three decades ago. The second reason is that there is no definite meaning for this concept. Some people consider it to be a mechanism that allows companies to get financing and to magnify the value of its shares and secure its continuity in the long run. Others define it from a legal perspective as the contractual relationship (be it complete or incomplete) which defines the rights and duties of the shareholders and the stakeholders on one hand, and of the managers on the other hand. Another group may look at it from a social and moral viewpoint and hence concentrate on the company's social responsibility to protect the rights of the minority shareholders or junior investors, to realize equitable socioeconomic developments and protect the environment. The third and last reason behind the vagueness of this term is that the concept itself is still in its formation stage, and its principles and rules continue to be revised and developed.

Nevertheless, there is a sort of agreement between the researchers and practitioners on the major determinants and evaluation criteria of this concept. As for the

determinants, it is agreed that, good or bad, governance depends on the presence and quality of two groups of determinants: external and internal (see Figure 1). External determinants refer to the general investment climate in the state, including: laws that regulate market performance (such as capital market, companies, competition and anti-trust, and bankruptcy laws); the efficiency of the financial sector (the banks and capital market) in providing the necessary financing for projects; the competitiveness of the commodities markets and the factors of production, and the efficiency of the supervisory bodies and authorities (the Capital Market Authority and the Stock Exchange) in exercising strict control over the companies. This is in addition to some self-regulating institutions that ensure the markets' efficient performance (such as professional associations that provide various codes of ethics for the market participants such as auditors, accountants, lawyers, companies working in the securities market, etc.). There are also institutions for independent professions such as law offices, auditing offices, credit rating offices and financial and investment consultation offices. The presence of external determinants is important for providing a sound corporate governance environment and ensuring the enforcement of laws and rules that reduce the conflict between social and private returns.

Internal determinants, on the other hand, refer to rules and principles that determine the decision-making process and the division of responsibilities among the general assembly, the board members, and the executive directors of the company. The presence and the application of these rules and principles reduce the conflicts of interest between those three parties.

Figure 1: External and Internal Determinants



* Private institutions refer to the private sector elements, self-management entities, mass media organizations, civil society and agencies that provide information, raise the level of control over companies and shed light on the opportunist behavior of the management.

Source: Iskander and Chamlou (2000).

In 1999, the Organization of Economic Cooperation and Development (OECD) laid out five sets of principles as guidelines to assess the level of corporate governance application:¹

- **The Rights of Shareholders:** These include the rights to transfer the ownership of their shares, to vote in the general assembly, to select board members, to receive dividends from their shares, to revise financial statements and the right to active participation in the general assembly meetings.
- **The Equitable Treatment of Shareholders:** This means equal treatment of shareholders in all categories and the defense of their legal rights, as well as their right to vote in the general assembly on fundamental decisions, to be protected

¹ OECD is revising these principles. Revised principles are expected to be issued before the end of 2003.

against any suspicious mergers or acquisitions and from insider trading, as well as their right to be informed of all transactions involving the board members or the executive managers.

- **The Role of Stakeholders in Corporate Governance:** This includes the respect of their legal rights and compensating them for any breach of these rights. It also includes mechanisms to enhance their participation in supervising the company and access to the required information. Stakeholders include the bond-holders, workers, banks, suppliers and customers.

- **Disclosure and Transparency:** This includes the disclosure of key information, the role of the auditor, and the ownership of the majority of shares, as well as disclosure related to the board members and executives. Disclosure should take place in a timely manner and without delay and will be conducted fairly among shareholders and stakeholders alike.

- **The Responsibilities of the Board:** These include its structure, its legal duties, the board member selection process, its main functions and its supervisory role of the executive management.

Corporate governance is important because, if applied properly, it helps to realize high and sustainable growth rates. It increases confidence in the national economy, deepens capital market and increases its ability to mobilize savings and raise investment rates. Moreover, it protects the rights of the minority shareholders or small investors. Corporate governance also encourages the growth of the private sector by supporting its competitive capabilities, helping to secure financing for projects, generating profits and creating job opportunities.

Corporate governance has been gaining increasing importance over the last two decades for several reasons. First and foremost, the switch by many of the world's countries to capitalist economic systems that rely greatly on private companies for the realization of high and sustainable economic growth rates. The expansion of these private projects led to a separation between corporate ownership and management. As a result,

projects started looking for financial sources that were less expensive than banks, so they headed to the capital markets. This was made easier by the liberalization of capital markets in many parts of the world. Capital began to move across borders at unprecedented rates. The expansion of project volumes and the separation of ownership from management weakened supervisory mechanisms on managers' behavior and caused many companies to fall into financial distress. The most serious of these was the South East Asian crisis at the end of the 1990s, which was followed by other crises involving companies such as the Enron and WorldCom in the US in 2001. All these factors placed corporate governance at the top of the world concerns. Discussions were held in an attempt to mend the deficiencies in the principles and rules regulating companies' activities, especially those concerned with the role of financial auditors and the responsibilities of the board of directors.

Egypt started to give due importance to the subject of corporate governance in 2001 with an initiative taken by the Ministry of Economy and Foreign Trade (now the Ministry of Foreign Trade). The Ministry was of the opinion that the economic reform program initiated in the early 90s could only be completed by installing an organizational and supervisory framework that governs the private sector performance in the context of liberalized markets. A study was conducted to assess the extent of the conformity of the Egyptian legal, regulatory and supervisory framework to the international criteria of corporate governance. The study aimed to trace and assess development achieved during the period from September 2001 to March 2003 in completing the rules and determinants that ensure the proper application of corporate governance in Egypt.

The following sections of this report include an overview of the various aspects of the capital market as well as five main sections that assess the development of corporate governance in Egypt according to the five principles introduced by OECD in 1999.

Preliminary Section: Comprehensive View of the Capital Market in Egypt

This section deals with the various aspects of the capital market such as the activity of the Stock Exchange, the legal and supervisory framework that governs corporate operations and finally, the ownership structure of the traded shares.

Stock Market Structure

Egypt's Stock Exchange dates back to the 19th century. The Alexandria and Cairo Stock Exchanges were officially established in 1883 and 1903, respectively. Both exchanges were very active in the 1940s, and ranked fifth in the world.² In spite of their dormancy beginning in the 1960s, they were never closed. They were revived in the early 1990s when the government adopted an integrated program for restructuring economic stabilization; especially after the issuance of Law No. 95/1992. Egypt's Stock Exchange is comprised of two trading exchanges, one in Cairo and the second in Alexandria. Securities are automatically registered in both exchanges and listing fees are mutually divided.

In December 2002 there were about 29,000 associations of capital in Egypt including about 22,000 joint stock companies, 280 limited-by-shares companies, and 7,000 limited liability companies.³ The legal framework allows for listing only joint stock companies and limited-by-shares companies. Listed companies enjoy tax exemption equivalent to the value of the paid-in capital multiplied by the interest rate, which is decided by the Central Bank of Egypt every three months. The number of listed businesses rose from 656 companies in 1992 to 1,151 companies in December 2002. While the legal framework for companies' continued listing in the Stock Exchange requires at least one trading operation per company every six months, it is difficult to substantiate this requirement.⁴ Market capitalization increased from approximately LE 11 billion in 1992 (8 percent of the GDP) to LE 123 billion in 2002 (32 percent of the GDP).⁵ The value of traded shares rose from LE 371 million in 1992 (3.4 percent of the market capital value) to reach a peak of LE 42 billion in 2000 (35 percent of the market capital value) then declined to LE 26 million in 2002 (21 percent of the market capital value) due to domestic and global events.

² Cairo and Alexandria Stock Exchanges (<http://www.mbendi.Co.za/exch/12/p005.htm>).

³ *Stock Exchange Monthly Bulletin*, January 2003 and Report of the Ministry of Foreign Trade on Egypt's Stock Market performance during 2002.

⁴ Such operations are mostly performed by individuals related to the company just to keep it listed.

⁵ Annex No. 1 shows Stock Exchange performance development from January 1992 to December 2002.

To date, nine Egyptian companies are listed on the London, Luxembourg and Frankfurt Stock Exchanges through the Global Depository Receipts (GDR).⁶ GDR trading value reached Pound Sterling 440 million in 2002. As of January 2003, there were 13 mergers among listed companies, and 108 purchasing and acquisition cases involving companies from the real estate, tourism, pharmaceutical, banks, energy, insurance, cement, communications, food and beverage sectors. International companies represented more than one-third of the buyers.⁷ Several indexes are used for measuring the development of Cairo and Alexandria Stock Exchanges the most important of which are: the Capital Market Authority Index; CASE30 issued by Cairo and Alexandria Stock Exchanges in March 2003; Standard & Poor's; Morgan Stanley MS Investible Index, in addition to indexes for domestic financial enterprises.⁸

Legal and Supervisory Framework

The legal and supervisory framework includes all the laws that govern the securities market in Egypt and the supervisory agencies that regulate its market activity. The following is a short description of the most important laws and agencies.

Legal System

The Egyptian legal system is largely influenced by the French Civil Law. However, the laws governing capital market performance, such as the Central Depository Law and the Capital Market Law, are based on the Anglo-American Law. The major laws regulating capital market performance are outlined below.

The Capital Market Law (No. 95/1992) governs the capital market, provides the legal framework for the Cairo and Alexandria Stock Exchanges and sets the rules for listed businesses. The Capital Market Law is currently undergoing a process of revision and intensive amendments. The proposed draft law provides more active support for minority shareholders, presents a new concept for legal action, defines procedures to be adopted in purchase tenders, and totally bans trading on insider information. It is expected that the Egyptian People's Assembly will discuss the draft law in 2003.

⁶ In addition to the Receipts of the Holding Financial Investments Co. (Lakah Group) which haven't been traded since 6/11/2002.

⁷ *Cairo and Alexandria Stock Exchanges Bulletin*, January 2003.

⁸ Hermes, Prime and the CIB Index for Brokerage.

The Central Depository and Registry Law (No. 93/2000) regulates the central registration for shareholders' records, clearance, settlement and depositing. This law became effective after its executive regulations were issued by the Minister of Foreign Trade Decision No. 906 in November 2001.

As for companies, there are three laws governing the establishment of a company that will be listed on the Stock Exchange:⁹

The Law on Joint Stock Companies, Limited by Shares Companies and Limited Liability Companies (No. 159/1981) regulates joint stock companies, limited-by-shares companies and limited liability companies.¹⁰ By virtue of this law, the share capital of a joint stock company is divided into shares of equal value. The shareholders' liability is limited to the value of the issued shares. As for the limited-by-shares companies, the share capital includes the portion that belongs to the joint partner(s) and shares of equal value for subscription by one or more subscribers. The joint partners are responsible for the company's liabilities and their responsibility is unlimited. However, the subscriber's responsibility is limited to the value of his shares. A limited liability company is not allowed to issue tradable shares.

The Investment Guarantees and Incentives Law (No. 8/1997) was created to boost investments in various economic sectors and specific industrial zones through income tax exemptions for 5, 10 or 20 years or permanently in tax-free zones. This Investment Law refers to the Companies' Law No. 159/1981 in all other aspects.

The Public Business Sector Law (No. 203/1991) cited 314 public sector companies to be sold.¹¹ These companies were established as joint stock companies and then became affiliated companies under 17 holding companies as of 1991. Once private ownership reaches 51 percent of the company's shares, it becomes subject to Law No. 159/1981.

Efforts are underway to draft and discuss a unified law that would replace a number of the current laws and dispersed provisions. It would ensure that all businesses

⁹ In addition to Capital Market Law No. 95/1992, Chapter Three.

¹⁰ Amended by Laws No. 212/1994, 3/1998 and 159/1998.

¹¹ 190 companies were privatized from the beginning of the privatization program until June 30, 2002.

(capital corporate sector and individuals' companies) in Egypt are adhering to a unified modernized regulatory system that facilitates investors' dealings with the administrative authorities and enhances transparency.

Governmental and Quasi-Governmental Supervisory Agencies

The supervisory agencies that regulate, supervise and monitor the capital market and ensure the proper application of corporate governance fall into two categories: Governmental Agencies and Quasi-Governmental (or self-regulatory) Agencies.

The Capital Market Authority (CMA)

CMA is a government agency subject to the supervision of the Minister of Foreign Trade. However, it is an independent agency. Its board of directors is its supreme authority. Two of its seven board members, namely, the chairman and the deputy chairman, are appointed by a Presidential Decree for a period of three renewable years. The other board members are appointed by a decree of the Prime Minister for a period of two renewable years. The Capital Market Authority is primarily funded by its revenues from accrued fees. The salaries of the Authority's employees are high in comparison to the salaries of their peers in the government sector. Foreign technical and financial support enabled the Authority to hire skilled professionals and pay them high salaries. Nevertheless, their salaries are lower than those of employees in the private sector and in the Cairo and Alexandria Stock Exchanges. The Capital Market Authority is responsible for the enforcement of the Capital Market Law and for supervising market development and regulating, as well as monitoring all its activities.

Moreover, the Capital Market Authority has the competence to impose administrative sanctions including warnings, writing off from the tables, suspending or canceling licenses,¹² canceling operations or bargains¹³ (even after settlement in case of any illegal action or behavior), conducting inspection operations and suspending the

¹² The common sanction is to suspend the brokerage license for a period not exceeding one month.

¹³ Immediate cancellation (before settlement) is the responsibility of the Chairman of the Cairo and Alexandria Stock Exchanges.

general assembly's decisions for a period of fifteen days in the case of verified damage to minority shareholders.¹⁴

The Cairo and Alexandria Stock Exchanges

The Cairo and Alexandria Stock Exchanges (CASE), a quasi-self-regulatory authority by virtue of law, is managed by an elected board of directors under the supervision of the Capital Market Authority (CMA). The board comprises eleven members: the Stock Exchanges' chairman who is appointed by the Prime Minister, six members representing trading companies, two members representing banks, one member from the Central Bank of Egypt and one member from the CMA. The Capital Market Authority has the right to object to the decisions issued by CASE's board of directors. CASE is responsible for ensuring commitment to listing rules, but has no authority for investigation or inquiries. CASE may impose sanctions that range from transferring a company from the formal to the non-formal table, suspending trading, or writing off the registration according to the nature and type of infringement.

Misr Clearing, Settlement and Central Depository Company

This joint stock company was established according to the provisions of the Capital Market Law No. 95/1992. CMA issued its approval on 21/8/1994 to establish the Company as a self-regulatory entity subject to CMA's supervision and responsible for enforcing the Central Depository Law No. 93/2000. Misr Clearing, Settlement and Central Depository Company comprises members from securities' brokerage companies, depository trustees licensed by CMA, issuers of securities, banks and financial institutions willing to participate in the Company provided they practice brokerage or depository trustees' activities.

Misr Clearing, Settlement and Central Depository Company is the sole central authority in Egypt entrusted with CASE's clearing and settlement operations. It is also responsible for the application of the central depository system in Egypt including verification of the central ownership of the securities trade in the Stock Exchange and transferring trading to book entries for easy handling by shareholders.

¹⁴ The Authority may ask defaulters to increase their portion of the insurance fund of Stock Exchange operations.

The General Authority for Investment and the Capital Corporate Sector

The Capital Corporate Sector (formerly the Company's Administration) supervises the enforcement and application of the Companies Law No. 159/1981. This Sector is subject to the General Authority for Investment and Free Zones (instead of the Ministry of Economy and Foreign Trade) under Decision No. 415/2001. The Sector has the competence to reject applications for the establishment of companies and to ratify the irregular general assembly's decisions to liquidate a company. The General Authority for Investment supervises companies established according to Law No. 8/1997.

The Ministry of Public Business Sector

This Ministry and in particular the holding companies are responsible for companies established according to Law No. 203/1991.

Private Institutions

In addition to the governmental and quasi-governmental supervisory bodies, two types of private institutions operate in the market. The first type is the non-profit or self-regulatory institutions that help ensure discipline in the capital market, and the second comprises profit-driven private institutions.

Non-Profit Private Institutions

The *Egyptian Capital Market Association* was established in 1996 as a professional association comprising 250 members representing most of the companies operating in the capital market.¹⁵ It is the main body for conveying the opinions of the workers in this field to the supervisory agencies for consideration while drafting capital market regulations and laws. The Association organizes training courses for the employees, convenes seminars for raising public awareness of investment, and resolves disputes that may arise between its members or between them and other parties.

Egyptian Association for Investment Management was founded in 2001. The Association comprises members from financial and investment establishments, banks, insurance companies and asset managers. Through training courses and workshops, it

¹⁵ The draft Capital Market Law proposes to make membership of this Association mandatory and to convert it to a self-regulatory organization.

acts to enhance the members' efficiency and improve the quality of the services they provide investors. Further, it issues a professional certificate to portfolio managers to ensure performance quality and qualification.

The Egyptian Accountants and Auditors Association was founded in 1946 with the main objective of promoting the professional and technical levels of accounting and auditing nationally and internationally. In addition to its essential role in the study of draft economic laws on topics such as taxes and investment and preparing accounting and auditing standards according to decisions of the Minister of Foreign Trade, the Association participates in studies and research on economic laws, taxes and investment. Those who have university degrees and post-graduate degrees in accountancy fields and have served for several years in accredited accountancy offices are allowed to join the membership of the association provided they pass the examinations held by the Association.

Profit-Driven Private Institutions

There are several profit-driven practitioners competing at the capital market. They include auditors, accountants, law consultants, credit-rating companies,¹⁶ financial analysts and information dissemination companies, securities brokerage firms, promoters, underwriters and asset management firms and law offices. To ensure the quality and accuracy of financial disclosure, the Authority approves a group of auditors.¹⁷ Nevertheless, Egypt's Capital Market lacks market makers who act to guarantee a regular performance of the market by buying or selling shares and thus preventing sharp and unjustified declines or increases in prices.¹⁸ It is worth noting that a market maker may also be a brokerage company.

¹⁶ There are seven credit-rating companies in Egypt accredited by the Capital Market Authority. The majority of the accreditation committee must be from one of the accredited international credit-rating institutions. To ensure impartiality, banks and auditors are not allowed as partners in these companies.

¹⁷ The Capital Market Authority keeps a list of 55 accredited auditors for investment funds. The Ministry of Finance accredits the auditors of joint stock companies. The Central Accountancy Authority accredits auditors for the public capital companies. As for banks, the auditors are accredited by the Central Bank of Egypt. For the Insurance companies, they are accredited by the Insurance Supervisory Authority. The Real Estate Authority will be responsible for accrediting the list of auditors for real estate finance companies.

¹⁸ They sell shares when demand is higher than supply and buy shares when supply is higher than demand.

Registration and Listing Requirements

Companies that issue shares must present the prospectus to the Capital Market Authority for revision and approval in order to guarantee the companies' compliance with the conditions. As soon as the application is approved, a company may disseminate and distribute its issuance prospectus as the first step in offering shares for public subscription. A summary of the prospectus must be published in two daily morning newspapers in Arabic language designating where the issuance prospectus is available.

Registration and disclosure procedures of the Cairo and Alexandria Stock Exchanges were updated in order to ensure the proper application of corporate governance principles. According to the new registration rules, as of August 2002, companies are now registered in one of four tables instead of three: Formal Table 1, Formal Table 2, Informal Table 1 and Informal Table 2. Formal Table 2 was added to list securities issued by the state for public subscription, securities issued by public sector companies subject to Law No. 97/1983, and the public business sector companies subject to Law No. 203/1991, all of which were formerly listed in Formal Table 1.

Three criteria were added to the new registration rules to conform to international standards. They are: profitability, number of shareholders, and the minimum level of companies' share capitals. These criteria defined and differentiated between public subscription and private subscription for the first time in Egypt. A company's securities will be considered a private subscription if the number of shareholders through their trading process reaches 50 or more; and will be considered a public subscription if the number of shareholders through their trading process reaches 100 or more. Thus, a company will not have the choice of being registered in a particular table, as was the case before. Registration takes place according to the criteria available in every company.¹⁹

The new rules oblige companies to publish their registration applications on the internet and the Stock Exchange daily bulletin to give those concerned the right to object to the Registration and Cancellation Committee within ten days from the publication

¹⁹ Some practitioners say that some registration rules are difficult to adhere to such as the condition of issuing financial statements every three months (it is suggested to be every six months) and obliging the auditing committee of the company to present monthly auditors' reports (it is suggested to make them quarterly or biannually).

date. From August 1, 2002, the Stock Exchange started the adoption of a system for registering agents at the Stock Exchange to make it easier for companies to complete their registration procedures through them. According to the trading rules of the Stock Exchange, the CMA supervises the shares' price movement, which should be within a 5 percent increase or decrease. But by virtue of the criteria issued by the Minister of Foreign Trade Decision No. 441 in July 2002, these price limitations were removed from the most active shares (which reached 14 shares in March 2003). Price limitations are expected to be lifted from all the remaining shares as well. There are no price limitations on bonds and the closing price is left for the market mechanisms except for the bonds convertible to shares, which are subject to current price limits.

The new rules gave companies with securities listed on the Stock Exchange tables a period of one year from 1/8/2002 to 31/7/2003 to adapt the registration position of their securities according to the new registration rules. Thirty-four companies harmonized their positions as of 31/12/2002, i.e., 2.95 percent of the total registered companies.²⁰

Ownership Structure

In 2002, investment percentage reached 17 percent for individuals (15 percent nationals and 2 percent foreigners), 78 percent for enterprises (64 percent national and 14 percent foreign) and 5 percent for investment funds (1 percent national and 4 percent foreign). Pensions and Insurance Funds invest a small portion of their assets in shares only.

The number of public businesses that were privatized and that publicly trade their stock reached 190 in 2002. Most of them were sold to an anchor investor or were sold to the majority through the Stock Exchange. Nevertheless, the state still keeps a share of many of the privatized companies through holding companies, and is the principal shareholder of those companies. In such cases, the structure of the board of directors and upper management is often identical to their structure before privatization. A decision was issued in March 2003 to sell the remaining portions in these companies to the private sector, which had a positive effect on their market trading value. The portion of the employee shareholders union in these companies ranges between 5 percent and 10 percent.

²⁰ All the changes in the rules of registration will be duly discussed.

1. Shareholders' Rights

This section deals with the extent to which shareholders are protected through the legal framework. It includes the right to transfer the ownership of their shares, to vote in the general assembly, to select board members, to obtain dividends from their shares, to revise the financial statements and the right to active participation in the general assembly meetings.

1/1. Fundamental Rights

There are no restrictions on transferring the ownership of shares registered in the stock exchange.²¹ On January 1, 2001 almost 62 percent of all shares were material (share warrants). But book trading (without handling share warrant) expanded to reach 99.6 percent of total Stock Exchange trading in 2002. The Central Depository and Registry Law obliged all the registered companies to register at Misr Clearing, Settlement and Central Depository Company. The total number of companies registered reached 870 in December 2002.²² The remaining 278 companies registered at the Stock Exchange were not registered at the Central Depository.

Clearing and settlement are made on the basis of cash-on-delivery in the sense that securities are delivered to the buyer against the payment of its value to the seller. If securities are deposited at Misr Clearing, Settlement and Central Depository Company, the purchased securities are delivered to the buyer in the form of book entries, i.e. they are added to the buyer's account of securities at the depository company and at the concerned depository trustees at the same time when their value is added to the settlement account of the selling broker.²³ It is worth mentioning that settlements of operations implemented on active securities whose price restrictions on market trading were lifted are made on the second day after trading (T+2). Settlements implemented on the other

²¹ According to Article 63 of the Capital Market Executive Regulations No. 95/1992, the founders' shares are non-transferable for 2 years, whereas according to Article 45 of the Companies Law No. 159/1981 the qualifying shares of the board members become transferable as soon as a manager resigns or is dismissed by the annual general assembly and the board of directors is acquitted.

²² Of these companies, 860 are registered at the Stock Exchange and 10 are not registered.

²³ Depository trustees are responsible for the management and depositing the accounts of securities' traders. In addition to Misr Clearing, Settlement and Central Depository Company, there are 16 banks that provide depository services. The five major banks in this field are: the National Bank of Egypt, Commercial International Bank, Citibank, American Express and HSBC.

securities in central depository are made on the third day after trading (T+3). Settlements implemented on material share warrants are made on the fourth day after trading (T+4).

Before the Central Depository Law was issued, all the clearing and settlement operations were made according to ISSA-630 recommendations with the exception of three subjects: the effective payment system with geographical spread, securities lending and borrowing, and the registration of all the companies registered at Misr Clearing, Settlement and Central Depository Company. The latter was dealt with by the Central Depository Law as mentioned earlier. The law also addressed the subject of securities lending and borrowing and decided the necessary means to ensure that Central Depository members would meet their obligations regarding settlements in securities, including a system for lending securities to Central Depository members. However, the regulations that organize the implementation of lending operations have yet to be issued.

The Settlements Guarantee Fund was established in January 2000 with capital provided by securities brokerage companies *pro rata* the volume of their trading at the Stock Exchange. The Fund is run as a self-regulatory organization under the supervision of the Capital Market Authority. The Fund's main function is to protect the investor against non-commercial risks and to guarantee the implementation of the financial and securities settlement operations liabilities for trading operations at the Stock Exchange in case either party fails to fulfill its obligation to the other.

As for the lack of a system of bank payments that are geographically widespread, negotiations are ongoing between the Central Bank of Egypt and Misr Clearing, Settlement and Central Depository Company to allow the Company to discount and add on the Banks' accounts at the Central Bank of Egypt according to the results of the securities' trading operations. Presently, shareholders can obtain the interest on their profits from 42 bank branches in 10 governorates covering all the regions of Egypt from Cairo and Alexandria to the Delta and Upper Egypt, in addition to all of the branches of the Central Depository Company. According to the Law, profits have to be distributed within 30 days from the issuance of the general assembly decision. Disbursement takes place either in cash, by cheques, bank transfers or by personal delivery from the Central

Depository Company to the customer's pre-determined address.²⁴ The system is not limited to interest disbursement, but includes bonds yields, depreciation values, and repayments for the restructuring of issuing companies deposited at the Central Depository Company.

1/2. The General Assembly Meetings and Disclosure of Financial Statements

The Companies' Law No. 159/1981 stipulated that the annual general assembly should be convened within three months from the end of the previous financial year. It also stipulated that summaries of the financial statements and the auditors' reports should be published in two daily newspapers or sent by registered mail to every shareholder at least 15 days before the date of the general assembly meeting. The chairman of the board of directors chairs the annual meeting of the general assembly. The invitation to the meeting must include date, time and place of the meeting as well as the agenda, the annual report, the auditors report (if not published), and the board of directors' report. In addition to notifying the shareholders, three other parties must be notified, namely the auditor, the Capital Market Authority and the administrative bodies to which the listed company belongs.

As mentioned earlier, the Capital Market Authority has a supervisory role over all the companies registered at the Stock Market whether they are founded according to Law No. 8/1997 or Law No. 203/1991. In addition to CMA's supervisory role, companies founded according to Law No. 8 /1997 and Law No. 159/1981 are subject to the supervision of the General Authority for Investment; and companies founded according to Law No. 203/1991 are subject to the supervision of the Ministry of the Public Business Sector or rather, the holding company.

Contrary to Law No. 159/1981, trading in or transferring the ownership of securities shall not cease during the convention of the general assembly of the company that issued the shares. However, trading in the securities of an investor willing to attend and vote in the general assembly shall cease so that he preserves his position as a shareholder. But practically speaking, this is difficult to implement. The legal quorum for convening the general assembly is three board members at least (as mentioned in the

²⁴ In the case that the shareholder belongs to one of the special categories such as widows or senior citizens.

company's statutes), the auditor and a number of the shareholders representing at least one-fourth of its share capital. If this quorum is not reached, an invitation may be addressed for a second meeting. No minimum quorum is required for the second meeting unless the company's statutes stipulate a higher percentage.

Shareholders representing 5 percent of a company's share capital may add items to the agenda up to three days before the meeting. The Law does not stipulate whether the company has to distribute the amended agenda publicly before convening its general assembly. It is also possible to discuss any urgent matters and vote on them without having them listed in the agenda if the majority of the shareholders present at the meeting agree they are worthy of discussion. Shareholders may ask questions, and the board of directors must answer them provided they do not cause "any harm to the company's interests or to public interest". If the concerned parties consider the answers to be insufficient, they may call the general assembly to make a decision on that subject.

Shareholders who paid 50 percent or less of the shares' issue value are entitled to all voting rights. However, the profits they may obtain are *pro rata* their paid-in amounts. Voting may be in person or by proxy, but voting by proxy is subject to certain restrictions. If the principal is a natural person, the representing person should be a shareholder (this does not apply to non-physical persons), who has a power of attorney and is not a member of the board of directors.²⁵ A natural person is not allowed to represent more than 10 percent of the total shares and 20 percent of the shares represented in the meeting (this does not apply on non-physical shareholders). Voting is by secret ballot if it is concerning the election, dismissal or penalization of a board member or if the board chairman or shareholders who represent one-tenth of the capital attending the meeting call for a secret ballot. The general assembly appoints two of the attendees, in addition to the secretary of the session, to count the votes and supervise the voting and casting process. In the past, voting was not allowed by regular mail or by e-mail, but this option is now available for shareholders. However, it has yet to be applied.

²⁵ Board members are not allowed to vote in person or on behalf of one or more shareholders because it is the shareholders who call board of directors to question.

The Central Depository Law differentiates between the registered owner and the beneficiary owner. Executive regulations give registered owners the right to vote on behalf of all the beneficiary owners (block voting). The law also allows the registered owner to fragment the votes of the beneficiary owners. This means that they can cast differing votes on the same subject.

Shareholders can get information on their voting rights on the different categories of shares either from the company's statutes, from the commercial registry at the Ministry of Supplies and Internal Trade for a required fee,²⁶ or from the Association of Capital Sector. Another source of information is the company's issuance prospectus and brokerage offices. In the past, it was not necessary to disclose the capital structure or the real structure of ownership in the annual report. But new rules made it obligatory for registered companies to forward biannual reports to the Stock Exchange (on 31/12 and 30/6) that include the shareholders' structure. Moreover a company has to forward a report as soon as a radical change takes place in the shareholders' structure throughout the year.

Shareholders have the right to review the financial statements, which include the company's financial position, income statements, cash flows, changes in equity and the attached clarifications and the auditors' report for the past three years. The information can be reviewed at the company's headquarters for two weeks before the general assembly meeting, provided a signed application for revision is filed. Article 15 of the Stock Exchange registration rules concerning disclosure obliges registered companies to designate a person responsible for relations with the shareholders to act as a liaison with the Stock Exchange and to answer the queries of the shareholders and investors.

The Companies Law No. 159/1981 gives shareholders who own 5 percent of the share capital the right to call for the annual meeting of the general assembly if the board of directors does not call for it. Extraordinary meetings of the general assembly may be held according to the request by shareholders owning 10 percent of the capital shares or by the board of directors. The legal quorum of the first meeting must be 50 percent of the share capital unless the statutes stipulate a higher percentage. If the quorum is not

²⁶ LE 20 per copy.

reached, the quorum for the second meeting will be 25 percent of the share capital. The auditor and the Associations of Capital Sector may also call for an ordinary or extraordinary meeting of the general assembly.

2. Equitable Treatment of Shareholders

Equitable treatment of shareholders refers to equality among of the holders of shares in each category, the right to defend their legal rights, to vote in the general assembly on fundamental decisions, to be protected against any suspicious mergers or acquisitions and insider-trading, and their right to be informed of all the transactions of the board members and the executive managers.

2/1. Voting Rights

Egypt's legal framework allows for multi-shares categories provided the shareholders of any category are treated similarly and equally. There are two main categories of shares: common shares and preference (or preferred) shares.²⁷ Common shares are either registered (sometimes called "nominal") or to-the-holder.²⁸ The holder shares should not exceed 25 percent of the total shares and they must be paid in full. Owners of holder shares may take part in the annual meeting of the general assembly if their shares are deposited at the bank, the issuer company or at Misr Clearing, Settlement and Central Depository Company, but they do not have the right to vote.

Owners of preferred shares enjoy three advantages. First, advantages related to voting: they may have multi-votes according to the statutes of the issuer company.²⁹ Second, the owners of "profit-collecting" preferred shares have the right to be paid a defined and fixed percentage of the revenue before any other profits are distributed. Third, priority upon liquidation and priority in share capital increase. The share capital may be increased through preference shares if a company's statutes stipulated such a

²⁷ Most of the shares traded in Egypt are ordinary shares. Ordinary shares represented 99.6 percent of the total market capital on 31/1/2003, whereas traded preference shares represented 0.4 percent. Cairo and Alexandria Stock Exchanges, *Monthly Bulletin*, January 2003.

²⁸ Holder or bearer shares were introduced by the Capital Market Law No. 95/1992 (Article No. 1 of the Executive Regulations), but the holder does not have the right to vote.

²⁹ In most cases, the voting rights comprise a maximum of two votes per share. But there is no legal limit.

clause upon incorporation and if it is approved at an extraordinary meeting of the general assembly according to a suggestion by the board of directors and the auditors, who must declare their justification for this action.³⁰

Every shareholder has the right to submit a complaint to the concerned administrative agency regarding any violation of the law. A shareholder who attends the annual meeting of the general assembly and registers his objection to a certain decision in the minutes of the meeting has the right to file a lawsuit before the court within one year from the date of the meeting. Article No. 76 of the Companies Law No. 159/1981 stipulates that all the decisions issued in favor of a specific category of shareholders or causing any damage or harm to them or decisions offering special benefits or advantages to the board of directors shall be nullified. Furthermore, shareholders who represent 5 percent or more of the share capital are entitled to submit a complaint to the board of directors of the Capital Market Authority. CMA shall have the right and the authority to cancel the decisions of the annual meeting of the general assembly if they are deemed to be in favor of a specific category of shareholders or may cause any damage or harm to them or offer unfair benefits or advantages for the board of directors or others. Shareholders who represent 10 percent or more of the share capital are entitled to ask the Capital Market Authority or the Capital Corporate Sector to conduct surveys and inspections.

In the past, the Capital Market Law allowed traders at the Stock Exchange to resort to mandatory arbitration. But because legal actions are costly and time-consuming, the High Constitutional Court ruled in January 2002 that mandatory arbitration is unconstitutional. However, optional arbitration is still allowed. The Stock Exchange recently announced a project to establish, in collaboration with the Cairo International Arbitration Center and the CMA, a new center for dispute settlement and arbitration for the securities market by the end of the current year (2003). The new system aims to accelerate the resolution of disputes occurring between the stock exchange traders and the securities' companies without resorting to the judicial system, which is often a lengthy

³⁰ Companies whose statutes did not stipulate upon incorporation the possibility to increase share capital through preference shares are not allowed to issue these shares. However, there are attempts to amend the law so as to allow this process by a special majority.

process, especially since there are no judicial circuits specializing in capital market lawsuits or in economic disputes.³¹ The proposed draft Capital Market Law allows CMA to file collective lawsuits on behalf of the shareholders. This is what is called a class action lawsuit.³²

2/2. Participation in the Company's Fundamental Decisions

Voting must be conducted with a two-thirds majority for decisions related to granting advantages to the present shareholders before increasing the share capital, failure to apply the priority rights if stated in the company's statutes, or adding new items to the company's objectives. Similarly, two-thirds of the shareholders in the same category must agree in order to make any changes to their voting rights. Voting shall be conducted with a 75 percent majority for decisions related to increasing or decreasing share capital, changing the original purpose of the company, prolonging or shortening the duration of the company or deciding to dissolve or merge the company. If the attained losses reach 50 percent of the issued share capital, the board of directors must call for an extraordinary meeting of the general assembly to consider whether to dissolve or continue the company.

2/3. Follow-Up and Supervision of Companies

Any person willing to buy shares that will raise his ownership to 10 percent or more of the share capital has to send prior notice to the company by registered mail two weeks before the completion of the purchase. Within one week from receiving this notification, the company must inform the shareholders who own at least 1 percent of the company or publish such information in two widespread newspapers. The allowed ownership limit for board members or employees is 5 percent of the share capital. This process must be completed within one month from the notification date. If the percentage exceeds 20 percent for shareholders before or after the planned ownership (15 percent for the directors and employees), an offer to purchase the required portion of the share capital must be issued to all shareholders. The offer may be for all the shares or just for a portion of the shares. The offered price must be at least equal to the average closing price during

³¹ Researches are currently being conducted to establish specialized legal circuits.

³² The Draft Law allows the filing of collective lawsuits on behalf of the shareholders.

the month that preceded the notification. The purchase offer remains valid for a period of two weeks, and may be extended. If the offered shares are more than required, the buyer must buy from all the shareholders *pro rata* their shares. Recently, CMA has started to refuse purchasing offers that may cause the buyer to own the majority of the company unless the offer is for 100 percent of the shares. This is to avoid one shareholder having control over the management of the company while the minority shareholders are negatively affected.

2/4. Insider Trading and Self-Dealing

Egypt's legal framework does not deal with the subject of insider trading and self-dealing in a definite manner. Article No. 64 of the Capital Market Law No. 95/1992 deals with any person who discloses secrets under his control by virtue of his duties or job, whose wife or children benefit from disclosing internal information related to his job, who uses important, false misleading or incorrect information, or who omits any important information from the reports he makes to the extent that affects the results of those reports. Despite its presence, this provision is insufficient. In order to secure the efficiency of supervision on trading in insider information, it is suggested that each of these cases be properly defined.

The new rules oblige companies to observe certain disclosure procedures applicable to those who deal with the companies' information and internal secrets. The procedures address the following issues.

- Persons who obtain the information in a secret manner should not trade in the securities of the concerned company until the information becomes publicized. The company must provide the Stock Exchange with any information in this respect, especially concerning the persons who have access to such information.
- If the company is willing to announce information in its general assembly that may cause a tangible change in the value of the listed shares, the company must take the necessary procedures to convey such information to CMA and the Stock Exchange. This ensures that such information will not be made available to shareholders before

it is published on the trading monitors, which occurs at the same time it is announced to the shareholders attending the meeting.

- The board members, officials and persons who have access to internal information agree that they will not buy or sell the company's securities according to internal information not disclosed to the public.
- The adopted internal supervisory procedures prevent the board members, managers and employees from trading the company's shares fifteen days before and three days after issuing or publishing any essential data or information that may cause an important change in the company's securities price.
- The adopted internal supervisory procedures oblige the company's board members, officials and persons who have access to the internal information to inform the exchange market and CMA of any operations they conduct to buy or sell the company's securities at least 24 hours before the implementation of such operations.

CMA created a database for all the individuals who have access to the companies' secrets and other sources of information. Cadres working in the trading supervisory field at the Stock Exchange and CMA were trained in the USA in the most recent techniques in this field. Guidelines were also prepared for methods of action.

The Cairo and Alexandria Stock Exchanges are responsible for immediate supervision during trading, while CMA is responsible for subsequent supervision after trading. A group of professional supervisors work at CASE both in Cairo and Alexandria. Some of them work with the brokers in the compartment. Others observe market activity to discover any insider trading or self-dealing. The Supervision Department inspects trading through code numbers for investors. It is also possible to inspect them by their names through the Information Department or through brokers' ledgers and orders. CMA and CASE are connected electronically online. In case of manipulation in prices, the chairman of CASE or CMA suspends the offer/tender prices and cancels the operations.

2/5. Deals with Related Parties

Egypt's accounting standards require that board members and managers disclose the trading, bargains and other businesses conducted with related parties, including board members or managers, regardless of whether such operations were already made or are going to be made. Disclosures must be written with the clarifications attached to the financial statements. A board member who has any conflict of interest must inform the board of directors, record it in the minutes of the meeting, and abstain from voting. The board of directors must inform the annual general assembly of any operations with the related parties.

The new registration rules defined the nature of dealings with related parties that the companies have to inform the Stock Exchange about, including:

- A summary of the important contracts of the company or of any related companies during the two years that preceded the registration application. The summary should include the amounts paid to or from the issuing company or its affiliates.
- The organizational structure of the company that shows whether it is a holding or an affiliate company.
- The capital structure including the percentage of the shareholders who own more than 5 percent of the holding company and its affiliates.
- Statement of the transactions between the issuing company and any of the shareholders in the company or in its affiliates.

3. Stakeholders' Role in Corporate Governance

This section analyzes to what extent Egypt's legal framework allows stakeholders to own a portion of the shares, to be informed of the company's essential operations, and how it protects their interests. Stakeholders include the bondholders, workers, banks, suppliers and customers.

3/1. Respect of Legal Rights

The Companies' Law No. 159/1981 gives the workers the right to 10 percent of the company's distributed profits with a maximum limit of their salary for one year. This right can only be exercised in the case of profit distribution. The Law also gives the workers the right to participate in the management of the company. Its statutes decide the most suitable methods and rules to be applied in this concern, with the exception of the public business sector. Presently, there are no representatives for workers on companies' boards of directors. Instead, companies establish "workers committees" or other similar bodies to handle matters for the workers including wage and other compensations. One of the board members is responsible for liaison with this committee. On the other hand, the Capital Market Law No. 95/1992 gives bondholders special protection. For example, they have the right to form bondholders' associations and elect a legal representative to work on their behalf and attend the annual meetings of the general assembly. These associations issue recommendations for the annual general assembly or the board of directors, but do not have the right to vote in the general assembly meetings.

3/2. Compensation for Rights Violation

Stakeholders' rights are protected by contracts and by certain laws such as the Labor Law, the Environment Law or the Bankruptcy System.³³ Stakeholders have the right to resort to legal procedures for compensation for any violations of their rights.³⁴

3/3. Mechanisms to Promote Stakeholders' Participation

Workers may establish federations or associations with the purpose of owning shares or distributing profits. The workers shareholders associations must be registered with CMA and must have written statutes. Only the workers of the company are entitled to its membership. The board of directors runs the association and its ultimate authority lies in the general assembly. The Workers' shareholders associations in privatized companies own 5 percent of the share capital on behalf of the workers. The association is usually

³³ The organization of bankruptcy rules is, at the present time, subject to the Commerce Law. But the new Capital Market Law will handle defaulting companies' problems in a manner similar to that of the Federal Bankruptcy Code, Title 11 of the US Code. Chapter 7: Liquidation, and Chapter 11: Reorganization.

³⁴ In the case of a merger, stakeholders are protected by a condition that does not allow prejudice of creditors' rights, and that stakeholders have priority in case of a company's liquidation.

given a seat on the board of directors when it owns 10 percent of the share capital if the statutes specify that shareholders are represented on the board of directors *pro rata* the shares they own. It is also allowed to re-buy the sold shares. In this case, the shares are called treasury stocks³⁵ and the re-buying process is called share buyback. Sometimes these shares are distributed to workers. Treasury stocks may be kept for no more than one year, then they are either resold or the general assembly is called for a meeting to make a decision on reducing the share capital by the nominal value of the treasury stocks. Some companies have share ownership programs for their employees and executive managers,³⁶ but there is no definite system for such programs to date.

3/4. Access to Information

Workers, in their capacity as shareholders, have the right to gain access to the same information as other shareholders. The bondholders' group has the right to review the financial statements and send a representative to participate in the annual meetings of the general assembly.

4. Disclosure and Transparency

This section deals with all aspects of disclosure and transparency in relation to the company's activities and the role of the auditor.

4/1. Disclosure of Important Information

Every company registered at the Stock Exchange is obliged to disclose its financial position and its operational performance to the CMA and CASE. This disclosure takes place either annually or quarterly. The information that must be disclosed in the financial position and the income statements includes the changes in equities, cash flows, complementary clarifications of the statements, the report of the board of directors, and the report of the external auditor.

³⁵ Treasury stocks have two characteristics: 1) they do not have the right to vote; 2) they do not have the right to profits. The company buys its shares if the market price is unfair. So, it buys some of its traded shares and distributes the profits to fewer shareholders in order to improve the company's market value.

³⁶ Such programs are not included in the company's statutes.

CMA examines the financial statements to ensure the company has met the requirements and the extent to which the statements conform to Egyptian accounting standards. CMA may ask a company to disclose and publish more items than it has in previous years. If a company fails to meet this condition, CMA publishes its comments on the company's financial statements at the cost of that company. Companies are also obliged to publish complete summaries of their annual and biannual reports in two widespread daily newspapers; at least one of them must be in Arabic. Companies must prepare their financial statements according to the Egyptian accounting standards, which are issued by the Ministry of Foreign Trade and are mostly in harmony with international accounting standards. In this context, it is worth mentioning that in 2002 the Ministry of Foreign Trade issued (by Ministerial Decree No. 345) three new standards in harmony with international accounting standards and other standards are still under preparation. According to said Ministerial Decree, companies have to apply the international accounting standards if no parallel Egyptian standard is issued.³⁷

Companies also have to immediately disclose to CMA and CASE all the important events that may affect the company's financial position or its operational turnover. As soon as the Stock Exchange is informed, it must publish the information immediately on the monitors and inform the brokerage companies. The Disclosure Department of the Stock Exchange supervises the companies to ensure they make the required disclosures. According to the new registration rules, the Stock Exchange may impose penalties and sanctions on companies that deliberately disclose wrong or misleading information in their financial statements. The penalty for failing to conform to disclosure rules is elimination from registration tables. The new registration rules impose financial penalties on companies that do not observe the rules of transparency and periodical disclosure of material information, financial statements and non-financial information.

The following are the major points of the new disclosure rules:

³⁷ This is with the exception of leasing standards prepared according to the Egyptian requirements, which do not group the leased assets with the assets of the lease-holder, but consider them assets owned by the lessor that appear in his balance sheets.

- Companies shall inform the Stock Exchange of any material events that affect their activities or financial position, or affect the trading of its shares. Companies must report these events immediately and notify the Stock Exchange at a time that allows it to publish these events on the monitors immediately or before the first subsequent trading session after the occurrence of these events as well as in the first bulletin issued after the occurrence of the events. This Article stipulates what a company must do if important or emergency events occur during formal holidays. The Article gives examples of such events.
- Important events are published in coordination with the company and the management of the Stock Exchange. Publishing does not take place during trading hours unless the information must be published immediately. In such a case, trading on the company's securities will be suspended for a period to be decided by the Stock Exchange Chairman, provided it does not exceed one hour.
- The company must take the necessary precautions to secure the confidentiality of the financial information and to prevent any deliberate or accidental leak before it is announced to traders.

4/2. The Auditor

Companies have to submit their annual and biannual financial statements following the revision and approval of the auditor. Quarterly financial statements are to be submitted together with a limited examination report. In this context, it is worth noting that the new registration rules necessitate that the company's upper management, executive manager and financial manager must verify that there is no unrecorded information that may affect the company's financial position and that there are no lawsuits filed against the company that may require building-up additional allocations other than those mentioned in the financial statements.

The annual general assembly has the mandate and the authority to appoint the auditors and to determine their compensation. It is not necessary to disclose the fees for consultative services at the annual general assembly meeting. However, the new rules of autonomy necessitate that auditors should not provide any consultation to a company for which they examine and audit its accounts unless they obtain a license from the Auditing

Committee. An auditor should not be one of the company's founders, board members, employees or related by any other means to the company or its board of directors. There is nothing to prevent an auditor from being a shareholder of the company he audits, which is against the principles of autonomy. An auditor is not allowed to become a board member or an employee of the company until three years after the expiry date of his work as its auditor.

An auditor has the right to examine all documents, data and the other necessary information and to ask for the support of the board of directors to help him realize his mission. If the auditor can not get all the information he deems necessary to accomplish his goal, he may forward a report to the board of directors or the general assembly denoting that he will not express his opinion due to insufficient information. The auditor must inform the general assembly to which he is also going to submit his auditor's report.

Any shareholder may submit a request for the dismissal of the auditor up to ten days before the date of the general assembly's meeting after providing, in writing, his justifications for the dismissal. The auditor has the right to reply to this motion in a letter defending the actions that were subject to criticism and consideration. The auditor is held responsible for any mistakes or distortion of facts, and is responsible for indemnifying the company and/or the shareholders for any damage resulting thereof. The new registration rules require companies to form internal auditing committees and to disclose the committee's activities to the financial community. All the members of these committees must be non-executive board members. These committees may also comprise non-board members and experts in order to supervise the internal auditing activities and to appoint the auditor, determine his fees and discuss his reports.

The first step any potential auditor must take is to register his name at the Ministry of Finance. After eight years of service and gaining experience, he or she will be entitled to audit the accounts of any company without having to sit for an examination. This is with the exception of the Egyptian Accountants and the Auditors Association (1,350 active members in a country comprising about 18,000 registered accountants) whose membership is only granted after passing high standard examinations.

It is worth noting that the Egyptian Accountants and Auditors Association in cooperation with the Ministry of Finance, the Commercial Syndicate, CMA and the Central Accountancy Authority prepared a draft law (an amendment of the current Law No. 133/1951) to regulate practicing the accounting and auditing professions in Egypt. The draft law was discussed at the State Council and was referred to the government in preparation for forwarding it to the People's Assembly for approval. The draft law comprises articles that deal with the strict supervision of auditors' performances and preconditions for registration at the accountants' tables, especially sitting for the examinations as stipulated by the Law. It also provides for the establishment of a Higher Council for Supervision and Monitoring of the Accounting Profession.³⁸ The Council will form a sub-committee responsible for monitoring and supervising the performance of the auditors of companies registered in the Stock Exchange and for inspection and imposing penalties on those who do not conform to the Egyptian and international accounting standards.

4/3. Disclosing Ownership of the Majority of Shares

According to the Central Depository Law, the settlement company must keep a registry of detailed information on the beneficiary owners, which are obtained from the registered owners. Nobody is allowed access to this registry except the issuers of securities and the authorized bodies within the limit that concerns each of them. The Law requires registered owners to disclose details of the beneficiary owners. The companies as well as Misr Clearing, Settlement and Central Depository Company keep registries for shareholders and update them continuously; however these registries do not denote the ownership of the ultimate beneficiary. Companies must present these registries to their annual general assemblies. Shareholders have the right to review the minutes of the general assembly meeting, which include, as annexes, the names of all the registered owners and the number of shares owned by each of them. Such information must also be

³⁸ The majority of the council would be comprised of non-accountants. It will be chaired by the Minister of Finance, with members from the CMA, the Insurance Supervisory Authority, the General Investment Authority, the Central Accountancy Authority and a representative from each of the Egyptian Accountants and Auditors Association, the Free Professions Practitioners' Branch and a number of accounting and auditing experts.

made available to the administrative bodies (the Investment Authority, the Associations of Capital Sector and the holding companies).

Recently, CASE has started to demand that the most active companies – which amount to about 30 companies and form CASE's index – disclose their ownership structure of 5 percent or more.³⁹ Under all circumstances, this practice is not considered mandatory either by virtue of the law or the current regulations.⁴⁰ The new Capital Market Law as well as the new registration rules aim to promote ownership disclosure.

4/4. Disclosure for Board Members and Executive Directors

The board members' degree of disclosure, which must be presented to the company's general assembly, is decided by the company's statutes. For example, the names of the board members and their remuneration are disclosed to the annual general assembly, but such information is not published in the annual report. The board members' remuneration includes their fees and travel allowances, and their annual portion of the profits which should not exceed 10 percent of the net income (after discounting 5 percent as statutory reserve and 5 percent to the paid in capital as divisible profits). The executive directors' compensation is not disclosed. CMA asks the companies to present annual lists of names and nationalities of their board members and key officials and managers as well as any information or relevant details regarding them. CMA must be informed immediately of any changes that take place on such lists.

Board members have to disclose any conflicts of interest and should not vote on board decisions connected with such conflicts. The board conveys such information to the annual general assembly. Board members must obtain special authorizations from the annual general assembly in order to trade for their own interests in the same business sector or to be a party to any contract presented to the board for approval. They should also not enter into contracts with other companies and take fees from them if their colleagues are board members, managers or executives in these companies.

³⁹ This is important when the Law requires certain limits of ownership such as airline companies.

⁴⁰ The Capital Market Law requires disclosure of 10 percent of the share capital.

4/5. Disclosure of Other Information

A relatively low number of companies publish formal annual reports in addition to the requirements stipulated by the Companies Law No. 159/1981 and the Capital Market Law No. 95/1992. According to the latter, a company that issues debt instruments for amounts exceeding the net value of its assets must get an annual rating from the rating institutions accredited by CMA.

5. Responsibilities of the Board of Directors

This section deals with the structure of the board of directors, the selection of its members, its main functions and its supervisory role over the executive management.

5/1. Structure and Legal Responsibilities

The board of directors' membership consists of an odd number with a minimum of three members. There are no rules that govern the board structure from executive or non-executive managers. So far the concept of the "independent board member" is not clearly applied in most of the companies in Egypt. The board chairman is often also the managing director. The board member responsible for administration is sometimes called the managing director or the executive director; and the board decides his/her remuneration. Board members must be shareholders or representatives of the participating companies with the exception of two members (as a maximum) who are chosen because they are "experts in the field". The board elects its chairperson and his deputy sometimes, and has the right to change them any time. The board holds its meetings at the request of its chairperson or two-thirds of its members. The board meeting is considered valid if the number of attendees is not less than half of its members plus one, provided the number of attendees is not less than three board members.

5/2. Selection of Board Members

The annual general assembly elects board members for a period of three renewable years and decides their remuneration. Election conditions include the ownership of a minimum number of shares as indicated in the company's statutes (with the exception of the two

experts). These shares will be kept as qualification shares until the expiry of the board's term and the ratification of the last annual report by the annual general assembly.⁴¹

A worker can not be appointed as a board member if his period of service at the company is less than 2 years. There should be no more than three executive managers on the board of directors. Board members should agree in writing on the appointment of the executive managers and their CVs should be sent to the general assembly provided they contain lists of the companies at which they worked during the previous three years. Managers may serve on a maximum of two boards, but managing directors should only serve on one board with the exception of the manager who owns at least 10 percent of the company's share capital. Board members lose their qualification immediately if they declare bankruptcy or commit a criminal action or a serious crime such as robbery, breach of trust or forgery. Shareholders may dismiss or fire managers. The law penalizes managers who commit crimes of bribery or forgery, give misleading information, divide illusionary profits or enter into self-dealings. Penalties include imprisonment and/or fines according to the gravity of the infringement.

5/3. Main Responsibilities

The board of directors is the high authority that governs the company or enterprise. It is responsible for supervising the implementation of the company's objectives as decided by its general assembly. The board is responsible to the shareholders as deputy for them. Consequently, all the provisions of proxy in the Egyptian Civil Law are applicable to the board of directors. The board is also legally responsible for any distortion or forgery of the company's information. For example, every board member is subject to imprisonment for not less than 2 years and a fine ranging between LE 2,000 and LE 10,000 if profits are divided in a manner different from the provisions of the Companies' Law No. 159/1981 or the company's statutes. The functions of the board of directors include: inviting the shareholders to meet, investing the company's funds, requesting loans, appointing executive managers and submitting financial statements and board reports to the annual general assembly meeting. The board report also includes a summary of activities and

⁴¹ It is worth noting that Egypt allows an artificial person to be a board member, which is why there are operational difficulties. Only France and Belgium also allow an artificial person as a board member.

proposed plans for the coming year. The board of directors may also allow an increase in the company's share capital within the authorized limits without the need for a special decision from the shareholders or from the general assembly.

5/4. Independent Supervision

By virtue of the Egyptian laws, the annual general assembly, the board of directors, the internal and external auditors and the governmental agencies all supervise and monitor the company's management. The annual general assembly is considered the top authority and all its decisions are binding. But in practice, shareholders do not play an active role in supervising and monitoring management. In most companies, there is no actual separation between the board of directors and the executive management. It is a one-tier structure of management. The board of directors does not include independent members, nor does it form ad hoc committees to consider assigned subjects.⁴² Some companies do not appoint an internal auditor. Even in companies with internal auditors, their authority is very limited. CMA and the administrative supervisory bodies, upon the request of the shareholders (and within their authorities and mandate), supervise the company's management through inspection activities. Representatives of the Investment Authority, the Associations of Capital Sector and CMA attend the general assembly's meetings to guarantee the integrity of the administrative procedures and make sure that the issued decisions are not biased toward a group of shareholders at the expense of the remaining shareholders. If there is doubt about the board's actions, the concerned agencies issue orders for examination and inspection. The Central Accounting Authority audits the accounts of companies with state ownership of more than 25 percent.

Conclusion: Main Results and Recommendations

Developments at the Cairo and Alexandria Stock Exchanges indicate that the period from September 2001 to March 2003 witnessed considerable progress in corporate governance standards in Egypt, with subsequent improvement of the overall assessment of these standards (Table 1). Standards that conform completely or considerably to the

⁴² With the exception of the executive committees which are responsible for the day-to-day operations.

international corporate governance standards rose from 40 to 45 standards. The number of standards unobserved in Egypt dropped from 8 to only 3 standards.

Table 1: Development of the Overall Assessment of Corporate Governance Rules in Egypt, September 2001 to March 2003

	Completely Observed	Considerably Observed	Slightly Observed	Not Observed
September 2001 Assessment*	14	26	6	2
March 2003 Assessment **	24	21	2	1

Sources: * Ministry of Economy and Foreign Trade (2001).

** As calculated by researchers.

The assessment showed that progress was achieved in the five principles of corporate governance, but the degree of improvement differed from one principle to another. According to this assessment, the order of the five corporate governance principles in Egypt based on their degree of conformity to international standards is as follows: the stakeholders' role in corporate governance, equitable treatment of shareholders, shareholders' rights, disclosure and transparency, and responsibilities of the board of directors.⁴³

The following are the most important procedures undertaken from September 2001 to March 2003 that had a tangible effect in improving the overall assessment.

- ***Shareholders' Rights***

- It became possible to vote by ordinary mail or electronic mail at the general assembly meetings.
- Development of registration rules to conform to the international principles of corporate governance.
- Provision of safe methods for registration, settlement and profit distribution, and the establishment of the Settlements Guarantee Fund.
- The establishment of dispute resolution center.

⁴³ Annex No. 2 contains a detailed assessment of the five principles and a comparison with the assessment of October 2001.

- ***Equitable Treatment of Shareholders***
 - CMA's right to suspend the decisions of a general assembly that are biased to a specific category of shareholders.
 - Allowing the registered owner to vote on behalf of the beneficiary owner either totally or severally.
 - The issuance of the new disclosure rules that allow for strict supervision of insider trading.
 - The organization of acquisition operations and purchase offers and allowing class action lawsuits.

- ***The Stakeholders' Role in Corporate Governance***
 - The establishment of shareholders' groups and allowing representatives of the groups to attend the general assembly meetings.
 - Licenses to form the workers' shareholders associations.

- ***Disclosure and Transparency***
 - The development of disclosure requirements of financial and non-financial statements, and their electronic dissemination.
 - Draft Law for practicing the accounting and auditing profession in Egypt.
 - The obligation to appoint a person responsible for the shareholders' affairs.

- ***Responsibilities of the Board of Directors***
 - Obliging the companies to appoint independent or non-executive members to the board of directors.
 - Obliging the companies to form auditing committees from non-executive board members.
 - Obliging the companies to disclose the ownership structure, the principal shareholders and the report of the board of directors.

In spite of this remarkable progress, there is still a need to complete the legal framework for corporate governance, and a great need to enhance the application of corporate governance principles. The major fields that still need additional efforts are: protecting the minority shareholders' rights; ensuring the board's performance of its functions and the strict supervision of its actions; emphasizing disclosure of the ownership structure details; completing the legal framework; and increasing the efficiency of the supervisory bodies. The following are some detailed suggestions for improving these issues.

- Enhance the instruments for protecting the minority shareholders by, for example, establishing a mechanism to protect their rights similar to the shareholders' group, starting the implementation of class actions and amending the rules governing purchase offers to ensure more effectiveness in protecting the minority shareholders. The executive regulations should stipulate that if the ownership of any shareholder reaches 40 percent of the share capital, he has to purchase the remaining shares. Those who own bearer shares should be allowed to vote provided they pay the complete value of the shares in order to enjoy voting rights.
- Establish rules that facilitate the performance of the board by obliging companies to appoint non-executive or independent board members, to activate the role of the auditing committees and to appoint an independent auditor. Moreover, companies should publicize their implementation of the principles of corporate governance after the approval of CMA and the Stock Exchange. There is no doubt that the establishment of a training center for managers and informing board members and executive managers of joint stock companies of their corporate governance duties will help improve the board's activities especially in relation to its supervision of the executive management.
- Secure the thorough and accurate disclosure of material and non-material information so that it includes the registered owner and the beneficiary owners in the equity statements and the cross-holding structure. Doing this would show the essential interests of every shareholder, the final owner of any share, the attendance percentage of board members in order to make the shareholder aware

of the time a member gives to managing the company, and finally it would support the automatic dissemination of disclosure.

- Complete the legal framework that secures the proper application of corporate governance. This includes issuing the amended Capital Market Law, the unified Corporate Law, the draft law on practicing the accounting and auditing profession, the Antitrust Law, Competition Law and the Monopoly Prevention Law. In addition, it is necessary to accelerate and start the activities of the dispute settlement and arbitration center and to establish specialized judicial circuits for cases concerning the capital market.
- Raising the efficiency of the supervisory, monitoring and judicial bodies, and establishing specialized circuits for courts concerned with capital market lawsuits, and improving the skills of the employees are basic elements for strict supervision of the capital market and for promoting corporate governance.

In conclusion, we cannot overemphasize the importance of increasing public awareness and the culture of corporate governance among traders. Equally important is making the self-regulatory organizations and companies that issue securities aware of the vital role activating corporate governance plays in the growth and sustainable development of companies.

Annexes

Annex No. 1: Development of Stock Exchange Activity from January 1992 to December 2002

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Annual trading value (LE million)											
Listed shares and bonds	3.714	2.749	12.140	22.942	87.692	202.824	185.006	328.510	417.446	246.580	258.69
Non-listed shares and bonds	225.3	293.7	1343.2	1555.2	2198.4	3937.4	4863.4	6235.1	7749.1	7016.4	8371.0
Average monthly trading value (LE million)											
Listed shares and bonds	30.9	22.9	101.2	191.2	730.8	1690.2	1541.7	2737.6	3778.7	2054.8	2150.6
Non-listed shares and bonds	18.8	24.5	111.9	129.6	183.2	328.1	405.3	519.6	645.8	584.7	698.4
Listed and trade shares and bonds (million)											
Listed shares and bonds	207	137	293	437	1.705	2.867	4.403	8.411	9.515	11.838	7.072
Non listed shares and bonds	8.9	4.0	30.5	28.5	37.2	85.8	130.5	233.0	79.0	76.0	196.9
No. of operations											
Listed shares and bonds	11648	11184	51862	260964	2279521	1142510	672649	892291	1276216	1142410	739631
Non-listed shares and bonds	855	750	42880	208651	36843	82841	14564	12909	10154	5521	94055
No. of companies listed and traded during the year	239	264	300	352	354	416	551	663	659	634	574
Average of companies with traded securities during the month	78	84	91	113	129	168	218	243	232	218	210
No. of listed companies at the end of the year	656	674	700	746	646	650	861	1.033	1.076	1.110	1.150
No. of listed shares at the end of the year (million)	405.7	424.0	451.0	1116.7	1387.9	1854.2	3354	4393	4672.8	5473.2	5605.7
Nominal share capital for listed companies (LE million)	8098	8890	8051	11052	13673	18291	33836	47077	74638	83020	92030
Market share capital for listed companies (LE million)	10.845	12.807	14.480	27.420	48.086	70.873	83.140	112.331	119.778	111.333	122.014
Market share capital / nominal share capital	1.3	1.4	1.8	2.5	3.5	3.9	3.0	3.1	2.0	2.0	2.0

Source: CMA's Information Center.

Annex No. 2: Summary of the Development of Corporate Governance Criteria in Egypt from September 2001* to March 2002**

Criteria	No. of Criteria for Each Principle	Assessment							
		Completely Observed		Considerably Observed		Slightly Observed		Not Observed	
		2001	2003	2001	2003	2001	2003	2001	2003
1. Shareholders' rights	16	7	11	8	4	0	0	1	1
2. Equitable treatment of shareholders	5	2	4	2	1	0	0	1	0
3. Stakeholders' role in corporate governance	4	3	3	1	1	0	0	0	0
4. Disclosure and transparency	10	0	3	7	6	3	1	0	0
5. Responsibilities of the board of directors	13	2	3	8	9	3	1	0	0
Total	48	14	24	26	21	6	2	2	1

Sources: * Ministry of Economy and Foreign Trade (2001).

** As calculated by researchers.

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