Chapter 3

Corporate Governance Codes in a Transitional Economy

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ABSTRACT

This study aims to investigate the influence of the introduction of a corporate governance code in 2005 on the levels of compliance with mandatory IFRS disclosure requirements by companies listed on the Egyptian Exchange (EGX) as a leading stock exchange in the Middle East. Using a disclosure index derived from mandatory IFRS disclosure requirements for the fiscal year 2007, this study measures the levels of compliance by a sample of 75 non-financial companies listed on the focus stock exchange. This study extends the financial reporting literature and the emerging market disclosure literature by being the first to investigate the influence of corporate governance requirements for best practices on the levels of compliance with mandatory IFRS disclosure requirements by companies listed on the EGX. Results provide evidence of the lack of influence of corporate governance best practices on the levels of compliance with mandatory IFRS disclosure requirements as it is not yet part of the cultural values within the Egyptian context. These findings are consistent with the notions of the proposed theoretical foundation.

INTRODUCTION

Across the globe a series of events over the last two decades placed corporate governance at the top of the agenda for business communities, international financial institutions, governments, and capital market regulators. Specifically, these were the Asian financial crisis and the high-profile corporate scandals such as WorldCom, Enron, Lehman Brothers and Tyco. Furthermore, in academia, the topic continues to attract much attention from researchers (e.g., Beasley, 1996; Haniffa & Cooke, 2002; Ghazali & Weetman, 2006; Brown 2007; Ezat & El-Masri, 2008; Felo, 2009; Al-Akra et al.,
Corporate governance is concerned with the system of directing and controlling companies, and it is the responsibility of BOD (Cadbury Committee Report, 1992). It is a fundamental element in improving economic efficiency and growth as well as enhancing investor confidence (OECD, 2004). ‘‘Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined’’ (OECD, 2004: 11). The BOD actions are subject to laws, regulations and shareholders in general meeting and the role of shareholders in governance is to appoint the directors and auditors and to make sure that the governance structure is appropriate (Cadbury Committee Report, 1992).

The development of corporate governance is a global phenomenon, influenced by legal, cultural, ownership, and other structural differences (Mallin, 2009), but as yet there is no widely accepted paradigm or theoretical foundation in its respect (Tricker, 2009). For transitional economies, good corporate governance practice may be essential to guarantee the success of their reform programmes and to create a healthy investment climate. However, the corporate governance codes for best practice were initiated in developed countries and only recently introduced in developing ones. Hence, its contribution towards enhancing capital market performance in such countries is subject to the extent to which the conditions for robust governance practice are consistent with the existing values, past experiences and the needs of all parties involved in the financial reporting process. It is expected, therefore, to be some time before the impact of applying corporate governance can be measured in developing contexts as this needs to develop, and favourable attitudes and belief must be formed as well as efforts being made to develop the human resource capabilities to apply corporate governance requirements for best practice.

The careful review of the Egyptian modern history demonstrates that the Arab Republic of Egypt has always been the regional leading reformer. The harmonisation of the Egyptian Accounting Standards with IASs/IFRSs began with the launch of the government’s economic reform and structural adjustment programme in the early 1990s which commenced under pressure from the international institutions specifically the WB and the IMF as a condition of their providing financial support to Egypt (Dahawy & Conover, 2007; Dahawy & Samaha, 2010). Mandating IFRSs enabled Egypt to access international exchanges, saved time and effort needed for developing national standards from scratch, improved fairness of financial statements prepared by Egyptian companies (Samaha & Dahawy, 2011: 63). The Cairo and Alexandria Stock Exchanges currently referred to as the Egyptian Exchange (EGX) are among the oldest stock exchanges worldwide, the latter being developed in 1888 and the former in 1903. For almost 40 years they experienced stagnation during the nationalisation regime until they were revitalised in 1992 as one entity with two trading floors (CIPE, 2003; Desoky, 2009).

The new listing rules issued by the Capital Market Authority (CMA) in 2002 aimed to enhance the implementation of corporate governance best practice by listed companies, and include comprehensive disclosure requirements (Articles 12 to 19), and detailed requirements for financial statements preparation and presentation (Articles 20 to 33). Article 4 requires the presentation of complete information about the company’s board members. Additionally, Articles 34 and 35 indicate delisting rules which compel publicly-listed companies to make a commitment to disclosure requirements, or to risk delisting. The application of the aforementioned listing rules resulted in delisting of 99 non-compliant companies in 2003 (ROSC, 2004).