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The extent of corporate governance disclosure and its determinants in a developing market: The case of Egypt

Khaled Samaha [a,*], Khaled Dahawy [b,1], Khaled Hussainey [c,2], Pamela Stapleton [d,3]

[a] Department of Accounting, The American University in Cairo, Room 2058—BEC Building, P.O. Box 74, New Cairo 11825, Egypt
[b] Department of Accounting, The American University in Cairo (AUC), Room 2001—BEC Building, P.O. Box 74, New Cairo 11825, Egypt
[c] Accounting and Finance Division, Stirling Management School, University of Stirling, Stirling FK9 4 LA, United Kingdom
[d] Manchester Business School, University of Manchester, Crawford House, Manchester M15 6PB, United Kingdom

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ABSTRACT

This paper assesses the extent of corporate governance voluntary disclosure and the impact of a comprehensive set of corporate governance (CG) attributes (board composition, board size, CEO duality, director ownership, blockholder ownership and the existence of audit committee) on the extent of corporate governance voluntary disclosure in Egypt. The measurement of disclosure is based on published data created from a checklist developed by the United Nations, which was gathered from a manual review of financial statements and websites of a sample of Egyptian companies listed on Egyptian Stock Exchange (EGX). Although the levels of CG disclosure are found to be minimal, disclosure is high for items that are mandatory under the Egyptian Accounting Standards (EASs). The failure of companies to disclose such information clearly shows some ineffectiveness and inadequacy in the regulatory framework in Egypt. Moreover, the phenomenon of non-compliance may also be attributed to socio-economic factors in Egypt. Therefore, it is expected that Egyptian firms will take a long time to appraise the payback of increased CG disclosure. The findings indicate that that—ceteris paribus—the extent of CG disclosure is (1) lower for companies with duality in position and higher ownership concentration as measured by blockholder ownership; and (2) increases with the proportion of independent directors on the board and firm size. The results of the study support theoretical arguments that companies disclose corporate governance information in order to reduce information asymmetry and agency costs and to improve investor confidence in the reported accounting information. The empirical evidence from this study enhances the understanding of the corporate governance disclosure environment in Egypt as one of the emerging markets in the Middle East.

1. Introduction

This paper focuses on one part of the reform process in Egypt—the development of the regulatory framework commencing in the late 1990s to improve corporate governance (CG) practices. Specifically, it is argued, if such practices follow international norms they can mitigate the financial problems of developing nations that include: weak and illiquid stock markets, economic uncertainties, weak investor protection, and frequent government intervention, (Ahunwan, 2002; Gugler, Mueller, & Burcin, 2003; Rabelo & Vasconcelos, 2002; Reed, 2002; Tsamenyi, Enninful-Adu, & Onumah, 2007); poor performance, and high levels of ownership concentration (Ahunwan, 2002; Rabelo & Vasconcelos, 2002; Tsamenyi et al., 2007); and state ownership of companies, weak legal and judiciary systems, weak institutions, and limited human resources capabilities (Mensah, 2002, Young, Peng, Ahlstrom, Bruton, & Jiang, 2008).

However, *de jure* reform does not necessarily translate into reform of actual practice, and although many researchers have examined corporate governance in developed nations, much less academic study has been made of developing and emerging nations. This is an important omission for a number of reasons. Firstly, globalization, international trade, and international investment practices are creating significant pressures towards the development of corporate governance in these nations (Reed, 2002).

Secondly, developing and emerging countries have tended to mimic the practices of developed nations, despite evidence, for example from Rabelo and Vasconcelos (2002), of the presence of differences between the factors giving rise to the need for corporate governance in developing nations and those in developed nations.

Thirdly, there are structural variations, such as the dominance of government ownership and/or family/close held companies that render the implementation of Western style corporate governance both of questionable value and troublesome (Mensah, 2002).

* Corresponding author. Tel.: +20 2 26152342.
E-mail addresses: ksamaha@aucegypt.edu (K. Samaha), dahawy@aucegypt.edu (K. Dahawy), khaled.Hussainey@stir.ac.uk (K. Hussainey), pam.stapleton@mbs.ac.uk (P. Stapleton).
[1] Tel: +20 2 26153261.
[2] Tel.: +44 1786 467286; fax: +44 1786 467308.
[3] Tel.: +44 161 306 3454; fax: +44 161 275 4023.

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Fourthly, developing and emerging nations are not homogeneous. Specifically, there are major differences between the emerging countries of Eastern European and China, as there are between countries in the Middle East, North Africa and sub-Saharan Africa (Euromoney, 2007; Fawzy, 2004). Finally, while there may be increasing convergence among national and international corporate governance codes, there is also significant deviation in terms of disclosure practices and content of disclosure between countries (Bhuiyan & Biswas, 2007).

The paper investigates the determinants of corporate governance voluntary disclosures in Egypt. It contributes to disclosure and governance literature by studying corporate governance disclosure practice in a developing country, which is distinguished from most developed nations by four important characteristics (Fawzy, 2004). Firstly, most companies are closely held, secondly there is considerable state ownership of privatized companies, thirdly that board independence is weak and finally disclosure is not a common practice. While Bremer and Ellias (2007) note that Egyptian businesses are starting to appreciate the need for corporate governance mechanisms, they argue that together with Fawzy's four characteristics, weakness in the economic structure, and lack of awareness of corporate governance concepts and benefits, hinder the development of corporate governance in Egypt. Thus the results of this research may be useful for regulators in developing and emerging nations with similar characteristics as they continue to deliberate appropriate corporate governance requirements in their own nations.

In an Egyptian context, Samaha and Dahawy (2010 and 2011) found that corporate governance mechanisms affect the Egyptian companies' general print-based annual reports voluntary disclosures. They found lower directors ownership, lower blockholder ownership, higher independent directors, and audit committee existence are more properly to monitor the manager's decision to report more voluntary information. Investigating the determinants of corporate governance disclosures in the 2005 annual reports of the top thirty Egyptian-listed companies' (EGX 30), Samaha (2010) found that board independence is positively associated with corporate governance disclosures. This paper extends the work done by Samaha (2010) as follows: firstly, it provides a more recent investigation (year 2009) to help assess developments in corporate governance disclosure. Secondly, it offers a comparative analysis with two international reports on corporate governance disclosure scores conducted by the United Nation Conference on Trade and Development (UNCTAD). Thirdly, the sample companies involve the EGX 70 constitutes along with the EGX 30 constitutes and thus enhancing the generalizability of the empirical results, along with. Finally, this paper introduces a more comprehensive set of corporate governance mechanisms including board size and duality in positions that—to the best of the authors' knowledge—have been not tested before in an Egyptian context in relation to corporate governance disclosure. Our descriptive findings relating to the extent of corporate governance disclosure for 2009 are relatively lower than those reported by Samaha (2010) for a sample of Egyptian firms in 2005, although during this period from 2005 to 2009, many regulation changes have taken place in Egypt such as the formation of the Egyptian Financial Supervisory Authority (EFSA), and the update of the CG code. All these changes aim to enhance CG disclosure and transparency in general; however our paper suggests that CG disclosure by listed Egyptian firms is almost negligible.

2. Corporate governance in Egypt

Corporate governance has many benefits for developing nations like Egypt. It helps developing nations to realize high and sustainable rates of growth, increases confidence in the national economy, and deepens capital market and increases its ability to mobilize savings. In addition, it results in raising investment rates, protecting the rights of the minority shareholders or small investors. Also, it encourages growth of private sector by supporting its competitive capabilities, helping to secure financing for projects, generating profits, and creating job opportunities (Dahawy, 2008).

In recognition of the need to enhance the level of confidence of foreign portfolio investors in the Egyptian capital market, the ministry of investment through the Egyptian Institute of Directors (EIoD) (http://www.eiod.org) introduced a corporate governance code in 2005 for companies listed in the stock market, especially those being actively trading. The Egyptian Corporate Governance Code (ECGC) is initially prepared in accordance with the Guidelines on Corporate Governance of State-Owned Enterprises in the Organization for Economic Cooperation and Development (OECD). Subsequently, a team of Egyptian experts drafted the initial code, which was then subjected to in-depth examination and extended discussions. At the end, the code was reviewed by experts from the OECD, the International Finance Corporation (IFC) and also the World Bank.

This code includes many provisions, the objectives of which are to guarantee the rights of all shareholders as well as various stakeholders. Enhancing corporate disclosure transparency is one of the pillars of corporate governance. The introduced ECGC searches for more accuracy of disclosed corporate information organizing the relationship between the shareholders, board of directors and management. However, compliance with the ECCG code is not mandatory.

Actual corporate governance practices of Egyptian-listed companies continue to lag behind the law on the books, in particular for companies outside the EGX 30 (World Bank, 2009). For example, a number of boards do not guide or supervise management by helping them develop and holding them accountable to a set of key performance indicators. Key policies on risk management, internal control and audit processes, and succession planning are often absent. Board nomination processes largely remain opaque and are frequently dominated by majority owners, at times leading to important skills-gaps and insider boards. Although financial reporting has improved markedly in terms of the timeliness and quality of disclosure, non-financial disclosure remains underdeveloped. Few companies publicly disclose their ownership and governance structures, remuneration policies, or foreseeable risk factors online or in their annual reports (World Bank, 2009).

However, the Report on the Observance of Standards and Codes (ROSC): A Corporate Governance Country Assessment for The Arab Republic of Egypt (World Bank, 2009) argued that Egypt can take a major step forward in closing these gaps by:

1. requiring companies to implement the Egyptian Corporate Governance Code (ECGC) on a 'comply-or-explain' basis,
2. amending the ECGC to better meet good practice,
3. strengthening enforcement capacity, and
4. supporting the EIoD to roll-out its director training program, focusing on family-owned businesses outside the EGX 30.

3. Development of hypotheses

Corporate governance mechanisms can be considered as key factors explaining the decisions of corporate voluntary disclosure from agency theory perspectives. Thus, these mechanisms will be examined in this paper. It is also worth noting that very limited research has been undertaken to examine the association between corporate governance mechanisms and corporate governance disclosure. To the best of our knowledge, only five published papers examine this research issue (two of these articles focus on the developed countries, while three focus on the developing countries). For the developed countries, using Canadian firms, Bujaki and McConomy (2002) find that firms with more unrelated directors are more likely to voluntarily disclose more corporate governance information. For a sample of European companies, Bauwhede and Willekens (2008) find that ownership structure affects levels of corporate governance disclosures. In the developing countries, Muhamad, Shahimi, Yahya, and Mahzan (2009) find that corporate governance mechanisms do not affect levels of corporate governance disclosure in Malaysia, while Al-Moataz and Hussainey (forthcoming) find that board independence