

THE CORPORATE GOVERNANCE EXPERIENCE UNDER THE EGYPTIAN PUBLIC BUSINESS SECTOR REFORM PROGRAM



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Since the kick-off of the reform program for public enterprises in 1991, the role of the state in the Egyptian economy has been undergoing significant transformation, allowing more private sector initiatives, whereas the state has been phasing out its role in several sectors, acting more as a regulator than an owner of assets. The 1991 Public Enterprise Law 203 (Law 203) served as the legal framework governing the reform and privatization of 314 Public Business Sector (PBS) companies, which represented part of

state-owned-enterprises (SOEs) slated for corporatization, restructuring and possibly privatization. Other SOEs remained under different ministries and were not subjected to Law 203. This includes for example companies in the fields of Oil & Gas, and Aviation.

This article addresses the efforts to introduce corporate governance in the PBS companies as part of the “corporatization” and administrative reform of SOEs in general.

First Phase of PBS Reform Program: 1991-2004

This phase witnessed some governance progress, mostly in terms of better transparency and disclosure. Prior to 1991, SOEs were created under various ministries. Ministries were regulators of industries and owned companies that competed in the same industries as well. The idea was to separate companies from ministries and to create level playing field. The change was triggered by a variety of measures, most notably the Law 203 which included a host of measures relating to corporate governance, as well as the Capital Market Law (CML) number 95 for the year 1992.

The 1991 Public Enterprise Law 203:

It is worth reviewing a few illustrative articles of Law 203. The law is not presented here as the best model, but rather as the umbrella under which the public enterprises have operated since 1991.

Here are a few highlights of important Corporate Governance-related Articles of Law 203:

- For the first time management has been separated from ownership in a structure based on Holding Companies (HCs) and Affiliate Companies (ACs). The HC is 100% owned by the Ministry of Finance (MoF), and in turn the HC owns shares in the ACs. Usually the ACs are wholly-owned by the HC, with the exception of some 30 companies (out of 145) which have private ownership stakes up to 49%.

- The new model corporatized the entities. The law mandated the issuance of articles of association, determination of capital and share structures, among others. The aim was to transform the public enterprises from centrally planned/operated entities to corporations which are profit oriented and accountable to owners.

- Each HC/AC has its own board of directors as well as a general assembly. The assembly evaluates the performance of the board and decides on any compensation or bonuses, as well as any changes in the BOD chairman or members. This structure facilitated drawing lines of accountability, follow-up and responsibility accounting. It is worth mentioning that the minister is the head of the GA of all HCs, members of the GA are appointed by the Prime Minister. Board members of the HC are members of the general assemblies of each of all its ACs, establishing an important link in the HC/AC organizational structure.

- The law also includes provisions relating to conflicts of interests and related party transactions.

- As for access to information by shareholders (whether the state or private sector minority shareholders), the Law 203 stipulates that “shareholders may have access to the registers of the affiliate company with the exception of the books in which the minutes of the BOD are recorded, and the company’s accounting books... they may have the balance sheet, P&L account, Auditors Report, for 3 financial years ... and access to all other

papers and documents whose contents and data should not cause prejudice to the company's position or to a third party".

- As for the reporting cycle, the HC shall report the estimated budget for an upcoming year to the minister 6 months prior to the first day of the budgeted year. Also quarterly reports from the AC to the HC and in turn to the minister are stipulated in the Law.

Capital Market Law:

The CML dictates disclosure requirements for listed companies such as quarterly statements, disclosure of board decisions on timely basis, and controls over insider trading and related party transactions. However, these measures were confined to listed PBS companies only.

In a nutshell, this phase witnessed progress in law-related efforts concerning the legal infrastructure for corporate governance, but not in outcome-related efforts.

Second Phase of PBS Reform Program: 2004- Early 2011

In 2004, the Ministry of Public Business Sector (MPBS) was merged under a newly formed Ministry of Investment, with the current top World Bank executive Dr. Mahmoud Mohieldin in charge as Minister of Investment (MoI) till 2010. This was the take-off phase for corporate governance not only in SOEs or PBS companies but in Egyptian business sector by and large.

With the adoption of the "asset

management" approach in mid-2004, more emphasis has been placed on restructuring and on corporate governance. The privatization component excelled but was eventually discontinued in 2009 since the sale of SOEs during this phase (PBS and other SOEs) faced increasing opposition fuelled by labor movements, politicians and even the media, with more calls for restructuring and support to SOEs in general.

The corporate governance component was a priority during these years, which witnessed several milestones, including the following:

- Establishing the Institute of Directors entrusted with all corporate governance-related efforts and mandates.
- Issuing the first Egyptian Guidelines on Corporate Governance for listed companies in 2005, and separate guidelines for SOEs in 2007.
- Adding corporate governance to the benchmarks against which PBS boards were evaluated, alongside the traditional financial and other indicators.
- Revitalizing the role of General Assemblies of HCs and ACs.
- Conducting extensive training on corporate governance, targeting middle and top level management.
- Extensive efforts were made to benefit from other country experience.

- Getting international organizations such as the World Bank to help in the process, not only financial assistance but in provision of technical expertise.
- Conducting a unique study including surveys, visitation and questionnaires to assess the governance climate in PBS companies, which was deemed to be weak in the absolute majority of companies.

Third Phase of PBS Reform Program: 2011- to Date

The dawn of 2011 witnessed the historical Jan 25th youth movement which gathered millions of supporters across the country. Unfortunately, efforts to further institutionalize corporate governance in SOEs in general were impeded, due to a few years of country-wide unrest that followed, which took its toll on SOEs suffering frequent strikes and labor instability.

Recently, however, corporate governance has gained traction again. Since early 2016, significant measures have been taken by the MPBS, which include the following:

- Ministerial decree was issued to establish a committee (in which I am a member) of governance experts to review and update the 2007 Corporate Governance Guidelines for SOEs in light of the new 2015 OECD Guidelines. The draft new guidelines have been produced and currently under review.
- Ministerial decrees were issued targeting corporate governance-related principles

to be applied and adhered to by all PBS companies. Examples include:

- Audit Committees have become mandatory.
- Injecting new blood with various expertise during the reformation of boards, to avoid having only industry-related experts -like engineers - occupying all the boards of industrial PBS companies, or physicians and pharmacists in boards of pharmaceutical PBS.
- Enhancing the measures relating to terms of board membership and criteria for selecting board members.
- Representation of SOE shareholdings in joint ventures also was targeted by another ministerial decree to achieve better accountability for those representing PBS companies on the boards of joint venture (private) shareholding companies.

- Much effort is being made to educate the officials in companies about stock market watch, especially for listed companies, and issues like alternative financing techniques and how to revamp the costing systems which were giving misleading information to top management in some cases.

Evaluation of Corporate Governance efforts in PBS from 1991 to-date:

The overall evaluation of governance in PBS companies from 1991 to date could be “satisfactory”, although, compared to pre-1991 circumstances, there is a remarkable improvement in terms of “corporatization”

of the PBS. Several factors contributed, positively or negatively, to the degree of progress achieved, including the following factors which we will state with reference to OECD 2015 Guidelines as a benchmark:

- There are two means to measure governance progress, (1) using law-based indicators and (2) using outcome-based indicators. The law-based indicators reveal that from 1991 through 2004 there was progress made in establishing -from scratch- a legal framework for corporate governance in PBS companies as well as the capital market. However, the degree to which those measures in the laws were abided by is questionable.

- Apart from the requirements set forth in the PBL and CML, there is limited awareness of corporate governance in most of the PBS companies today, not to mention insufficient corporate governance practices. This was documented in a study by the World Bank which included visits and surveys conducted in a huge number of PBS companies to assess the extent to which good governance is being practiced. It showed slightly better governance conditions and awareness in listed companies only like Eastern Tobacco and Misr Aluminum, though in general the assessment was weak. Although this study was conducted around 2007/2008, the current the situation is not markedly different, especially due to the effect of the last few years.

- PBS companies had somehow continued to have preferential treatment, though in rare cases like where a distressed PBS

company would run out of cash to pay its payroll. To avoid labor unrest especially in large “town factories” like Mehalla or Kafr El Dawar Spinning and Weaving Companies, cash was paid directly by the treasury. This is still the situation today. It is worth mentioning that the 2015 OECD Guidelines mention clearly that “SOEs economic activities should face market consistent conditions regarding access to debt and equity finance”. It is worth mentioning that Law 203 also stipulates that PBS companies must not enjoy exceptional privileges or unfair burdens.

- On the other hand, a few of the aforementioned governance-related aspects of Law 203 were not adhered to, and represents extra burden on PBS. An example today is the continued influence of the state on some PBS companies to play a costly role in maintaining social stability through the provision of goods and services at subsidized prices and the treasury never paying back those companies the due compensation. This was –and still is today- clear in foodstuffs and pharmaceuticals companies. It is worth mentioning here that the new 2015 (G20) OECD Guidelines on Corporate Governance in SOEs added a complete chapter (Chapter 3: SOEs in the marketplace) mostly to confirm the importance of a “level playing field and fair competition in the marketplace when SOEs undertake economic activities”. It is clearly stated that “costs related to public policy objectives should be funded by the state and disclosed”.

- Resistance or even skepticism from PBS companies' management to some of the corporate governance principles still exists, though much less than during early phases.

- Still there is a grey area regarding the role of the HC versus its affiliates. Few HC chairmen complain about the HC's inability to maintain close control over their ACs, whereas on the other hand some ACs of other HCs complain that the HC interferes in their work more than necessary.

Conclusive Remark:

Corporate governance is necessary for any company, regardless its ownership. Examples of international scandals like Enron, WorldCom and Arthur Andersen serve a lot in showing how improper governance practices may well cause huge companies to fall.

However, in the case of Egyptian SOEs, particularly those Law 203 PBS companies, there have been several challenges whether in the introduction of the corporate governance code and principles or in the institutionalization. However, there are several positive indicators about the degree of success the governance efforts. These have been evidenced by feedback from participants in workshops and the increasing acceptance of governance principles, not only as laws and regulations but as a healthy work environment that secures the interests of the shareholders and – in turn – the stability and continuity of the enterprise and its workers.

It is mandatory to approach those who are supposed to implement corporate governance by showing what's in it for them, because corporate governance is not just rules and laws to abide by, but rather principles and guidelines to adopt.

