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THE ROLE OF INSTITUTIONAL INVESTORS IN THE EGYPTIAN CAPITAL MARKET

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TABLE OF CONTENTS

Tables

Figures

Abstract

The role of institutional investors in capital markets of the Middle East and North Africa region has not been explored, in large part due to the fact that most markets continue to be retail-based, despite the fact that stock exchanges and securities regulators have sought to attract domestic and foreign institutional capital. It is also a result of the fact that institutional investors remain largely passive as judged by the level and quality of their engagement with investee companies.

This paper aims to identify the role and the influence of institutional investors on corporate governance and company performance in the Egyptian market, taking a historical perspective and seeking to pinpoint the role of state and private institutional investors in the Egyptian Exchange. To do so, it categorizes institutional investors' strategies in order to highlight the extent of their engagement with the investee companies, in particular the largest listed firms (EGX 30 companies).

Keywords: institutional investors, capital markets, Middle East and North Africa, corporate governance, stock exchange, investor engagement

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EXECUTIVE SUMMARY

Since early 1990s, policymakers in Egypt have made it a policy priority to restore capital markets infrastructure and to present the Egyptian Stock Exchange (thereafter EGX) as a viable and vibrant venue for attracting local and foreign investment, including institutional investment. Market activity was considerably supported by the launch of the privatisation programme in Egypt in 1994 that saw the Egyptian government divest its stakes in a range of financial and non-financial corporations, including hundreds of joint ventures and as well as strategic companies such as Eastern Tobacco (tobacco monopoly), Commercial International Bank and Bank of Alexandria (largest banks), Mobinil (then sole mobile operator), and Egypt Telecom (the largest telecom company) as well as a number of large cement companies.

While the market has grown impressively in the following ten years, eventually becoming the largest in the MENA region in terms of the number of listed companies, it remained largely illiquid and retail based. Due to the history of nationalisations and the winding down of the stock market activity in 1950-1960s, the largest domestic institutional investors remained under state control and their activity in the capital markets limited. With the upgrade of Egypt to the MSCI Emerging Market Index in 2000, foreign institutional investment began to flow in the capital market and with the reform of pension funds regime and of the rules governing banks and insurance companies, local institutional investors became more active in the capital market.

At the same time, the securities regulator and the stock exchange, have implemented a number of measures to improve the quality of governance of Egyptian listed firms, notably through the Corporate Governance Code introduced in 2005 and supporting the activities of the Egyptian Institute of Directors established in 2003 to promote good governance practices. Despite the introduction of relevant governance standards, at first for listed companies and subsequently for state-owned companies (in 2006), for securities companies (in 2007) and banks (in 2011), the quality of governance of listed firms improved only marginally, driven primarily by regulatory requirements as opposed to demand from the market.

For their part, institutional investors have remained relatively silent in terms of their engagement with listed firms, much like other countries in the MENA region. This owes in large part to the fact that a significant portion of institutional investment in the market was by channeled by state controlled investors who did not face particular incentives to engage and who often had other, less formal mechanisms of engagement. The inflow of foreign institutional investment (except for a few private equity investors) due to its diluted nature and the fact that it was skewed towards better governed firms did not markedly affect the quality of governance of Egyptian listed companies.

Encouraging better dialogue between boards and management of Egyptian listed companies and investors remains essential to improving the quality of corporate governance and to addressing key investor concerns regarding weak transparency practices as well as other challenges such as separating CEO and Chairman roles, assuring sufficient representation of independent directors on boards, ensuring adequate approvals of treatment of related party transactions and charitable donations, improving the quality of internal control and risk management processes as well as the auditor selection process.

Practical measures are proposed to incentivize large institutional investors to dedicate resources to dialoging with their investee companies. Requiring large state controlled investors to define their voting policy and disclose their voting results publicly, as it has been done in some jurisdictions such as Chile is proposed. Self-regulatory associations such as the Egyptian Investment Management Association can also play a constructive role in setting stewardship standards, while regulators may also review the laws governing investment limitations placed on institutional investors with a view to consider relaxing existing limits on capital market investments and refining the duties of institutional investors to their clients.

PART I. DEVELOPMENT OF THE EGYPTIAN CAPITAL MARKET

Origins of the Egyptian capital market

The Egyptian capital market is the oldest in the Middle East and North Africa region, having been established in late 19th century. The Egyptian Exchange traces its origins to 1883 when the Alexandria Stock Exchange was established, followed by the Cairo Stock Exchange in 1903. Prior to its demise as a result of a wave of nationalisations in 1950-1960s, the then-already merged Cairo and Alexandria Bourses together represented the fifth largest exchange in the world. In this wave of nationalisations, almost a hundred of most active listed companies had their stock transferred to government "nationalization bonds" and with that, the number of listed companies dropped from 275 to 55 in 1958-1974 and market capitalisation from 13% to 1% of the GDP (OECD, 2014).

Following this decline, the Egyptian Stock Exchange was relatively inactive until the passage of the Capital Markets Law 95 in 1992 which introduced a number of changes into primary and secondary markets, including encouraging private investment, improving investor protection, and enhancing the role of banks in capital markets. Following the enactment of the Law, the Cairo and Alexandria Exchanges started growing rapidly, encouraged by changes in the regulatory environment and privatisation ushered by the Asset Management Programme introduced in 1994.

Prior to the implementation of the Asset Management Programme, the ownership of most of the traded companies in the Egyptian market was dominated by the government through investments by the four major government-owned insurance companies (El Shark, Misr, Ahlya, Misr Re-insurance) and the four major government-owned commercial banks (Banque Misr, Banque Du Caire, National Bank of Egypt, and Bank of Alexandria). High level of state ownership was not a consequence of a particular investment strategy: instead, these holdings were "inherited" from the nationalisation policy adopted in the 1960s.

As a result of the Asset Management Programme, the government of Egypt become the most active "privatiser" in the region, divesting most actively in the MENA region, alongside Morocco and Tunisia, with over $11.5 billion USD of privatisation proceeds accruing to the government between 200 and 2008 (OECD, 2012). At the same time, ownership of listed companies held though the Employee Shareholder Association were also significantly reduced and are today insignificant relative to market capitalisation of the EGX. [2]

These measures were also accompanied by the efforts of the stock exchange to attract large companies and SMEs to list on the EGX. Listed companies were provided with a tax

[2] The only ESA's stake remaining is in Eastern Tobacco Company for about 0.2% of the company's shares, with representation of two board seats despite the insignificant size of ownership.

exemption equivalent to three months' deposit rate paid by the Central bank on the paid up capital. This resulted in an influx of companies to the public market and by the end of 2001, 1100 companies were listed with a combined market capitalisation of USD 24 billion (OECD, 2014).

Inspired by other markets' experience to encourage SMEs to access equity financing, in October 2007 the Egyptian government launched the first SMEs Exchange in the MENA region called Nilex. First applications for listing on NILEX date back to 2008 and trading officially started in 2010, when shares of 3 local SMEs were floated, raising $5 million USD. The inflow of large and small cap companies on EGX and NILEX respectively has resulted in the deepening of the market, despite the massive de-listing of over 800 companies from the exchange in 2003-2005 for failing to meet the liquidity and transparency requirements.[3]

Market capitalisation as a percentage of GDP rose from only 29% in 2000, reaching a peak at 107% in 2007 (WDI, 2009), in large part due to the privatisation of stakes in state-owned enterprises on the EGX, and to a lesser extent due to an effort to attract family owned firms and SMEs to the market. Following a period of instability in the capital market due to the recent political events in Egypt, market capitalisation recovered to 500 billion LE (equivalent to 65 billion USD) by end of 2014, reaching its pre-crisis level.

In conjunction with the privatisation programme and initiatives aimed to bring SMEs and family controlled companies to the stock exchange, the government adopted a number of steps to improve the regulation of capital markets. Capital market regulatory institutions and key infrastructure were significantly restructured and the pace of reforms was increased in 2000. In 1996, the government established Misr for Central Clearing, Depository, and Registry (MCSD) whose regulatory framework was further clarified by the issuance of Central Depository Law 93 in 2000.[4]

The institutional framework for capital market regulation was most significantly revamped with the passage of the Law 10 in 2009 which established the Egyptian Financial Services Authority (EFSA) to replace the former Capital Markets Authority (established in 1981) and to consolidate functions previously exercised by the Egyptian Insurance Supervisory Authority (established in 1981) and the Mortgage Finance Authority (established in 2001).[5] In parallel, the powers of the securities regulator were significantly increased,

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[3] This occurred after new Listing Rules were adopted in August 2002, which the companies were given one year to comply with.

[4] The law reduced the dates of settlement and clearing to T+2 after from previously unspecified date of clearing and settlement. Ownership registration is secured and legally approved as proof of ownership. Consequently, voting process in general assemblies has been aligned with international practices.

[5] Previously, the Capital Markets Authority, the Egyptian Stock Exchange, and a number of other regulatory agencies, operated under the umbrella of the Ministry of Investment and it was the Minister of Investment who had the authority to approve any regulations put forth by these bodies.

providing the regulator with a range of criminal and civil penalties and the scope of punishable offenses was enlarged.[6]

The newly empowered securities regulator had introduced a number of measures to improve the governance of listed companies, in addition to de-listing non-compliant companies, such as by introducing better disclosure standards and tightening the auditor qualification process. Subsequently, the EGX - officially overseen by the EFSA (Egyptian Financial Services Authority) - has integrated a number of corporate governance provisions in its listing rules. The EGX has also played an important enforcement role though it is not technically a self-regulatory organisation and to this day remains organised as a governmental, non-corporatised entity, similarly to most of its peers in the region (OECD, 2012).[7]

Improving market quality

Despite the rapid growth in the number of listed companies, which reached 1100 by 2001 with market capitalisation exceeding $24 billion USD, the market was illiquid and dominated by retail investors, as indeed other markets of the region. As the vast majority of companies were attracted to the capital market through tax incentives[8], they were subsequently discovered to be illiquid and of little interest to investors. Trading in the stocks of these companies was therefore limited: instead, the top 100 companies accounted on average for more than 85% of the volume traded (OECD, 2014).

In order to bring liquidity and "clean up" the market, over 800 companies were delisted from the exchange by 2005 for failing to meet the liquidity and transparency requirements. This occurred after new Listing Rules were adopted in August 2002, which companies were given one year to comply with. In 2010, approximately 100 additional companies were de-listed from the exchange, mostly for failure to comply with disclosure and free float requirements. The number of companies listed on the EGX decreased dramatically from 795 in 2005 to approximately 370 by 2008 and to 213 by 2010. [9] The development of the EGX, which has seen only a few voluntary de-listings but many regulator driven de-listings, is somewhat unique in the region.

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[6] CMA's enforcement powers extend to a range of companies, including not only listed entities, but also securities companies and investment funds. In particular, CMA's Market Participants Complaints Department (now FSA's Corporate Governance Department) is charged with investigating all complaints filed with the CMA.

[7] The only privately owned stock exchange in the region is the Palestine Stock Exchange and NASDAQ Dubai also has a minority private ownership stake.

[8] At the time of their listing, a key condition to listing was that there must have been at least one trade every 6 months. This requirement was relatively easily to circumvent since trading could be done by a company insider.

[9] Furthermore, the de-listing of Orascom Construction in 2014, the largest listed company, also significantly impacted the market.

Against expectations, these measures have reflected positively on main market indicators. Specifically, market capitalisation grew from LE 234 billion (about $42 billion USD) to LE 500 billion ($90 billion USD) and the number of traded companies as percentage of all the listed companies increased from around 60% in 2004 to 95% in 2010. Value of trading increased tenfold from about LE 36 billion ($6.5 billion USD) in 2004 to an average of LE 430 billion ($77.5 billion USD) during the period 2008-2010 and the turnover ratio increased from 14% in 2004 to more than 40% during the period 2008-2010 on average (EGX Annual Reports).

The Exchange continues to de-list companies which are non-compliant with the listing rules or which are not sufficiently traded. On the other hand, the efforts of the EGX and the EFSA to attract listings have not been particularly successful in recent years. While privatisations have increased the breadth of the capital markets, few private companies chose to list their equity in recent years, although the listing environment improved in 2014 as a result of 13 new listings, with total capitalisation amounting to almost LE 2 billion (equivalent to $260 million USD).

Corporate governance reform

Generally speaking, the corporate governance framework in Egypt is underpinned by the Capital Markets Law of 1992 and its Executive Regulations which apply to all firms listed on the stock exchange and any others offering securities to the public, and the Companies Law 159 of 1981 and its Executive Regulations which apply to joint stock companies, partnerships limited by shares and limited liability companies. These laws have been amended on a number of occasions, *inter alia,* to reflect the emerging recognition of good corporate governance practices, and as such, they bear on a number of key issues such as the exercise of shareholder rights, board composition and functioning, the relationship between the management and the board, as well as procedures around acquisition of corporate control, insider trading and many others.

As the need for corporate governance reform gained the attention of policymakers, the Egyptian Institute of Directors (EIOD) was established in 2003, initially as a project of the Ministry of Foreign Trade and Economy and subsequently of the Ministry of Investment. The EIOD was launched as a first institute of directors in the MENA region and its first major project was the introduction of corporate governance recommendations. The *Egyptian Code of Corporate Governance* was introduced in October 2005 by the EIOD as a non-binding, voluntary code which expanded on the governance provisions of the abovementioned laws. At the same time, the official translation of “corporate governance” (i.e. "Hawkamet Al Sharikat”) was accredited by the Arabic Linguistic Department of Egypt. (Aboul-Atta, 2003)

Egypt was one of the first countries in the region, along with Oman, to begin a comprehensive corporate governance reform and it was indeed the second in the region to introduce Corporate Governance Code in 2005, based on the OECD Principles of Corporate

Governance and developed with the assistance of the Organisation.[10] Despite being voluntary, this code is an important awareness-raising instrument which succeeded in elevating the importance of good corporate governance on the agenda of management, boards, shareholders, going beyond the existing legal requirements (i.e. by recommending for instance, the establishment of board committees and separating Chairman and CEO posts).

A year later, following the introduction of the general corporate governance code, Egypt was the first country in the region to introduce governance guidelines addressing specifically state-owned enterprises, whose ownership at the time lied primarily with the Ministry of Investment, which as of 2005 continued to oversee a portfolio of 150 companies, structured in 9 sectoral holding companies. Prior to the introduction of these guidelines, the governance of state-owned enterprises in Egypt was addressed primarily by the Public Business Sector Law of 1981 which set up the structures of board and relationships between governance organs of both the holding companies and the individual SOEs.

Although both codes were introduced on a voluntary basis, resulting in uneven quality of implementation, they ushered a wave of governance reform which arguably continues today.[11] The level of awareness of good governance practices in listed companies increased significantly, although the regulator does not measure compliance with its provisions since the code remains voluntary. That said, the enforcement ability of the Egyptian Exchange and the EFSA against the code but also broader market conduct rules have been improving in recent years (OECD, 2014).

For instance, in July 2014, the Egyptian Exchange had taken a decision to publish all violations of listed companies on its website and through the trading terminals. In addition, annual financial statements for most active stocks have become available for a limited time on the website of the exchange~~.~~ In addition, the Egyptian Exchange updated listing rules issued in 2012, requiring all listed firms to disclose certain financial and non-financial information on the company website in Arabic. The EGX reports that as of June 2014, 75% of companies complied with this rule and disclose all the required information (OECD, 2014).

To this day, the Code remains the primary source for the continuous revisions of the Egyptian Exchange's listing and disclosure rules that are mandatory for all listed companies. To some extent this is a unique model in the region where listing rules include relatively few

[10] The first version of the Egyptian Code of Corporate Governance was prepared by Dr. Ziad Bahaa El Din (then Chairman, General Authority for Investment) and co-authored by Maged Shawky Sourial (then Chairman of the Cairo And Alexandria Stock Exchange) through a project supported by the Center for International Private Enterprise (CIPE) and the Middle East Partnership Initiative (MEPI), based on the OECD Principles of Corporate Governance.

[11] For instance, a corporate governance standards for securities companies were established by a CMA decision in 2007 and a governance code for banks was introduced by the Central Bank in July 2011.

corporate governance provisions. The Egyptian regulators decided instead to follow the example of other exchanges which have included corporate governance rules directly in the listing requirements as a source of market differentiation and potentially competitive advantage. That said, it is expected that the revised corporate governance code to be released by the EFSA later this year will apply to all listed companies on a comply-or-explain basis.

Five years after the introduction of the Code, to promote investor interest in well-governed companies and to provide companies with incentives to improve their governance practices due to market mechanisms, the EIOD and the Egyptian Exchange in collaboration with Standard & Poor's created an investible ESG index. The index provides investors with exposure to 30 of the best performing stocks in the Egyptian market as measured by environmental, social, and governance parameters and is the only such index in the Arab world, apart from the Hawkamah-S&P index which covers the entire region. The index includes 17 of the EGX 30 largest companies.

The returns of the index appear to be modest (less than 1 percent) if based on the 5 year annualized returns but rising in recent years (4.3% annualized over one year, and 13.5 over annualized over 3 years) (Standard and Poors, 2015). Volumes of fund inflows by institutional investors and asset managers have not demonstrated a great appetite in this index. This raises questions, explored in this paper, as to whether investors appreciate the incremental governance improvements made by listed companies and if so, what importance they attribute to good governance of listed companies and how they have contributed to promoting changes in their investee companies.

In recent years, the EFSA and the Egyptian Exchange have tightened market standards and obligations on listed companies. The regulator has also been more active in regulating the governance of capital market intermediaries, introducing in 2007 new rules through Resolution 62 stipulating key provisions regarding the composition of boards, auditor nomination procedures and protection of shareholder rights. At the same time, the EGX issued new membership rules in 2014, aiming to institute specific measures to protect market participants, as well as introduced new arbitration rules to solve commercial disputes between market participants.

Recent developments

To date, the vast majority of changes in governance of listed companies were introduced and promoted by the EFSA, the EGX and the EIOD. The challenge of engaging investors in the capital market remains, as in other countries of the region, tied to the fact that ownership in the market remains highly concentrated, with low free float, especially outside EGX 30 listed firms. In addition, the market continues to be characterized by low levels of institutional capital, passive investment approach of most domestic institutional investors, and somewhat volatile foreign institutional investment.[12]

Portfolio investment in Egypt has seen a flight since the revolution in 2011, although the levels of investment by foreigners are – at the time of issuance of this paper - essentially back to the pre-revolution levels. Following the revolution and the fall of the Mubarak government in 2011, the EGX was closed for over a month, leading to rumors that it would be downgraded from its Emerging Market status.[13] Market capitalisation dropped sharply in the months following the revolution and the exchange was subject to significant volatility. Further volatility ensued in the intervening months and following the disposal of the Morsi government, the exchange rallied, gaining 7% in one day. Figure 1 below provides further details on investor reactions to major events.

Capital flight was motivated by concerns regarding the political future of the country but also by concerns over potential cronyism in the companies listed on the stock exchange. A recent study found that connected firms in Egypt had larger market share in the sectors in which they operate, with market valuation of political connections accounting for 13-16% of the value of connected firms (Hamouda and Diwan, 2014). Since the revolution, the high levels of cronyism in Egypt have been documented and investigated by the EFSA and the EGX immediately following the revolution in 2011 but also in subsequent years, during which hundreds of complaints were filed by investors to the EFSA.[14]

The exchange has been active, alongside the EFSA, in ensuring the integrity of listed companies by monitoring trading activity. For instance, the EGX cancelled 2728 trades-- worth a total of 15.29 million LE ($2.2 million USD) on Agwaa Food Industries. The company was subsequently fined for breach of various capital market regulations related to a planned IPO and agreed to pay 20 million Egyptian Pounds ($2.8 USD million) to the securities regulator in settlement. The ability of the EFSA to pursue an active enforcement stand vis-à-vis listed companies was also reinforced by the 2014 Constitution which recognised by the status of the entity as formally independent.

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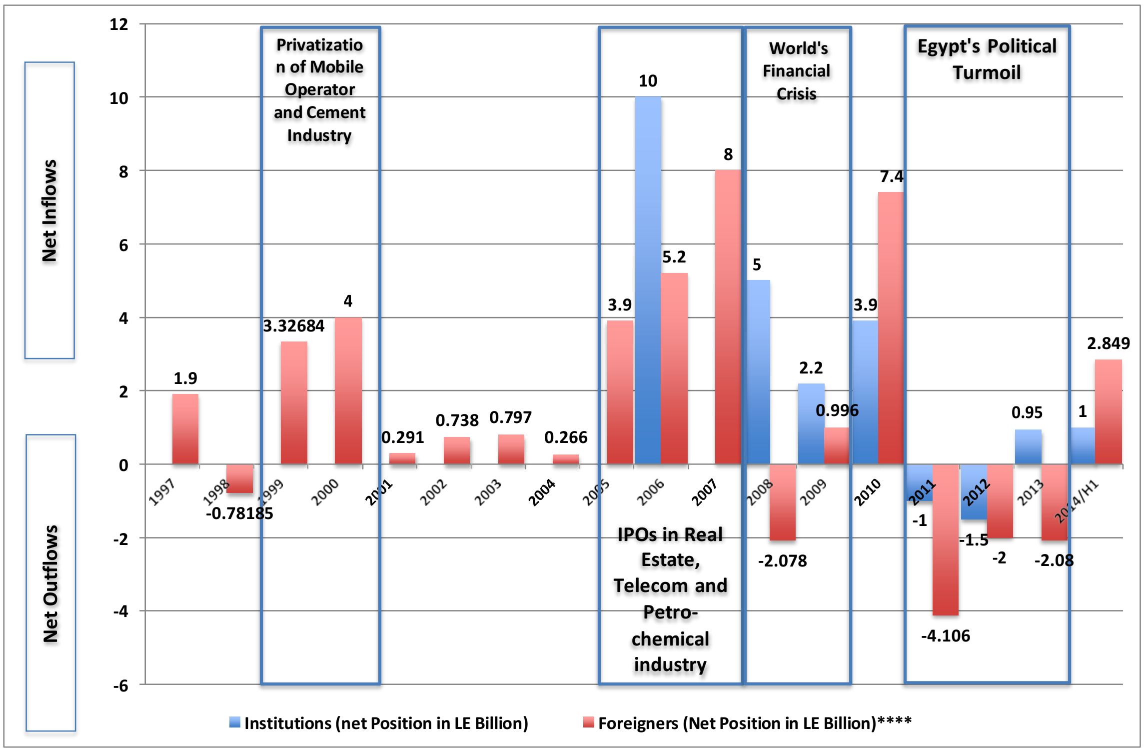
[12] For instance, the market declined by 42% in reaction to the 2008 global crisis between mid-September 2008 and end-November, driven by foreign investors liquidating their portfolios to cover losses in their home markets (Chekir, Hamouda and Ishac Diwan, 2014).

[13] Few exchanges in the region have been classified as emerging markets, most are considered as frontier markets. UAE and Qatar were in 2014 upgraded to emerging market and Morocco was re-classified as a frontier market.

[14] Following the re-opening of the stock exchange after the revolution, all Egyptian listed companies were required to make a declaration to the exchange and the capital market regulator on the ownership of the companies and any linkages that may exist between individuals under investigation and listed firms (Abdel Salam, 2011).

Figure 1. Reactions of Domestic and Foreign Investors to Major Events



* Excluding major transactions such as M&A's and public offerings

** Prior 2003, data was distorted by major transactions of sales of major stakes, mainly through privatization program

*** Prior 2001, data of foreign participation includes Arab activity

**** Includes Arab activity

Source: Ministry of Foreign Trade various reports, EGX Factbook issues and EGX annual reports

In 2013-2014, the performance of the EGX rebounded: as of end of 2014, market capitalisation stood at approximately LE 500 billion (equivalent to 65 billion USD), equivalent to 25% of GDP[15], fifth largest in the MENA region. In 2014, performance of the exchange rebounced and it was one of the best emerging market globally, alongside India, Indonesia and Philippines. In terms of the number of listed companies, the exchange remains the largest in the region with over 230 listings, followed by Kuwait and Saudi Arabia. Further information on the evolution of the EGX in the months preceding and following the revolution in Egypt is available in Annex I.

Current market and ownership structure

Today, the Egyptian capital market consists of two tiers. The main market includes 213 listed companies with market capitalisation of LE 478 billion (equivalent to $68 billion USD), representing approximately 25% of the GDP as of June 2014. NILEX, the SME market,

[15] EGX 2014 Annual Report.

currently has 24 listed firms with market capitalisation equivalent of 1 billion LE ($147 million USD). In terms of the sectoral composition, 12 sectors are represented of which 3 (i.e. real estate, financial services and telecommunications) dominate the market. [16]

Trading activity is concentrated in EGX 30 companies which historically have represented approximately 50% of the total market capitalisation and value traded. In the past 5 years, the 10 most traded domestic companies represented between 45-56% of total market turnover (WFE, 2014). This is generally in line with other countries in the region: for example, market capitalisation excluding top ten companies to total market capitalisation is estimated 30% in Jordan and Morocco. Smaller cap companied on the EGX as well as NILEX listed companies remain largely illiquid: total trading activity on NILEX during first half of 2014 amounted to 486 million LE (equivalent to $68 million USD). Beyond SMEs, improving the liquidity of listed companies is in fact a challenge for the entire market.[17]

Equity markets are dominated by retail investors, a tendency which is on the rise following the 2011 events which saw the exit of foreign institutional capital from the EGX. Prior to the revolution, retail investors held 14% of the market capitalisation and contributed to 70% of the trading activity. These figures rose to 15% of market capitalisation and 80% of trading post 2011. Domestic institutional investors account for approximately 45% of market capitalisation and foreign investors for 42% (Misr Clearing and Depositary, 2014). Foreign institutional investors' participation reached its peak in 2007 (47% of total market capitalisation), declining to 36% in 2011.

The EGX, much like other exchanges in the region is characterized by concentrated ownership, in large part owing to the legacy of the privatisation programme. Privatisation in the banking industry started in 1994 through state-owned banks selling their stakes in joint-venture banks[18] and continued with the sale of the telecom company Mobinil in 1999 and various cement sector firms in the following years. The retraction of the state from the capital market is highlighted in the figure below, which compares the ownership structure of 30 most actively traded companies in 2000 and 2014. As a result of these divestments, the free float jumped from 20% in 2000 to approximately 50% in 2014.

[16] According to latest available data (as of June 2014), the financial services sector represented 18% of the trading activity, following by real estate at 13% and telecommunications at 11%.

[17] For the 400 largest listed companies in the region, free float oscillated between 45 and 38 percent in 2014 according to MSCI data.

[18] The first was Commercial International Bank (CIB), which was almost totally owned by the National Bank of Egypt.

PART III. INSTITUTIONAL INVESTOR LANDSCAPE

The following section explores the participation of specific categories of institutional investors in the Egyptian capital market in further detail. As explored in the following sections, the largest institutional investors in Egypt are domestic mutual funds and insurance companies. Foreign investment in the EGX remains limited: non-Egyptian institutional shareholding in EGX 30 companies is about 4% of their market capitalisation, however other foreign stakes in major companies not part of EGX 30 are sizeable (e.g. Vodafone Egypt, Credit Agricole Bank, Arab Cement and others). Currently, international and regional direct investments are of significance in the banking, telecom and cement industry.

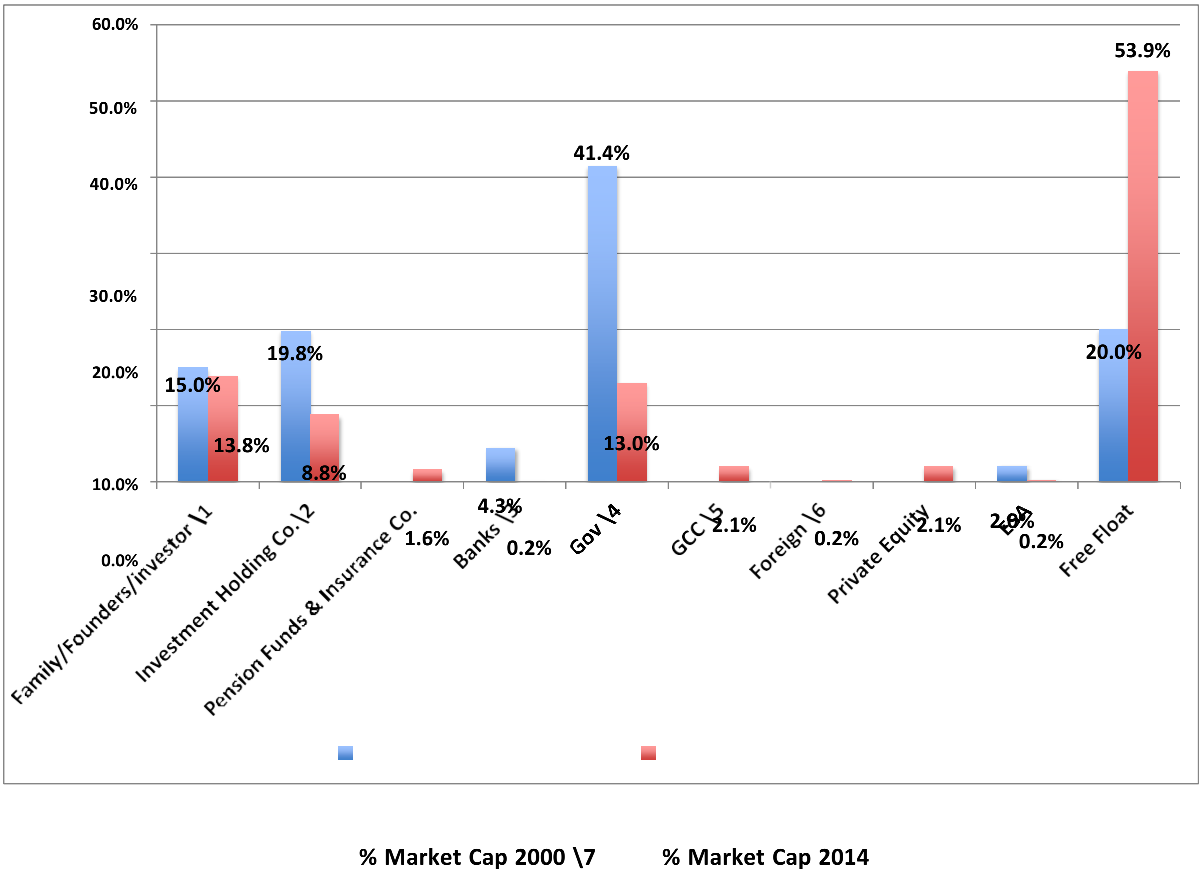
Foreign institutional investor participation in the Egyptian market has been increasing through direct and indirect investments, especially after the inclusion of Egypt in the MCSI Emerging Market category in 2001. The transformation in the type of institutional investors who have exposures to Egyptian markets has been experienced for a number of years. Initially, the largest institutional investors were mutual funds and insurance companies. In recent years, these were joined by private equity funds, sovereign wealth funds, hedge funds, international endowment and pension funds, asset managers and exchange traded funds (ETFs).[19]

However, since 2011 and due to the political unrest and sluggish economic performance, institutional investments experienced significant setback. International and regional institutions withdrew significant investments from the market, and local institutions resorted to low risk investments dominated by government bonds and treasury bills. Foreign institutional investment dropped to 36% of the total market capitalisation, while domestic institutional investors' share reached its peak of 48% of the same.

Focusing on the EGX 30 companies, the following figures present the nature and the evolution of institutional investment in Egypt. They highlight notably the declining role of state-controlled investors, the minimal growth of investments by insurance companies and pension funds, the stable participation of family offices and holding companies, and ultimately, the growing free float in the market.

[19] The first Egyptian ETFs was listed in 2014 and started trading in January 2015.

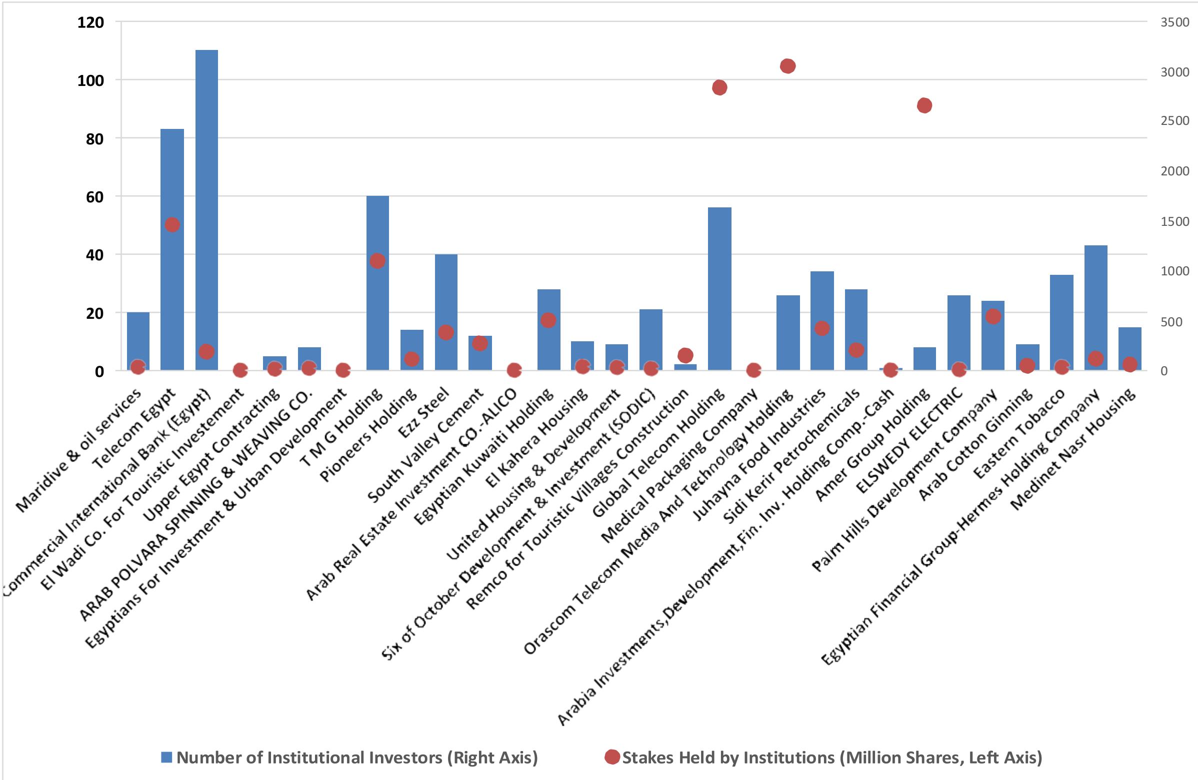
Figure 2. Institutional Investors as % of Market Capitalisation of EGX 30 Companies, as of June 2014



1. Egyptian nationality; founders family companies through off-shore companies are considered as direct local ownership, to avoid distortive representation of institutional investment.
2. Investment holding companies are private companies not considered in this Figure.
3. Thank bank category includes private insurance companies, only for the 2000 figure.
4. Government includes stated owned companies, government holding companies, National Investment Bank (NIB), Egypt Post, public pension funds and other government institutions.
5. GCC institutional investors represent wealth funds, family offices, holding companies and other GCC institutions.
6. Non-Private Equity
7. Based on most active 30 stocks in year 2000. Foreign shareholding included in the non-governmental categories.

Source: Bloomberg, Egyptian Stock Exchange, Beltone Research, and author calculations.

Figure 3. Institutional Investors in EGX 30 Companies, as of June 2014



Source: Bloomberg

Mutual funds development

In Egypt, banks and insurance companies are the only institutions allowed to incorporate mutual funds, without a need to establish separate company.[20] The origins of the mutual fund industry can be traced to the early 1990s, when open-ended equity funds were established by three local Egyptian banks[21] in late 1994 for LE 700 million. At the time, they accounted for about 5% of total market capitalisation and less than 1% of the GDP.[22] By 1996, Egypt had 7 country funds with cumulative assets under management (AUM) amounting to $414 USD million.

Currently, there are 84 open-ended funds, 3 closed-ended funds and 2 fund of funds, with total AUM worth of LE 63 billion[23] (3.6% of GDP). Despite the increasing number of mutual funds, it is estimated that equity investments of mutual funds stand at LE 3 billion,

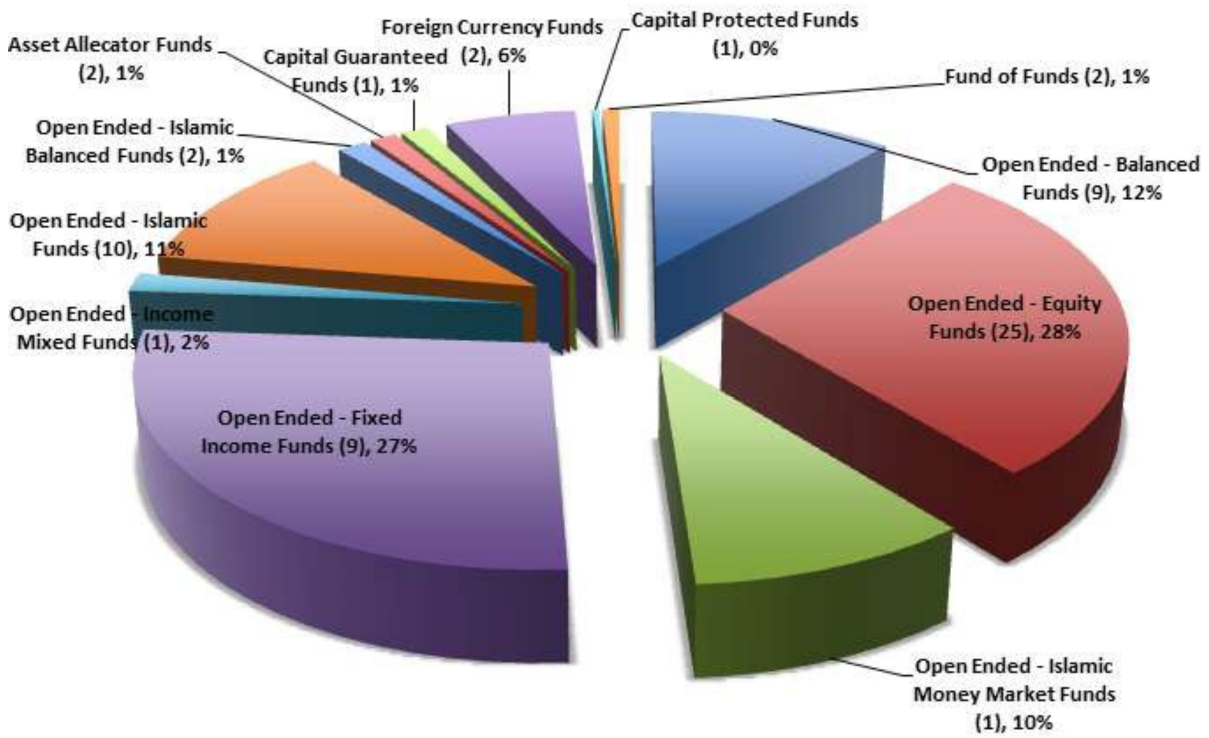
[20] Law # 95/1992 Articles 35 & 41 and Art. 173 from the Executive Regulations.
[21] National Bank of Egypt size of LE 200 million, Bank of Alexandria size of LE 200 million and Egyptian American Bank (Credit Agricole, now) size of LE 300 million.
[22] In 1994, GDP was about LE 200 billion and market capitalisation was LE 14.5 billion (7.2% of GDP).
[23] As at end of March 2014; source: EIMA report.

equivalent or 5% of their AUM, This is equivalent to 0.6% of total market capitalisation (as of end Q1/2014[24]) and 0.2% of GDP.

Egypt mutual funds' AUM as percent of market capitalisation is generally consistent with the level of development of such products elsewhere in the region, including in the GCC countries where mutual funds control an estimated 2% of total market capitalisation (Markab Advisory, 2012).[25] Importantly and contrary to global trends, AUM as percent of market capitalisation has been in a continuous decline, averaging 2.5% during 2001-2008, dropping to 1% on average in 2009-2010 mainly due to the financial crisis. Since 2011 and due to the political turmoil in Egypt, AUM as percent of market capitalisation dropped to less than than 1%.

Egypt's mutual funds industry is dominated by money market funds (almost 90%) consistent with the general trend in the MENA region. For example, money market funds constitute about 45% of the total GCC mutual funds portfolio. The participation in the equity funds are mainly the sponsor institution[26], local institutions and retail investors. This is unlike the GCC markets where mutual funds offer access to markets otherwise restricted to foreign portfolio investors.

Figure 4. Mutual Funds Allocation by Type (as of March 2014)



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[24] Market capitalisation stood at LE 470 billion at end of March 2014 (Source: EGX quarterly report).
[25] Refer to a study conducted by Markab Advisory (2012).
[26] By law, at least 5% of the targeted size should be seeded by the sponsor.

Money Market Funds are excluded from the chart for better interpretation of the chart; Money Markets Funds is 88% of total AUM;

Labels: Type of Fund (Number of Funds); As % of Total AUM including the Money Market Funds.

Source: EIMA.

Asset allocations depend on the type of the fund, from risky where allocation to listed equity represents 80-90% of AUM to low risk funds similar to money market funds where asset allocation is heavily focused on government debt, bank deposits and cash. The majority of funds prefer liquid equity and are hence concentrated in the EGX 30 companies. Regardless of their ultimate sponsor, a proposal for the establishment of a fund including an offering memo, including the investment/asset allocation guidelines, needs to be approved by the EFSA.

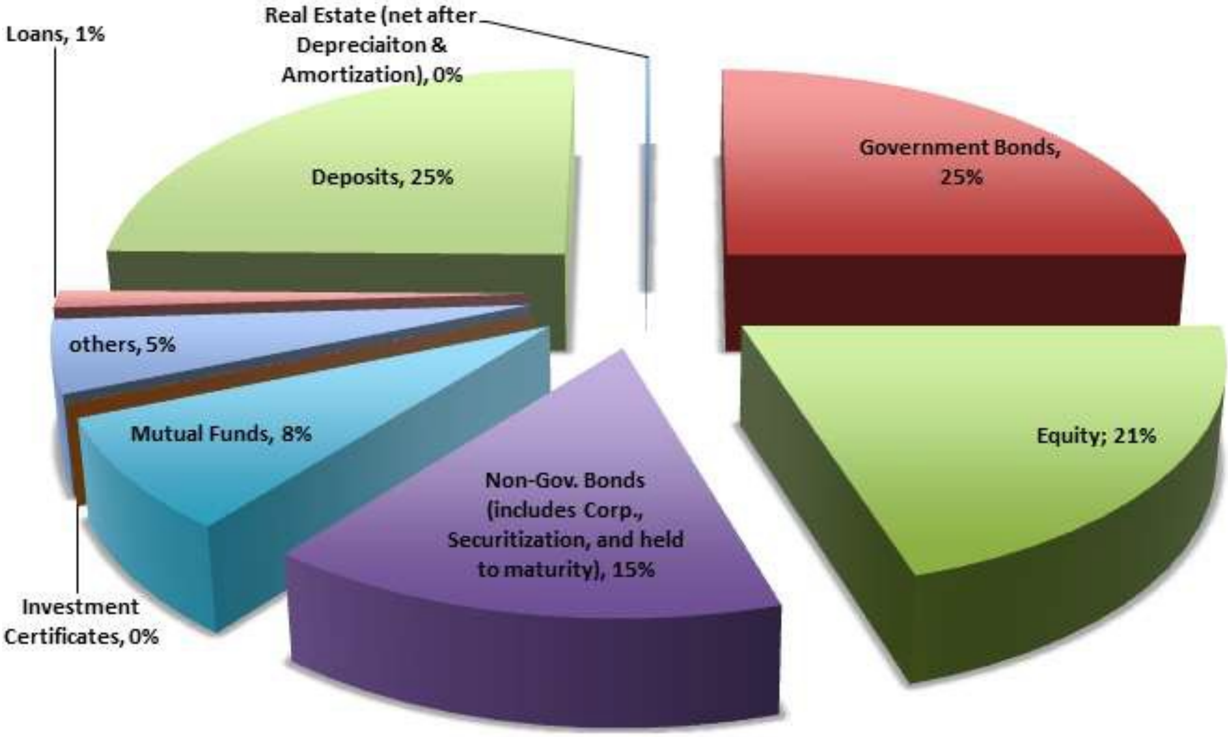
Insurance Companies

The insurance sector in Egypt has a very long history and used to be dominated by state-owned insurance companies since the 1960s due to the nationalisation of large insurance firms. Prior to 2004, the 4 state-owned insurance companies accounted for about 70% of total premiums (Nasr, 2004). Following the adoption of a strategic plan to reform and develop the insurance sector, stated-owned insurance companies' market share dropped to 49% of total premiums (Insurance Statistical Yearbook, 2012, 2013). Currently, there are 30 insurance companies operating in Egypt out of which 12 are life insurance companies, all private joint ventures with foreign institutions with exception of one governmental company Misr Life Insurance. The entrance of foreign institutions has allowed for innovation and the development of a new product mix, mainly investment linked life products.

Total premiums for life and non-life insurance is about 5% of GDP and total investments amounted LE 47.6 billion (equivalent to $8.6 billion USD) or 2.7% of GDP in 2012-2013. Asset allocation strategies are formulated based on Article 28 of the executive regulations of Law 10/1981. For life insurance, the maximum allocation of equity-based investments should not exceed 20% of the investable portfolio, while for non-life insurance a 25% limit applies. These limits are comparable to similar limits in the region: for example, Saudi Arabia caps equity investment of insurance companies at the 30% while Oman at 15% only (Kotilane, 2010).

The investment portfolio of the insurance industry amounts to LE 47.6 billion, of which 60% remains in the hands of public insurance funds and the remaining in the hands of the private sector (Insurance Yearbook, 2012, 2013). Egyptian insurance companies are required by law to invest in Egyptian equities only unlike peers in other MENA countries such as the UAE which allow them to invest in foreign equities. Life insurance companies are to invest in government debt and/or certificates guaranteed by the government at a minimum of 25% of their investable portfolio with no ceiling, and for non-life insurance companies at minimum of 20% with no ceiling. For further information on the portfolio allocations of insurance companies, refer to the Figure below.

Figure 5. Insurance Sector Investment Portfolio Allocation (as of 2013)



Source: EFSA annual Report, 2012/2013.

Private insurance companies, which control 40% of the total Egyptian insurance industry, have adopted a risk-averse strategy, investing almost 50% of their portfolio in government bonds and bank deposits. The remaining investment portfolio is a mix of equity (20%), commercial bonds (15%), mutual funds (9%) and other investments. As a result, total equity investments of the insurance sector stood at LE 9.5 billion (0.5% of GDP) as of the year end 2013.[27] In addition public insurance companies, also have key, some strategic stakes in listed companies.

The Social Insurance System (SIS), the oldest in the region having been established in 1952, and still managed by the National Organisation for Social Insurance[28], has some key stakes in listed companies (e.g. 10% stake of in Ameriyah Cement). SIS seeks to support government presence in strategic companies that have been privatised and to support the market performance. In September 1998, the SIS launched 3 investment funds and outsourced their management to the private sector fund managers. The total amount

[27] There isn't enough information about the portfolio mix between listed and unlisted stocks.
[28] Refer to Selwaness (2012) for further analysis of SIS in Egypt.

committed to these funds was LE 900 million (equivalent to $265 million USD), less than 1 % of the total social insurance funds available for investment.[29]

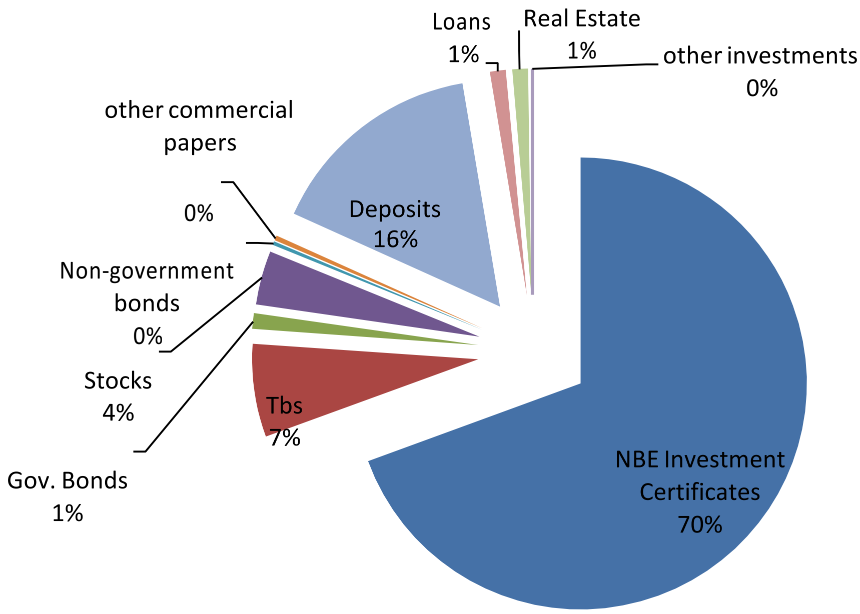
Pension Funds

The pension fund scheme in Egypt is mostly dominated by the Defined Benefit scheme (DB), while, Defined Contribution (DC) scheme is new in Egypt and it is subject to voluntary subscriptions in addition to the statutory DB scheme. Currently, there are 4 governmental pension funds with total investments around LE 340 million (equivalent to $62 million USD) mostly invested in National Bank of Egypt Investment Certificates for about 60% the total investable funds, as well as government bonds and bills (25%). Equity investments, debt investments, investments in mutual funds, money market funds and other commercial papers together account for 13% of total AUM of public pension funds (Ministry of Finance, various quarterly reports).

In addition, there are 661 private pension funds, with total investments of LE 35.3 billion (2% of GDP). Almost 70% of their portfolio is invested in the National Bank of Egypt Investment Certificates, through by law they are only required to invest only 25% of their portfolio in this product. The remaining funds are distributed among bank deposits (15%), government bonds and bills (7.5%) and stocks including both listed and unlisted stakes (4%). These figures highlight that 70% of total pension funds' investment portfolio in Egypt (1.5% of GDP) is allocated to investment certificates and demonstrate that pension funds do not yet play an important role in capital markets in Egypt. Current regulations prohibit them from investing in foreign stocks and bonds and limit domestic equity investments to 10% of their overall portfolio.

Since the passage of the law 54 in 1975 and until 2005, investment of pension funds' assets was highly restricted. In 2005, this Law was amended, allowing investment in equity not to exceed 20% of total investments. Investments in bonds are not to exceed 10% of total investments, provided that investments in bonds issued by a single issuer do not exceed 5% of the total investments or 20% of the capital of the issuer of the said bonds. A final stipulation is that the total value of investment in bonds, stocks (direct and through mutual funds) by a pension fund does not exceed 10% of its total investments (OECD, 2014).

Figure 6. **Pension funds Investment allocation 2012-2013**



Source: EFSA annual Report, 2012/2013.

International investors

International, including GCC-domiciled investors, have been one of the pivotal contributors to the Egyptian market activity, making direct investments and investing through collective investment vehicles. During late 1990s and early 2000s, the market was significantly influenced by the international investors' activity[30] to the extent that local investors considered this activity as an important vote of confidence and a barometer of health of the Egyptian capital market.

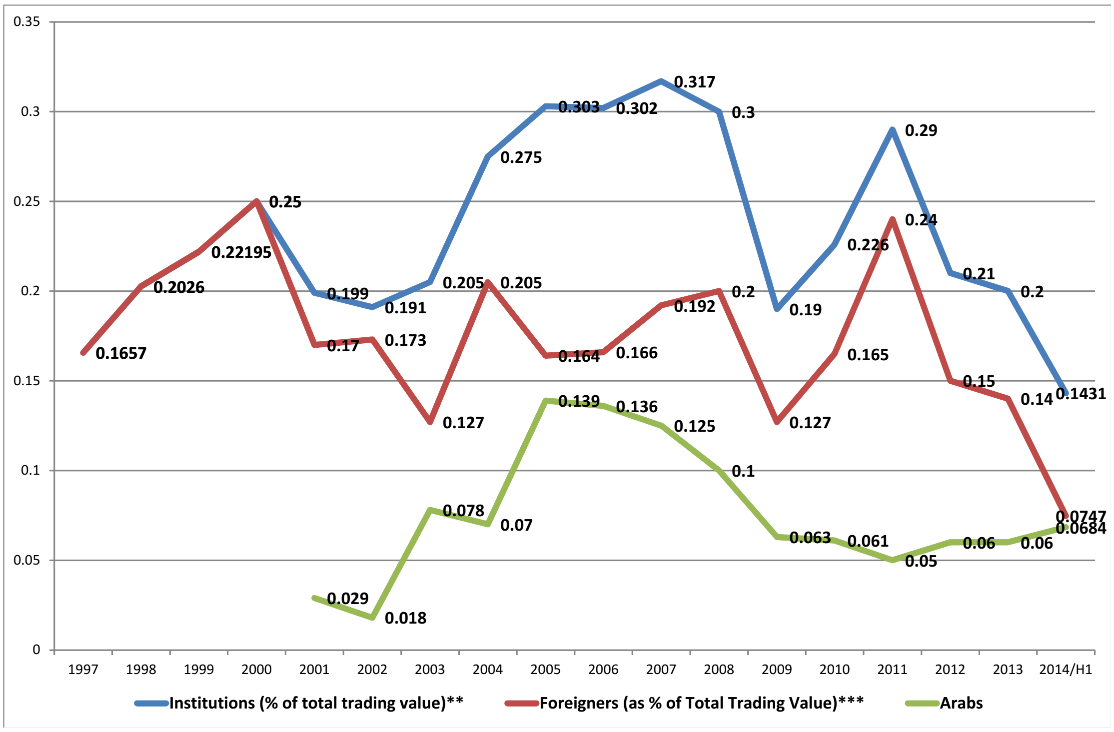
As highlighted by figures above, foreign ownership was comprised of investments from Europe and North America as well as of investments by other Arab investors (primarily from the GCC), which resulted in the fact that EGX performance was closely "coupled" and influenced by the performance of regional markets, as highlighted by the significant decline of the EGX valuation during the stock exchange crisis in the Gulf in 2006.[31] On the date GCC markets declined, the Egyptian Exchange experienced the biggest drop in EGX 30 since

[30] For empirical evidence see Hindy, *et al.* (1999) and Samak, *et al.* (2000).

[31] An empirical investigation done by EGX showed that the correlation coefficient between the Egyptian market and Regional markets recorded its peak during 2005 and 2006 with average of 30% (EGX Annual Reports 2006 & 2007).

inception (i.e. by almost 12% in the first hour of trading).[32] Overall, while foreign ownership in the EGX has fluctuated between 30-40% in recent years, the volume of trading by institutions outside the region has been on the decline in recent years, while the volume of trading by Arab institutional investors has been relatively steady, as per the Figure below.

Figure 7. Local and Foreign Contribution to Market Liquidity



*Institutions denotes local institutional investors, Arab institutional investors and foreign institutional investors are split into two categories
** Prior to 2003, data was distorted by major transactions of sales of major stakes, mainly through privatisation program
*** Prior to 2001, data of foreign participation includes Arab investment contribution
Source: Ministry of Foreign Trade various reports, and EGX various Factbook issues and annual reports.

Since 2011, political events resulted in an outflow of capital and a reduced activity by foreign investors. Moreover, hurdles in profit repatriation and foreign currency scarcity have had a great impact. Institutional investment embarked on declining trend to contribute 46% of total market liquidity compared to the peak 59% in 2011. It is important to highlight that the peak reached in 2011 was due to a sell-off pre- and post- market closure[33] due to the political unrest.

Foreign institutional investors' participation declined to 7% of the total value traded compared to an average of 20% in previous years. Regional institutional investors maintained their level at 6% on average of the total value traded. It is evident that in 2011-2013, the market experienced net outflows from international and regional investors.

Due to strong market performance following the June 2013 events, a number of international funds increased their exposure to the Egyptian market. A recent survey of regional asset managers suggests that 33% of the managers surveyed expect to raise their Egyptian equity allocations and only 7% to reduce them (Reuters, 2014). The following Table highlights examples of regional and international funds investing in Egypt, along with their weight allocations.

Table 1. International and Regional Funds investing in Egyptian Market

Fund Name	Fund Size (USD million)	Egypt Weight	Factsheet Date
Makaseb Arab Tigers (Mashreq)	39	27.3%	31/12/2014
Franklin Templeton MENA	243	15.4%	30/11/2014
FT Emerging Arabia	45	14.2%	30/9/2014
Magna MENA Fund	44	12.0%	31/12/2014
EFG-Hermes MEDA	47	9.0%	30/9/2014
SHUAA Arab Gateway Fund	36	9.0%	30/11/2014
Amundi Funds MENA Equity	142	8.1%	31/12/2014
Barings MENA Fund	13	8.0%	31/12/2014
Rasmala - Arabian Markets Growth Egypt Fund	10	8.0%	31/12/2014
Schroder International Selection Fund (Middle East)	234	7.1%	31/12/2014
JPMorgan EM Middle East Equity Fund	245	3.6%	30/11/2014
Markaz Arabian Fund	49	0.3%	31/12/2014

Source: Beltone Asset Management.

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[33] The Egyptian market for the first time in its history suspended completely market activity from 28 January -22 March 2011.

New institutional investors

In terms of "alternative" institutional investors such as hedge funds, exchange traded funds and sovereign investors which can be considered relatively new investors in capital markets in Egypt, this scene is dominated by private equity firms and GCC-based sovereign wealth funds. Currently, 17 private equity firms operate in Egypt, of which 6 are representative offices (Preqin, 2014). At the height of the privatisation programme in 2005 - 2009, Egypt was the top destination for private equity investment in the MENA region, attracting about $2.5 billion (Egypt AmCham, 2011). In recent years, Egypt recorded 15 private equity deals, most of which were aimed at acquiring stakes in private companies (ibid). For further information, refer to Table 2 below.

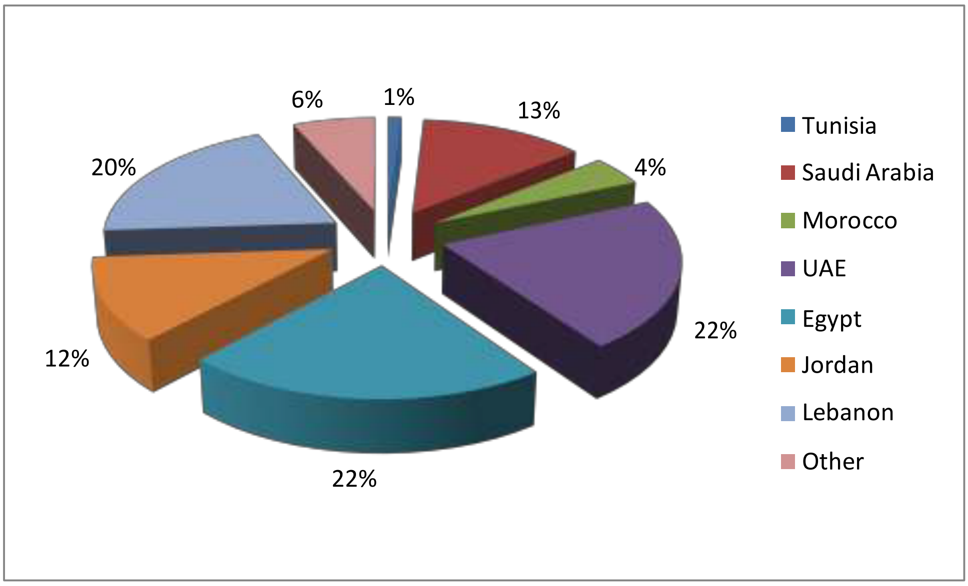
Table 2.Summary of Major Private Equity Deals in Egypt, 2005-2014

Year	Private Equity	The Deal	Size *(In million USD)*	Sector	Company status
2014	Fairfax	Acquiring 6.5% of CIB	300	Banking	Listed
2014	Ripplewood	Acquiring 10% of SODIC	31	Real Estate Development	Listed
2014	Ripplewood	Acquiring 2.3% of Palm Hills	19	Real Estate Development	Listed
2013	Actis	Acquiring 30% of EDITA	102	Agro industries	Plan for listing
2012	Capital Trust Group	Acquiring 51% of Al Oyoun Al Dawli Hospital	N/A	Health Care	Unlisted
2009	Actis	Acquiring 9.3% of CIB	244	Banking	Listed
2006	Beltone Investment Group	Acquiring 31% of Madinet Nasr City for Housing & Development	100	Real Estate	Listed
2005	Concord International Investments	Acquiring 63% of Bisco Misr	N/A	Agro industries	Listed

Source: Reuters, EMPEA Legal & Regulatory Bulletin Winter 2014, private equity firms' websites

According to the MENA Private Equity Association, in 2013 Egypt and the United Arab Emirates led as destinations of private equity investment in the MENA region with a 20% share each, followed by Lebanon and Saudi Arabia. With the increasing significance of private equity activity in Egypt, the Egyptian Private Equity Association (EPEA) was established to develop and represent the industry as well as to set industry standards.

Figure 8. Private Equity Investment Volumes in the MENA Region, 2013



Source: MENA Private Equity Association, 2013

Asset managers

As noted in Isaksson and Celik (2013), asset managers have become a category of institutional investors on their own right. In Egypt, the industry comprises 44 licensed asset managers, the first of which was established in 1994 by the National Bank of Egypt. Today, the industry has developed but remains dominated by less than a dozen players. Assets under management are estimated to have reached LE 63 billion (equivalent to USD $10.5 billion) by March 2014 of which 10% are invested in Egyptian equities and the remainder in money market and fixed income products.

Asset managers in the Egyptian market are in fierce competition with each other. Their ultimate beneficiaries, whether government entities, banks and insurance companies, are focused on annual performance regardless of their beneficiaries' business model being long-term oriented. As a result, their investment strategies are characterized by short-termism and active portfolio management (i.e. active fundamental strategies). Their fee structure varies between a flat fee and performance-based which in other markets has resulted in a misalignment in the incentives of asset managers and the ultimate beneficiaries, leading for example to portfolio churning (Celik and Isaksson, 2014).

In 2000, the Egyptian Investment Management Association (EIMA) was established to represent the asset management industry in Egypt. Shortly, EIMA published the Egyptian Investment Performance Standards (Egypt-IPS), inspired by the Global Investment Performance Standards (GIPS). The Association's role is more educational as it offers training on financial and asset management related subjects. It also represents the industry before the public and the government.

Other major investors

Egypt Post

Local and foreign banks and Egypt Post are also important investors in the capital market. Egypt Post is one of the richest financial institutions in Egypt and has some major investments in the capital market which include notably a 20% stake in the third mobile operator in Egypt "Etisalat Egypt"[34], an investment worth almost to LE 3 billion (equivalent to USD 600 million) in 2006. The major source of funding is the Postal Saving Passbook, which covers over 20 million non-recurring customers[35]. Almost 80% of the revenues come from the saving accounts services, which are deposited at the National Investment Bank (NIB) (El Din, 2013). In 2005, the government decided to re-direct a portion of the funds transferred to the NIB to other investment channels and as a result 7 equity portfolios worth LE 3.3 billion were created and managed by outsourced professional asset managers.

National Investment Bank

The National Investment Bank was established according the Law 119 in 1980. Unlike traditional commercial banks, its main objective is developmental, supporting the country's five-year plans and financing social and infrastructure projects. The bank finances its activities primarily through issuing the National Bank of Egypt's investment certificates (about 40% of the banks resources), followed by SIS deposits (30%) and the EP deposits (30%) (Ministry of Finance various quarterly reports). In mid-1990s, NIB started to enter the stock market though an allocation of LE 2 billion (equivalent to $580 million USD), managed by professional asset managers. NIB owns strategic stakes in two listed companies: Abu Keir Fertilizers (25%) listed in 1994 and Sidi Krair for Petro-chemicals (7%) listed in 2005.

[34] Not listed on the Egyptian Exchange.

[35] According to Law No. 9 of 1982 it is not allowed to open more than one account for the same customer, unlike banks that a single customer can have more than one account in his name.

FACILITATING ENGAGEMENT BY INSTITUTIONAL INVESTORS IN EGYPT

International experience

The long held belief that institutional investors are key to developing capital markets and enhancing corporate governance practices has been questioned given that in many jurisdictions, large investors tend to outsource asset management functions, resulting in the lengthening of the investment chain. The potential role of institutional investors in MENA markets is important to explore considering that regulators are increasingly seeking to attract foreign institutional capital and also increase the level of investor engagement. While corporate governance standards introduced through laws, regulations and codes have become increasingly sophisticated across the region, including in Egypt, levels of governance engagement by investors has not followed suit.

The lack of engagement by institutional investors in Egypt and the wider MENA region stands in contrast with local developments and international trends. Domestically, the EGX has integrated a number of key corporate governance requirements into listing rules (considering that the corporate governance code remains voluntary) and the EFSA is currently in the process of revising the corporate governance code with the intention to change its status to "comply or explain". Internationally, institutional investors have faced criticism for failing to act as "guardians at the gate" of key corporate assets during the financial crisis and as a result, have developed or been asked to adopt better stewardship practices.

In the Americas and Europe, the levels of engagement on a range of governance issues ranging from board appointments to remuneration to mergers and acquisitions to dividend strategy, have been rise. These developments have spurred an active debate regarding the impact of investor engagement on the creation of corporate value, to some extent shaking the belief that institutional ownership is necessarily value creating. While these debates are certainly relevant for Arab markets, given the generally low levels of institutional investment and much less developed dialogue between management and boards on the one hand, and investors on the other, they have so far not been echoed in the region.

Until the financial crisis which revealed a number of fundamental governance weaknesses in financial and non-financial firms, institutional investors were considered as key to the dialogue between shareholders on the one hand, and corporate boards and management on the other, considering the significant growth of institutional investment worldwide and the resources available to these investors. However, recent OECD research highlighted that the degree of ownership engagement is not determined by share ownership as such, but by a number of factors which together dictate a given investors' business model.

The degree of institutional ownership and investment horizon is a function of country-specific variables such as the extent of investors' protection, political stability and ease of repatriation of funds as well as company-specific variables such as the quality of corporate governance practices, financial and non-financial performance. In a recent OECD Working Paper, Celik and Isaksson (2013) examined institutional investors as owners of listed companies, categorizing investors as "traditional" investors (i.e. pension funds, investment funds and insurance companies) which have historically and remain the largest in terms of AUM, and "alternative" investors (relatively new investors such as hedge funds, private equity and exchange traded funds), exploring their investment strategy and level of engagement.

The paper described engagement as a function of a number of variables such as liability structure, portfolio structure, fee structure, regulatory constraints and the investment strategy. The objective of the last section of this working paper is to apply this taxonomy to the landscape of institutional investors in Egypt in order to shed light on the reasons behind the lack of engagement by local and foreign investors as well as to provide some preliminary recommendations on how effective dialogue between investors and boards of listed firms can be facilitated.

Corporate governance weaknesses in Egypt

Better dialogue between large investors and asset managers and corporate boards in Egypt is also important in order to raise the quality of governance standards in Egypt. As described in earlier sections of this report, a number of key institutions, notably the EIOD, the EFSA and the EGX have been driving corporate governance reform in Egypt since early 2000 and these efforts have borne fruit. The effort to delist hundreds of companies which were illiquid and which failed to provide the requisite public reporting have also contributed to making the market more attractive. In addition, the abuse of corporate assets uncovered following the revolution have further heightened the interest of the general public, of the regulator, and of the listed companies in the implementation of good governance practices.

At the same time, governance practices in Egyptian listed companies continue to be subject of distrust and criticism in the investor community, in large part due to the fact that the corporate governance code remains voluntary and the regulator therefore has few mechanisms to enforce it.[36] While an evaluation of the Egyptian corporate governance framework and practices is beyond the scope of this paper, available research and discussions with investors underscore significant a gap between investor expectations and market practices.

A recent study by Shehata and Dahawy (2013) benchmarked the disclosure provided by top 29 listed firms in Egypt and found that, on average, even these large firms provided less

[36] Except for banking institutions which are subject to separate guidelines issued by the Central Bank of Egypt.

than half of the items in the ISAR benchmark (52 items in total).[37] Obtaining accurate information on non-listed firms is even more challenging: a recent study of joint ventures in Egypt found that of 1000 joint ventures examined, only about 60% had a functioning website and the information disclosed was insufficient (Bremer, 2013).

Governance challenges that continue to present concern to current and prospective shareholders include the lack of separation of CEO and Chairman roles, few independent directors on boards, the treatment of related party transactions and charitable donations, the preparation and communication around board meetings and AGMs, and the quality of internal control and risk management processes. The Institutional Shareholder Services, a leading global proxy advisor, has in the past recommended its clients to vote negative on a number of issues, and in fact, the number of “against” recommendations in Egypt has grown from 15% in 2012 to 20% in 2013 (ISS, 2013).[38] Some of the governance gaps at the board level in EGX 30 companies are documented further in Annex II.

Investor engagement in Egypt

Despite these governance gaps which, *prima facie*, would seem to justify shareholder engagement in listed companies in Egypt, this paper found very limited evidence of this While this may appear to be paradoxical, we advance a number of reasons for this phenomenon, explaining why engagement may not appear as an option whose benefits outweigh its costs. This lack of shareholder engagement in Egypt is a consequence of a number of key factors.

First, most markets in the region, including in Egypt are retail driven. Approximately 15% of market capitalisation and 80 % of trading remains in the hand of retail investors. This is result of the slow development of private institutional investors, whether pension and social security funds, mutual funds or insurance companies in Egypt and in the wider region. On the other hand, state-controlled investors (pension funds and insurance companies) continue to hold sizeable stakes in the market, “having inherited” stakes following the nationalization programme implemented in 1950s.

The investments of these entities - which often take form of substantial blockholdings - are generally not dictated by a particular investment strategy but instead by their “legacy” shareholdings. Their investment decisions are usually a function of the governments’ interest to invest in strategic sectors. Examples of such cases include Egypt Post’s 20% stake

[37] While 9 items in the ISAR benchmark were disclosed by more than two-thirds of the companies in the study, 40 items were disclosed by less than half (ibid).

[38] For instance, for the Remco for Touristic Villages Construction’s (Egypt) May 2013 general meeting, shareholders were recommended by ISS to vote against the financial statements due to concerns relating to the valuation of goodwill and the poor disclosure surrounding its subsidiaries. At Telecom Egypt’s (Egypt) March 2013 general meeting, shareholders were also recommended to vote against

the remuneration of directors due to a significant increase that was not seen as justified. In Etisalat Egypt, National Investment Bank's 25% stake in Abu Keir Fertilizers, Misr Insurance and Misr Life insurance 20% stake in Cement Kena. These blockholdings allow government investors to have direct board representation and an insider view on company strategy and governance mechanisms. Thus, the investment strategy could be categorized as "passive fundamental".

More recently, state-controlled investors such as Egypt's Post and Misr Insurance Holding Company have been exposed to participation in the capital market though investments in collective investment schemes, which are estimated to have reached LE 9 billion, or nearly 2% of total market capitalisation (EIMA and EGX). Regardless of the investment style and horizon, their ability to effectively monitor governance of their investee companies is limited.

Their investment decisions are delegated to investment committees composed of the institutions' executive management and board of directors (not necessarily independent) whose investment approach is usually characterised by conservatism and skepticism of capital markets.[39] In addition, the profile of board members nominated by these investors often lack skills to effectively represent investors' interest in board discussions since they are not subject to any governance training and may not have the requisite understanding of particular sectors, and by consequence the risks and the opportunities in these sectors.

This picture has been recently changing with the entry of domestic private investment funds and asset managers, however their ownership still accounts for less than 5% of market capitalisation. This is not only due to the relatively small size of assets under management but also, as mentioned, to the legal limitations on investments in the capital market which imply that their exposure to and stakes in individual listed companies remain relatively low.[40] This low participation of by domestic private institutional investors in Egyptian capital market is also consequence of insufficient liquidity and perhaps chiefly, the conservative investment strategies adopted by investors after the international financial crisis and the recent political unrest in Egypt.

Other factors which negatively affect prospects for meaningful engagement include a short termism approach of some major investors which, while having a long-term obligation to their beneficiaries, often have short to medium-term contractual agreements (1- 3 years) with asset managers. That said, the role of asset management firms has changed significantly in 2007 when a Ministerial decree was issued to allow asset managers to participate in general assemblies and to be represented on boards of companies on behalf of

[39] Few state controlled investors outsource their investment management and stewardship functions to asset managers.

[40] The limits of equity investments placed on some investors have also reduced their potential role in the local market, however the requirement that they do not invest in international equities has arguably acted to counterbalance this.

the fund's sponsors. Asset managers generally adopt "reactive engagement" approaches, primarily focusing on dividend policies and items that might quickly affect stock performance (e.g. merger and acquisitions, new contractual agreements, sales of assets).

A number of asset managers continue to be reluctant to engage with investee companies, in part because asset managers sitting on boards are considered to be insiders. Thus, their active asset management will be constrained by the rules governing insiders' trading activities. According to the listing and disclosure rules, any insider trade should be reported to the Exchange. Blackout period of insider trading in case of board meetings and/or material events is 5 working days prior the event date and 1 working day after the event date.

At the same time, there is little evidence that disintermediation in Egypt has led to the same outsourcing of monitoring responsibilities as we have seen in the United States and Europe. This is in part related to the size of ownership stakes, a number of which are strategic stakes, resulting from, for example, acquisition of stakes by banks in privatisations. It is also related to the fact that local institutional investors do not allocate their portfolios to foreign equities and hence do not face the dispersion of their equity portfolio to hundreds of companies which would make the performance of their ownership responsibilities difficult.

Due to these reforms, domestic institutional investors' reliance on asset managers in terms of governance engagement has grown. One notable exception to this are domestic insurance companies which are directly represented on boards of investee companies (e.g. United Housing and Development, Unirab Polvara Spinning and Weaving, TMG holding). In case of direct investments, local institutional investors are more likely to adopt "alpha engagement". Unlike mature markets, prominent governance debates on issues such as remuneration, CSR and other topics, have not yet been seen in Egypt.

International institutional investors (all except Arab investors) generally follow a "passive index" investment strategy, which is adopted by most international asset managers investing in the Egyptian market, especially following its upgrade into the MSCI Emerging Market. Their impact on improving corporate governance practices is also limited by the fact that their investments are concentrated in a few large cap, liquid companies which already have above average corporate governance practices. The interest of institutional investors in EGX 30 companies appears primarily driven by their size, as opposed to stellar governance practices.[41]

[41] Only two companies' boards (CIB and EFG-Hermes) are dominated by independent directors and with the exception of these two companies, boards are dominated by non-executive directors at 60%. The highest number of institutional investors is in CIB, despite the fact that its Chairman and CEO roles are not separated.

In addition, the quality of their dialogue with investee companies is affected by the fact that large institutional investors commonly outsource their portfolio management functions to international asset managers, with the exception of family offices from the Gulf countries which have in-house asset management capabilities, having sourced internationally experienced portfolio managers. Regardless of the investment strategy deployed, the levels of engagement of domestic and international investors in the Egyptian capital market can be characterised by no or very low levels of engagement due primarily to the diversification of portfolio by international investors who, as a result, do not face sufficient incentives to engage with any given company.

That said, "alternative investors" in Egypt (e.g. Actis, Ripplewood and Fairfax), which include a number of large private equity houses do face greater incentives to engage with their companies. Private equity funds, similarly to government investors, typically take sizeable stakes in listed and unlisted companies and hence their engagement strategy typically ranges from "alpha engagement" to "inside engagement". Indeed, private equity funds have made sizeable investment in some firms, including in some EGX 30 firms. All recent deals executed by private equity funds show active participation in general assemblies of investee companies and in company boards.

The profile of Arab institutional investors differ from their counterparts globally: they are mostly banks (including their asset management arms), family offices, endowments and sovereign wealth vehicles, which unlike their peers, have less diversified holdings and generally adopt an "active fundamental" investment strategy. Given that Egypt remains one of the larger capital markets in the region, a number of Gulf-based family offices have acquired significant experience investing in the market and being able to better access company filings in Arabic, are able to better engage with boards and management of Egyptian companies.

Their investment strategy has been generally index oriented and hence their ability to meaningfully impact governance of their investee companies is limited by the dispersed levels of their international investment portfolio. In examining the ownership of EGX 30 companies, it appears that while some companies have only one or two institutional investors (e.g. Remco), some companies have over 50 institutional shareholders (e.g. CIB and TMG) and their ownership stake is highly variable.

Facilitating dialogue with institutional investors

As highlighted throughout this Working Paper, little public information on the levels of institutional engagement in Egypt's capital market exists. In principle, incentives have been created for institutional investors to act as "engaged investors" in the Egyptian market, mainly though regulatory action aimed at increasing level of disclosure and transparency especially on related parties' transactions and insider-trading, providing investors with mechanisms to exercise their voting rights, including through proxies; and providing investors with protection of their rights by law and through EFSA enforcement.

There is no clear disclosed policy and procedures regarding corporate governance engagement by various institutions. Dialogue between management and shareholders, in general, is more established and facilitated by the companies' investor relations departments, CFO and/or CEO, through conference calls and regular press conferences. It is worth noting that this takes place only for actively blue chip traded companies.

Based on the empirical research undertaken for this Working Paper and discussions with the investment community in Egypt, a number of preliminary recommendations can be put forward to improve the exercise of stewardship responsibilities by domestic and international institutional investors active in the Egyptian market. These recommendations are aimed both at the EFSA and EGX in considering their primordial role in facilitating capital market activity, but also the investors and boards and management of listed companies in Egypt.

First, it is important to recognise that not all institutional investors are "born alike" and as referred to throughout this paper, their objectives and investment style are naturally different. Therefore, investor voting based on a pre-defined formula or even abstention from voting may be rational from the perspective of institutional investors as their degree of engagement is not determined solely by ownership. As a result, this paper does not seek to provide suggestions that would be equally relevant for motivating all categories of investors to engage with their investee companies, instead taking a more nuanced approach tailored to specific categories of investors.

A recent OECD peer review on *the Role of Institutional Investors in Promoting Good Corporate Governance* highlighted a number of measures aimed at bringing state controlled investors to engage in governance of their investee companies and select examples are of relevance to Egypt. In addition, it provided a number of general insights that may be relevant to specific types of investors, notably on prudential regulations such as capping the percentage of a company's equity that can be held by a given institutional investor. [42]

Considering that state-controlled investors such as pension funds and banks are still considerable investors in the Egyptian capital market, encouraging them to act in their stewardship capacity would yield positive results both for the state as their ultimate owner, for the general public which is the beneficiary of their services, as well as for improving the quality of governance of listed companies and hence could be a priority for the regulators.

For instance, in Chile, which similarly to Egypt is characterised by a concentrated ownership landscape and presence of family groups, regulations adopted in 2007 as part of a

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[42] The review of Chile's framework noted the benefits of permitting pension funds to take a significant stake in companies (up to 7%).

broader pension fund reform, require pension funds to disclose their overall corporate governance voting policies. They are moreover obliged to attend shareholder meetings and exercise their voting rights in cases where they hold more than 1% of a corporation's equity. Regulations also prevent pension fund administrators from voting for a board candidate related to the controlling shareholder, instead requiring them to vote for independent directors, as well as publicly disclose their voting intentions and proposed candidates.

If implemented in Egypt, such measures would have the effect of raising the awareness of pension funds of their stewardship obligations and improving the transparency of the extent and impact of their ownership. Requiring state owned pension funds and banks to introduce a voting policy and disclose their voting results may not only improve transparency and improve the quality of board nominees, but also set a precedent for private sector institutional investors who would be required to reconsider their own standards and practices.

While such measures admittedly fall short of introducing a stewardship code for the entire institutional investor industry as have now done several jurisdictions (e.g. UK, Japan, etc.), this incremental approach is arguably better suited to the realities of the Egyptian capital market. Considering that the EFSA is expected to shortly release a "comply or explain" corporate governance code for listed companies, requiring institutional investors to have a voting policy may also encourage them to align their recommendations with the provisions of the code.

While a number of jurisdictions have moved to introduce stewardship codes, such measures may be premature for the Egyptian market and may motivate a box ticking approach instead of encouraging institutional investors to consider the exercise of their responsibilities. Instead, the relevant regulators may wish to consider requiring all investors above a certain size to introduce an investment committee and for this committee to be composed of qualified individuals. In addition, if regulators wish to encourage shareholder engagement, they may wish to consider practices already adopted in other jurisdictions to encourage investor collaboration, including by reviewing provisions on "acting in concert".

As in other jurisdictions such as Turkey, UK and Australia, industry associations could also have a role to play in creating appropriate standards for their members. For instance, in Australia, the institutional shareholder landscape also includes two influential industry bodies, Investment and Financial Services Association (IFSA) an investment manager industry body and the Australian Council of Superannuation Investors (ACSI), both of which have introduced good governance standards for its members. In France, the AFG (French Asset Management Association) has also introduced good governance standards for its members and conducts regulator surveys of its members on their voting at AGMs and their interaction with issuers.

In Egypt, the Egyptian Capital Market Association (ECMA) and perhaps even more so the Egyptian Investment Management Association (EIMA) can be used as platform to introduce self-regulatory standards for institutional investors. ECMA was established as a not-for-profit professional organization in the securities industry dedicated primarily to providing a forum for all capital market participants in their efforts to set high professional standards for the industry, adhere to the ethical conduct of business and the rules of fair practice, and uphold the integrity of the marketplace.

On the other hand, EIMA was been established specifically to represent asset and investment management industry in Egypt. The Association's objectives so far have been targeted at promoting views of the industry vis-à-vis regulatory initiatives and organising training initiatives. Going forward, it may also be in position to establish standards for asset managers who, with the development of private insurance and pensions in Egypt, will likely also receive more mandates from these types of investors.

Naturally, the extent to which institutional investors may be able to promote good governance practices in listed companies is contingent on their ability to access relevant and timely information. In this regard, both the EGX and the EFSA have an instrumental role to play by facilitating timely disclosure by listed companies and indeed, the EGX has recently moved to disclose some corporate information on their website. The experience of other MENA countries such as Saudi Arabia and Turkey which have introduced electronic disclosure platforms (Tadawulaty and eGem[43], respectively) as well as the UAE which has required listed companies to adopt XBRL reporting in order to facilitate financial analysis.

The Emirati securities regulator, the Emirates Securities and Commodities Authority has also recently introduced regulations requiring all listed companies to introduce an investor relations officer to act as a link between the management and boards of listed companies and their investors. Given that weak transparency continues to dominate the list of investor concerns in Egypt, similar measures may be useful to encourage a better informed dialogue between investors and company boards. XBRL reporting by listed companies will enable investors, asset manager and analysts to analyse financial and non-financial performance metrics of listed companies, may also be relevant.

Another measure that would significantly improve the exercise of the ownership rights in Egypt is investor access to ownership data which is currently unavailable or difficult to access for most listed companies, especially for international portfolio investors who have limited access to filings in Arabic. Obtaining beneficial ownership data is generally a challenge across the region, even for regulators. Misr for Central Clearing, Depositary and Registry has a particular role to play in this regard.

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[43] The EGX and OMX have jointly established Egypt Information Dissemination (EGID) portal which provides online data and information on EGX listed Companies, however this is a paid service not available to all investors.

Beyond these targeted measures, a broader review of the corporate governance framework in Egypt would be beneficial in order to align provisions with best practices internationally and regionally, to reflect recommendations from the international financial crisis and to address gaps between different types of enterprises in Egypt (i.e. state-owned, listed, and banks). It is understood that since laws and regulations governing the operation of pension funds and insurance companies are currently under consideration by the EFSA, these measures can be addressed during this process, which can aim to clarify duties of institutional investors and specify the mechanisms for these investors to create a demand and incentives for the adoption of good governance practices.

ANNEX 1: EVOLUTION OF EGX: KEY INDICATORS, 2010-2014

Indicator	Unit	2010	2011	2012	2013	2014
Number of listed companies	Number	212	213	213	236	214
Domestic market capitalization (companies admitted to listing only)	billion $USD	84.28	48.85	59.18	61.63	70.03
Market capitalization of new listings	million $USD	229.29	94.68	179.49	24.75	1049.9
Market capitalization of de-listings	million $USD	16181.22	41.29	331.81	528.09	28.36
Electronic Turnover Domestic	million $USD	37215.4	15897.55	17093.39	12735.11	27335.9
Share in total market cap of the 5% most capitalized domestic co.	Percentage	45.8%	49.9%	51.4%	54.0%	48.2%
Share in total trading value of the 5% most traded companies	Percentage	47.1%	48.6%	60.5%	54.5%	54.5%
Share in total market cap of the top 10 most capitalized companies	Percentage	44.3%	46.2%	48.0%	50.1%	46.5%
Share in total trading value of the top 10 most traded domestic companies	Percentage	45.6%	45.4%	56.3%	51.5%	51.5%

Source: The Egyptian Stock Exchange and World Federation of Exchanges, 2014

ANNEX 2: EGX 30 COMPANIES

Name	Number of Institutional Investors	Free Float	Share holding ≥ 5%	Total Institutional Investors Ownership	Executive	Non-Executive board members	Independent board members	Total Board Members	Executives as % of Total Board Members	Non-Executives as % of Total Board Members	Independent as % of Total Board Members	Chairman/ CEO
Maridive & oil services	20	47.7%	1	22%	2	12		14	14%	86%	0%	Unified
Telecom Egypt	83	20.0%	1	80%	1	7	3	11	9%	64%	27%	Separate
Commercial International Bank (Egypt)	110	93.2%	1	7%	1		6	7	14%	0%	86%	Unified
El Wadi Co. For Touristic Investement	0	44.0%	1	0%	2	3		5	40%	60%	0%	Unified
Upper Egypt Contracting	5	67.5%	1	33%	1	8		9	11%	89%	0%	Unified
ARAB POLVARA SPINNING & WEAVING CO.	8	83.7%	1	16%	2	7		9	22%	78%	0%	Separate
Egyptians For Investment & Urban Development	0	74.3%	1	0%	1	2		3	33%	67%	0%	Unified
T M G Holding	60	49.7%	1	50%	2	5	3	10	20%	50%	30%	Unified
Pioneers Holding	14	46.1%	2	15%	3	4		7	43%	57%	0%	Unified
Ezz Steel	40	35.4%	1	65%	2	3	2	7	29%	43%	29%	Unified
South Valley Cement	12	44.8%	1	55%	2	4		6	33%	67%	0%	Separate
Arab Real Estate Investment CO.-ALICO	0	85.2%	1	15%	2	3		5	40%	60%	0%	Unified
Egyptian Kuwaiti Holding	28	73.4%	1	27%	1	12	2	15	7%	80%	13%	Unified
El Kahera Housing	10	49.1%	1	51%	2	5		7	29%	71%	0%	Unified
United Housing & Development	9	76.0%	2	24%	1	6	2	9	11%	67%	22%	Unified
Six of October Development & Investment (SODIC)	21	65.6%	4	34%	4	7		11	36%	64%	0%	Separate

Remco for Touristic Villages Construction	2	26.9%	3	0%	3	1	1	5	60%	20%	20%	Unified
Global Telecom Holding	56	50.0%	1	50%	2	3	2	7	29%	43%	29%	Separate
Medical Packaging Company	0	90.5%	1	10%	2	1		3	67%	33%	0%	Separate
Orascom Telecom Media And Technology Holding	26	48.3%	1	52%	3	4		7	43%	57%	0%	Separate
Juhayna Food Industries	34	48.0%	1	52%	2	7		9	22%	78%	0%	Unified
Sidi Kerir Petrochemicals	28	27.8%	3	72%	1	12		13	8%	92%	0%	Unified
Arabia I nvestments,Development,Fin. Inv. Holding Comp.-Cash	1	100.0 %	0	0%	3	4		7	43%	57%	0%	Unified
Amer Group Holding	8	24.0%	1	76%	3	4		7	43%	57%	0%	Unified
ELSWEDY ELECTRIC	26	36.1%	3	0%	3	1	3	7	43%	14%	43%	Separate
Palm Hills Development Company	24	94.5%	0	6%	5	5		10	50%	50%	0%	Unified
Arab Cotton Ginning	9	84.5%	2	15%	1	8		9	11%	89%	0%	Separate
Eastern Tobacco	33	45.0%	2	55%	3	2		5	60%	40%	0%	Unified
Egyptian Financial Group-Hermes Holding Company	43	81.2%	1	19%	2	2	5	9	22%	22%	56%	Separate
Medinet Nasr Housing	15	47.7%	3	52%	1	7	1	9	11%	78%	11%	Unified

Source: Bloomberg, EGX 30 companies' Disclosures as of July 2014

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