

Corporate Governance of Banks and Its Role in Enhancing the Efficiency of the Stock Market: A Comparative Study Between Algeria and the Arab Republic of Egypt

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Abstract:

this research aims to study the concept of governance and its importance, as well as review its most important principles and know the impact of the proper application of corporate governance for banks in strengthening and stabilizing the stock market, and this is applied to Egypt and Algeria.

The study concluded that the success of governance in Egyptian banks is only linked to the establishment of regulatory rules and their proper implementation. As for Algeria: to improve the governance of banks and enhance the efficiency of the stock exchange, the governance experience remains plagued by challenges compared to developed countries

Keywords: Bank governance, efficiency, stock market stability, Egypt, Algeria.

JEL Classification Codes: M02.M21

1. INTRODUCTION

The interest in the concept of governance has grown in many advanced and emerging economies over the past few decades, (the Asian Tigers), , and a decline in stock prices in a financial disaster. Therefore, the concept of corporate governance has become concerned with finding and organizing sound applications and practices for those in charge of managing companies in a way that preserves the rights of shareholders, bondholders, employees and stakeholders.

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Several economic organizations and global regulatory bodies (such as the Organization for Economic Cooperation and Development and the Basel Committee on Global Banking Supervision) have issued international papers that include abundant standards and guidelines for governance in banking and financial institutions. These papers have become agreed-upon international guidelines, such that the countries of the world have begun to focus on them and work in their spirit to preserve a sound, healthy and strong banking and financial process.

The Central Bank of Egypt issued decisions regarding the instructions for bank governance, according to which all banks registered with it are obligated to establish and develop their governance systems in accordance with the instructions, provided that each bank implements the instructions in a manner that is consistent with the size of its business, its degree of complexity and its policies, and in line with its ability to absorb risks. The holding of the International Forum on Good Corporate Governance in 2007 also played a prominent role in providing the scientific and theoretical basis for the legislation of an Algerian Charter for Good Corporate Governance as the first recommendation and practical step taken in this field.

Through the above, the following problem can be raised:

How can the principles of corporate governance for banks enhance the efficiency of the stock market? And what is the reality of this in the Algerian and Egyptian markets?

To answer the problem and cover the research aspects, we have these hypothesis:

- governance refers to the existence of a structured system that governs the relationships among key parties influencing an organization's performance
- The success of governance in Egyptian and Algerian banks is linked to the establishment of regulatory rules by relevant authorities such as the Basel Committee and the Central Bank, which in turn affects and enhances the efficiency of the stock market.

Importance of the study:

- As a result of banks being exposed to risks and because their shares are traded on the stock exchange, the existence of corporate governance is an important and necessary issue for these banks
- The implementation of corporate governance principles, such as the protection of shareholders' rights and stakeholders' interests, will be reflected in the improved efficiency of the stock market.
- A strong governance framework can effectively minimize potential losses stemming from inadequate internal control and oversight mechanisms, as well as from an overextension in risk-taking.

I- The theoretical framework of governance in the banking sector

Given the vital role played by banks, the application of governance principles in the banking system is of utmost importance

I-1- The emergence of the concept of corporate governance.

If we search for the economic literature on corporate governance, we find that in 1932, Berle and Means were among the first to address the issue of separating ownership from management, in which corporate governance mechanisms attempt to bridge the gap between the managers of the institution and its owners, as a result of negative practices that could harm the institution and the economy as a whole (Ben Jaballah & Ben Thabet, November 21-22, 2006, p. 4)

The emergence of Agency Theory highlighted the issues stemming from conflicts of interest between company board members and shareholders. It underscored the necessity of implementing a framework of laws and regulations aimed at safeguarding shareholders' interests and curbing financial and administrative manipulation by board members seeking to maximize their personal gains, given their dominant control over corporate affairs.

In 1976, Jensen and Meckling paid attention to the concept of corporate governance and highlighted its importance in limiting and reducing the problems that may arise from the separation of ownership and management,

which was represented by the agency theory. After that, a group of scientific and practical studies, especially those whose shares are registered with the stock exchanges. The matter was not limited to the United States of America, as many reports appeared in Canada, France, Germany, Italy and many other countries (Mohamed Mustafa, 2006, p. 13.14).

I-2- Definition of corporate governance and its objectives:

The term 'governance' has been defined in various ways, with each definition reflecting the perspective of its author. Below are a few illustrative examples of these definitions, though they are by no means exhaustive

The International Finance Corporation (IFC) defines governance as: The system through which companies are managed and their business is controlled. (National Bank of Egypt, Method of Exercising the Powers of Good Governance in Companies: Corporate Governance, 2012, p. 04)

The OECD defines it as: “The set of relationships among the company’s management, the board of directors, shareholders and other stakeholders.” (Freeland, 7 May 2007)

It can be defined as: “The set of organizational mechanisms that limit and influence the decisions of managers, control their orientations, and clarify the scope of their powers.” (charreux, 1997, p. 01)

It is known that the best approach is to separate ownership and management because it allows shareholders and company leaders to focus on their competitive advantage, which is providing risk capital on the one hand and managing real investment portfolios on the other hand. (Razzaq, 2006, p. 75)

The term *corporate governance* remains somewhat ambiguous due to three main reasons, all of which are linked to the relative novelty of the concept:

- ✓ **The first reason** is that, although the underlying principles and many of the issues related to corporate governance date back to the early nineteenth century, the term itself was not present in the English language, and its conceptual framework only began to take shape around two to three decades ago

- ✓ **The second reason** is the lack of a single, definitive definition of this concept. While some view it from an economic perspective as the mechanism that helps a company obtain financing and ensures maximizing .
- ✓ **The third reason.** there is a near agreement between researchers and practitioners about its most important determinants as well as its evaluation criteria. The rules and controls of governance seek to achieve a set of objectives, the most important of which can be summarized as follows: (Al-Najjar, March 2007)
 - ❖ Achieving transparency in all companies' activities.
 - ❖ Reducing the exploitation of power in a way that is not in the public interest.
 - ❖ Ensuring the right of accountability before rights holders to manage companies.
 - ❖ Protecting the rights and interests of employees in companies of all categories.
 - ❖ Achieving and ensuring justice for all stakeholders and those dealing with companies.
 - ❖ Developing savings and encouraging their flow in a way that leads to the development of productive investments to maximize profits and away from monopolies.
 - ❖ Working to confirm the review of the performance of all companies' activities, including financial performance, through external review committees independent of executive management.

I-3- Bank Governance: (Concept - Importance - Active Parties)

I-3-1- The concept of bank governance:

It is a set of systems and laws that provide correct information to all parties involved through disclosure, transparency and clarity.

According to this definition, for the governance process to succeed, a policy of transparency and disclosure must be practiced. If shareholders and stakeholders do not obtain correct and sufficient information about the

bank's performance, such as growth in the financial statements and the risks it faces, this may lead to disruption of the banking system.

Governance deals with the manner in which the Board and senior management of the bank direct and conduct its daily affairs and activities, which affects the following: (Central Bank of Egypt, September 19, 2024, p. 02)

- ✓ Develop strategies and set objectives.
- ✓ Direct the bank's daily business and activities.
- ✓ Balance commitment to shareholders' responsibility, protect depositors' interests and take into account the interests of other stakeholders.

I-3-2- The importance of applying the principles of governance in banks

Experts view governance from a banking perspective as the development of internal structures within banks to enhance transparency in performance, improve the quality of management, and establish clear regulations that define the roles of supervisory and regulatory bodies overseeing the banking system. According to the Basel Committee, banking governance refers to the manner in which a bank's board of directors and senior management oversee and manage operations and transactions in a safe and sound manner, in compliance with applicable laws. This approach is intended to safeguard the rights of all stakeholders associated with the bank, including employees, customers, shareholders, and others. (Abdel Qader, 2017, p. 219)

In addition, governance is important for banks through:

- ❖ economic system characterized by globalization and intense competition between different banks to enter the financial markets for investment.
- ❖ The application of governance principles leads to improving bank management and helping managers.
- ❖ Adopting standards for disclosure and transparency in dealing with investors and lenders within the framework of the proper application of governance principles helps prevent banking crises.

- ❖ The Central Bank has a role in promoting and encouraging corporate governance in commercial banks for the following reasons: (Houari & Amjad, 2013, p. 09)
 - Commercial banks differ from other joint stock companies because the nature of their work entails risks, in addition to the fact that these banks are responsible .
 - their shares are traded on the stock exchange, the existence of corporate governance is an important and necessary issue for these banks;
 - Board members in banks need to ensure that the risks .
 - There are also risks represented by appointing board members who are called: “semi-independent” to give a false impression of corporate governance.

I-3-3- Actors in the governance process in banks

The most fundamental elements of the governance process can be categorized into two main groups: (Youssef, 2007, p. 11):

- **The group comprises external actors**, the deposit insurance fund, the media, credit rating and evaluation agencies, as well as the broader legal, regulatory, and supervisory framework

Governance is based on basic elements that must be available in order to complete effective control over the performance of banks, which are summarized in transparency, availability of information, application of international accounting standards, and raising the level of human competencies through training.

I-4- Governance principles in banks:

The financial collapses experienced in the markets of several countries, corporate governance and its effectiveness in both developed and emerging markets. This collaboration resulted in the formulation of five key sections, which were announced by the OECD in 1999 under the title " Principles of Corporate Governance"

I-4-1- Principles of governance according to the Organization for Economic Co-operation and Development

Governance is applied according to five standards reached by the Organization for Economic Co-operation and Development in 1999, noting that it issued an amendment to it in 2004. These principles include: (OECD, 2023)

- 1) **Ensuring the existence of a basis for an effective corporate governance framework:** clearly delineate the responsibilities among supervisory, regulatory, and executive bodies.
- 2) **Protecting the Rights of All Shareholders:** This principle ensures that shareholders are able to exercise their rights fully and fairly , reviewing financial statements, and actively participating in general assembly meetings.
- 3) **Ensuring Equal Treatment of All Shareholders:** All shareholders should be treated equally within their respective classes. This includes the right to defend their legal interests, vote on fundamental decisions at general assembly meetings, and be safeguarded against unfair practices such as insider trading, questionable mergers or acquisitions. Additionally, shareholders must have access to full disclosure of transactions involving board members or executive management..
- 4) **The role of stakeholders in the methods of exercising management powers in the company:** This includes respecting their legal rights, compensation for any violation of those rights, as well as mechanisms for their effective participation in monitoring the company, and obtaining the required information. Stakeholders include banks, employees, bondholders, suppliers, and customers.
- 5) **Board of Directors Responsibilities:** This includes the structure of the Board of Directors, its legal duties, how its members are selected, its primary tasks, and its role in supervising executive management.

I-4-2- Governance principles according to Basel decisions

a) Basic aspects of the first Basel agreement

The Basel Committee was represented by the Group of Ten (The Basel Committee includes 10 countries: France, Canada, Belgium, Germany, the Netherlands, Japan, Sweden, Switzerland, Italy, the United States of America, in addition to Luxembourg, and is headed by "Cook", a banking expert who was previously the) in 1974 in the Swiss city of Basel, headed

by Cook, especially after the debt crisis of developing countries worsened. In 1988, it set a minimum capital level to indicate the strength of the financial position of banks, which was known as the first Basel Agreement on capital adequacy. The committee recommended its implementation starting at the end of 1992, but it was criticized for its bias towards major industrial countries and for not taking into account the type and quality of assets. Banks that hold low-risk assets such as government bonds do not need the same amount of capital compared to banks that invest in highly risky assets. The Basel Committee focused on the following aspects: (Al-Radhi, April 2 and 3, 2005, p. 08):

- Focus on credit risk: The agreement aims to calculate the minimum capital requirements and adequacy in consideration of credit risk (represented by the risk of default)
- a) The first group: Low-risk countries: includes the OECD countries, in addition to two countries: Switzerland and the Kingdom of Saudi Arabia.
- b) The second group: High-risk countries: includes the remaining countries.
- Setting weights for the degree of risk of assets
- Setting a conversion factor for contingent liabilities:
- Setting the components of capital adequacy: according to the following equation:

$$\text{Capital adequacy} = \frac{\text{Capital (Tier 1 + Tier 2)}}{\text{Risk Weighted Assets}} \geq 8\%$$

b) The basic pillars of the Basel II Accord

With the increase in diverse risks and the spread of dealing in financial derivatives, the Basel Committee sought to introduce amendments to the extent of capital adequacy that are compatible with the nature of the risk to which banking institutions are exposed, as well as other non-banking financial institutions, in order to ensure optimal management of capital. All of this led to a reconsideration of introducing amendments and preparing the Basel II Committee standards.

During the period 1999-2003, the Basel Committee made amendments and issued the fourth and final version in August 2004, which focused on increasing and strengthening capital and the size of the risks to which the bank is exposed. Risks were also divided in an environment characterized by the development and increase of financial instruments, as the committee submitted more precise and detailed proposals on January 16, 2001, and then the final document was issued on April 26, 2006, and it identified three axes for the Basel II standards.

Axis One: Minimum Capital to Cover Credit Risks:

$$\text{Capital adequacy} = \frac{\text{Total Capital (Tier 1 + Tier 2 + Tier 3)}}{\text{Risk-weighted assets + market risk measure} \times 12.5\%} \geq 8\%$$

The second axis: Comprehensive supervisory review of capital adequacy: aims to monitor capital adequacy and the strategy for maintaining the required levels, with the possibility of increasing it above the minimum level recognized by banking institutions, so that they have the ability to do so, and supervisors or authorities must intervene to prevent the banks' capital adequacy ratio from falling below the minimum level in a timely manner and they must take prompt measures to address such cases.

The third axis: Market discipline: Market discipline works to practice banking activities safely to enhance and strengthen the safety of the banking sector, and this axis is complementary to the previous two axes, and to make market discipline more effective, a set of disclosure requirements must be developed that allow participants in the banking market to evaluate key information related to the overall risk facing banks and the level of capital to cover those risks.

c) The basic pillars of the Basel

The following criteria were included: (Basel III" and the Application of Governance Principles are the Two Most Important Events for Banks in)

a) The first criterion: Improving the quality, structure and transparency of the banks' capital base and making the concept of core capital limited to subscribed capital and undistributed profits on the other hand, in addition to capital instruments that are not conditional on returns and are not restricted by maturity date, i.e. instruments capable of absorbing losses

as soon as they occur. As for the supporting capital, it may in turn be limited to capital instruments restricted for at least five years and capable of bearing losses before deposits or before any third-party liabilities of the bank. Basel III dropped all other components of capital that were acceptable in accordance with previous agreements.

b) The second criterion: The Basel Committee's proposals emphasize covering the risks of counterparty borrowers arising from derivatives operations.

c) The third criterion: The Basel Committee introduces a new ratio, the leverage ratio, which aims to set a maximum limit for the increase based on risks and provide additional guarantees in the face of risk models and error standards and act as a reliable additional criterion for the basic risk requirements.

d) The fourth criterion: Preventing banks from following lending policies that are more than necessary, which increases excessive financing of economic activities during the growth and prosperity phase, and refraining from lending during economic recessions, which deepens the economic recession and prolongs its time period.

e) Fifth Criterion: Emphasis on Liquidity

This criterion addresses the crucial role of liquidity in the stability and functioning of the financial system and markets—a fact that was underscored during the recent global financial crisis. The Basel Committee has recognized this importance and aims to establish a global liquidity standard. To that end, it proposes two key ratios:

- **Liquidity Coverage Ratio (LCR):** Requires banks to hold a sufficient stock of high-quality liquid assets to cover net cash outflows over a 30-day stress period.
- **Net Stable Funding Ratio (NSFR):** Focuses on promoting medium- and long-term resilience by ensuring that banks .

d) The basic pillars of the Basel IV Accord (Basel III amendments):
We review the most prominent amendments related to the Basel III

requirements, which were called Basel 4 (which was due to be implemented on January 1, 2023) as follows: (Obeid, March 2023, p. 08)

- a) **Credit Risk Framework:** A revised framework for both the standard methodology and the internal assessment methodology has been developed to achieve more risk-sensitive measurement methods. The Committee has also eliminated some internal assessment methods to reduce reliance on banks' internal models.
- b) **Revised methodologies for calculating market risks:** For market risks, the Basel Committee on Banking Supervision has developed guidelines to assist banks in classifying instruments in the banking portfolio and the trading .Additional classification guidelines have also been introduced for transferring instruments between the banking portfolio and the trading portfolio. Market risks are calculated according to the internal model methodology as follows:

Market risk according to the internal model methodology =
Capital requirements associated with approved trading
units + Default risk requirements + Total capital
requirements based on risk sensitivities (used in the
standardized approach)

- c) **Operational Risk Framework:** A new methodology has been issued to measure capital requirements for operational risks under the name of the standard methodology to replace the four methods included in the previous framework. The new methodology is based on the bank's income and historical losses that have a direct relationship between them and operational risks. According to this new methodology, capital requirements for operational risks are calculated as follows:

Operational risk requirement = (Business index X Business index
coefficient X (α) Internal loss multiplier)

- d) Leverage
- e) Risk of counterparty credit rating adjustment.
- f) **Securitization Framework (A)** The Securitization Framework specifies revised methodologies for calculating regulatory capital

requirements for securitization exposures held by banks in the banking portfolio.

g) New capital requirements arrangements: The new approach will allow banks to calculate their risk-weighted assets to be higher than:

- ❖ Total risk-weighted assets calculated according to the approach adopted by central banks.
- ❖ 72.5% of total risk-weighted assets calculated using the standard methodology, where total risk-weighted assets calculated cannot be less than 72.5% of the risk-weighted assets determined through the standard methodology.

In general, the papers issued by the Basel Committee indicated that there is a set of basic elements that must be available to support the proper application of governance within the banking system, which we will review below: (Bank of Alexandria, 2005, p. 26)

- a) Setting strategic objectives and a set of values and principles that are known to all employees of the bank.
- b) Ensuring the competence of the members of the Board of Directors and their awareness of the role assigned to them in the governance process, and that they are not subject to any influences, whether external or internal. In some countries, including Egypt. The Board of Directors of the bank establishes some specialized committees such as: the Risk Management Committee, the Audit Committee, the Salaries and Remuneration Committee, and the Governance and Nominations Committee.
- c) Ensuring the availability of appropriate monitoring by senior management.
- d) Actually, benefiting from the work carried out by internal and external auditors in realizing the importance of the oversight function they perform.
- e) Ensuring that incentive systems are consistent with the bank's systems, objectives, strategy, and surrounding environment.

- f) Taking into account disclosure and transparency when applying governance.

II- The role of governance in risk management in banks

II-1- Types of banking risks

The main types of financial risks that banks are exposed to include credit risk, liquidity risk, market risk, and operational risk.. Therefore, the bank must enter into derivative financial instruments such as futures contracts for the purpose of risk management. Financial risks must also be managed effectively by management to ensure compliance with the risk limits set by the bank. The risk limits set must be evaluated on a regular basis to ensure their suitability in light of the bank's objectives and strategies and current market conditions. (Saunders & Marcia, 2003, pp. 139-151)

a) Credit Risk: Credit risk refers to the potential for financial losses incurred by the bank when a customer or counterparty to a financial instrument fails to meet their contractual obligations. This also includes risks related to credit concentration, as well as the bank's inability to accurately assess asset quality. Such failures can result in insufficient provisioning, thereby exposing depositors' funds to unforeseen losses.. Credit risks include on-balance sheet items such as loans and bonds and off-balance sheet items such as letters of guarantee or documentary credits. (Abdel Qader, 2017, p. 206)

This occurs most often in respect of loans and advances made by the bank to customers and other banks and in respect of investments in securities. For the purpose of reporting on risk management, the bank studies and aggregates all elements of credit risk exposure (such as the risk of individual default, country or sector risk). For the purposes of risk management, credit risk arising from trading in securities must be managed separately, but is reported as one component of the risk exposure.

b) Liquidity Risk: Liquidity risk refers to the current and potential risks to a bank's profitability and capital arising from its inability to meet its financial obligations as they come due, without incurring significant losses. This risk affects the bank's ability to access funds promptly and at a

reasonable cost. Liquidity risk includes the bank's inability to manage unexpected declines or changes in funding sources. It also results from the bank's failure to identify or confront changes in market conditions that may affect the ability to liquidate assets quickly and with minimal loss in value. Therefore, limits must be set for the maximum permissible limit for managing cumulative gaps based on gap reports as well as absolute limits such as the loan-to-deposit ratio in order to have greater control over liquidity risks. Internal alerts are generated based on pre-determined controls to ensure compliance with regulatory controls.

There are several reasons behind exposure to liquidity risks, including: (Abdel Qader, 2017, p. 206)

- Weak liquidity planning in the bank, leading to mismatch between assets and liabilities in terms of maturity.
- Poor distribution of assets to uses that are difficult to convert into liquid balances.
- Sudden transformation of some contingent liabilities into actual liabilities.

External factors such as economic recession and severe crises in financial markets also contribute to exposure to liquidity risks.

The bank can improve liquidity risk management by introducing controls to try to limit the concentration of deposits from one customer and also deposits that mature within certain time periods and then provide diversified sources of funding.

To achieve this, a detailed analysis of liabilities must be conducted periodically to distinguish between renewal patterns and identify basic deposits and behavioral trends of short-term funds and the interrelationships between macroeconomic variables.

In addition, the bank's liquidity policy requires appropriate planning to be conducted periodically and effective tests are carried out based on scenario analysis. Developing a detailed contingency plan is also part of the liquidity management framework.

c) **Market Risk:** Mismatches in the value of assets and liabilities held at different rates and maturities can create risks associated with interest rates. In order to minimize these risks, the Bank's management must seek to minimize such mismatches. Investments in fixed-rate instruments must be financed from a mix of short- and medium-term liabilities, and interest rate gaps must be monitored periodically, sensitivity analysis must be conducted, and risk limits must be measured (Nofal, 2009, p. 8).

d) **Operational risks:** resulting from human or technical errors or accidents. These risks fall under general risks if they are caused by external factors such as natural disasters. These risks fall under special risks if they are caused by internal factors such as insufficient equipment, technical means, qualified and trained human resources, corruption of accounts, or lack of administrative efficiency.

II-2- Risk management functions: (National Bank of Egypt, 2012, p. 35)

- ❖ **Risk Analysis:** the analysis is conducted accurately and in a timely manner to address potential issues at the earliest and most appropriate opportunity.
- ❖ Definition of specific work steps regarding measuring, monitoring and controlling risks.
- ❖ Continuously work to measure the continued suitability and effectiveness of the work steps related to measuring, monitoring and controlling risks and make any adjustments to them if necessary, according to market developments and the environment in which the bank operates.
- ❖ The bank as well as the risk management committee with the correct information in a timely manner as well as periodic reports.
- ❖ Management reports must be presented in an easily understandable manner that enables board members to evaluate the risks presented and make the appropriate decision regarding them, especially with regard to the results of stress tests

II-3- Governance and risk management according to Basel decisions:

The Basel Committee indicated the need to pay attention to governance through the following points:

- Internal classification must be an integral part of the reporting process for relevant parties reports should include the nature of risks according to their severity, changes in exposure levels, an estimate of the relevant criteria for each level, and a comparison of default rates against expectations. The frequency of report submission may vary depending on the importance and type of information, as well as the level of the entity receiving the reports.

The essence of banks' work is based on risk management. If the bank does not take a risk percentage in its business, it will not be able to achieve any returns. Losses usually arise from not managing these risks or not obtaining appropriate returns for those risks.

The availability of a good risk management system is what allows for the alignment between returns and risks within the limits permitted by the bank's position

Good governance works to reduce losses that may arise due to the lack of internal control and monitoring systems, or due to the expansion of risk taking, as the availability of good governance systems includes independent monitoring of the bank's compliance with written policies and the established risk limits in order to protect the rights of depositors, which is consistent with the objectives of the Central Bank.

Governance also works primarily to combine laws and instructions and monitor them in order to ensure that the bank adheres to them and is consistent with the bank's objectives and safety standards in general.

III- The impact of applying governance principles on the efficiency of the stock market.

We will detail how governance principles affect the efficiency of the financial market as follows: (Ahmed, 2010, pp. 46-52) (Hindi, 1999, p. 112)

III-1- The impact of applying sufficient disclosure and transparency in providing information

Audit committees are considered one of the most critical tools of institutional governance in banks, playing a pivotal role in providing sufficient information to both internal and external parties. They are also responsible for evaluating the performance of the internal audit department, organizing the relationship with external auditors, and working to improve the informational content of financial statements. This, in turn, strengthens the company, enhances its financial position, and supports its competitiveness, which positively reflects on the efficiency of the financial market.

The mechanisms for providing appropriate information to internal and external users to support investment decision-making—particularly in terms of the credibility of financial statements and their fair representation of operational results and financial position will have a positive impact by instilling trust and reassurance among market participants. On the other hand, the lack of credibility in financial statements, which fail to reflect the true operational results and financial position, along with poor informational content, will negatively impact market efficiency due to the absence of one of the key governance principles: disclosure and transparency. This undermines confidence in the credibility of the stock exchange.

It is worth noting that translating the principle of adequate disclosure and transparency requires the preparation and review of financial statements in accordance with Egyptian accounting and auditing standards that are consistent with international standards.

The information content of these financial statements includes financial information as well as non-financial information, and an independent external auditor is assigned the task of reviewing the financial statements and approving them at the general assembly of shareholders so that they are discussed by shareholders.

Here, the external auditor becomes accountable to the members of the company's general assembly in the event of discovering any fraud or distortion in the financial statements that he has approved. The concept of complete market efficiency should be distinguished from the concept of economic efficiency.

The first is a theoretical concept that cannot be achieved in practice because it is based on an unrealistic assumption that the information that reaches investors will have an immediate impact on the stock prices associated with this information.

The second concept, related to the economic efficiency of the market, is a realistic concept as it is based on the existence of a (time dimension) between obtaining the available information and its impact on the stock prices associated with this information, which is what the Egyptian Stock Exchange does.

When information reaches the Stock Exchange or the Financial Regulatory Authority, the offers and requests are cancelled and this information is announced later through a time interval that allows the new information to be absorbed and reached by all investors. This procedure will achieve economic efficiency in the market.

III-2- The impact of applying the principle of equal treatment for all shareholders

It is certain that applying the principle of equal treatment for all shareholders without discrimination between holders of a large percentage of shares and holders of minority shares by making information available to all investors are similar, and therefore the impact of this fair treatment of shareholders limits the possibility . Since the information available to all shareholders that affects stock prices in the stock market is represented by:

- ❖ Historical information available to all and is the basis for technical analysis that predicts future prices according to the historical database of stock prices.
- ❖ Current and emerging information such as material events that affect stock prices for all shareholders.
- ❖ Special information related to future plans

III-3- The impact of applying the principle of (protecting shareholders' rights)

There is no doubt that the positive return of applying the principle of

protecting shareholders' rights will be reflected in improving the efficiency of the stock market according to the following reasons:

- ❖ Ensuring an appropriate degree of reassurance for investors and shareholders contributes to achieving an appropriate return on their investments while working to preserve their rights, especially minority shareholders.
- ❖ create a favorable environment and encourage local and international sources of financing to finance the needs of expansionary companies through the banking system or the stock market, especially since adjusting the status of some companies according to the new listing rules will lead to an increase in the capital of many companies that had a small number of shares, which makes it easy for a limited number of speculators to acquire their shares and manipulate their prices in an exaggerated manner. Therefore, increasing the capital of this type of companies to adjust their status will improve the efficiency of the stock market by bringing market share prices closer to their fair values and increasing the number of their shares, which does not make them a means of achieving extraordinary profits for a category of speculators.
- ❖ One of the most important positive practices in Egypt to support the principle of protecting shareholders' rights is to guarantee and ensure the basic rights .

III-4- The impact of applying the principle of (stakeholders' role)

law protects the rights of stakeholders from bondholders, lenders and workers. One of the most prominent trends in this regard is what the Financial Regulatory Authority is doing to license and allow the formation and organization of the work of shareholder workers' unions, as well as regulating the formation and work of bondholder groups. It is certain that these legal procedures aim to emphasize respect for the rights of stakeholders and are the result of legal contracts that allow stakeholders to obtain compensation in the event of any breach of contracts.

It goes without saying that applying the principle of participation to include stakeholders means positive participation in improving the efficiency and effectiveness of companies' performance, and coordinating efforts and initiatives with members of the board of directors to achieve the

company's strategic goals. There is no doubt that the outcome of this pivotal role of stakeholders in the governance system will contribute positively to improving the efficiency of the stock market.

III-5- The impact of applying the principle of the responsibilities of the Board of Directors

which affects improving the efficiency of the stock market as a result of the following considerations:

- ❖ **The Board of Directors developing a clear strategy that reflects both the vertical and horizontal expansion plans of the company's operations.**
- ❖ A number of non-executive members are appointed who are characterized by neutrality and independence and achieve balance within the Board of Directors.
- ❖ all guarantees must be put in place to prevent the misuse of this information and profit from it, because this constitutes a violation of the law and also a violation of the ethical rules that must be observed when applying the principles of governance.
- ❖ Avoid slipping into accounting and financial problems in order to ensure the integrity of the company's financial and accounting reports, which are prepared in light of Egyptian accounting standards and consistent with international accounting standards, thus supporting and stabilizing companies' activity and preventing collapses in local and global financial markets

IV- Application of governance principles and its impact on the efficiency of the stock market (Algeria - Egypt).

IV-1- The emergence of governance in Egypt

Interest in governance in Egypt began in 2001, following an initiative by the Ministry of Economy and Foreign Trade at the time (now the Ministry of Trade).

The World Bank, in cooperation with the Ministry of Foreign Trade, the Capital Market Authority, and the Stock Exchange, in addition to a number

of research centers, accounting and auditing firms, and interested economists and legal experts, prepared the first report to evaluate corporate governance in Egypt. The most important results of the evaluation were: (Youssef, *Determinants of Governance and Its Standards with Special Reference to the Pattern of Its Application in Egypt*, 2007, p. 14)

- 1) The most important laws are Companies Law 159 of 1981, Public Business Sector Law 203 of 1991, Capital Market Law 95 of 1992, Investment Law 8 of 1997, and Settlement, Deposit and Central Custody Law 93 of 2000.
- 2) The corporate governance rules applied in Egypt align with international principles, covering 39 out of a total of 48 principles. The laws governing companies and the securities industry uphold these principles, and their application is fully implemented, reflecting standards of good performance.

As for positive practices in Egypt, we find that the law guarantees the basic rights of shareholders, such as participation in the distribution of profits, voting in general assemblies, and access to information about the company. Egyptian law protects the rights of stakeholders from bondholders, lenders, and workers.

Egyptian accounting and auditing standards are also consistent with international standards. As for negative practices, they are related to disclosure of ownership and management, including disclosure of explicit, hidden, or overlapping ownership structures, board of directors' remuneration, and disclosure of financial and non-financial information (such as potential risk factors).

Egypt is the first country in the Middle East to be interested in applying governance principles. Applying governance leads to achieving transparency, which helps attract new investments, whether local or foreign, and leads to a decline in corruption.

IV-2- Bank Governance in Egypt

The financial soundness indicators of the banking sector significantly exceed the regulatory ratios set by the Basel Committee in addition to those set by the Central Bank of Egypt. (Central Bank of Egypt, 2024, p. 40)

Financial services regulators in Egypt have given importance to bank governance. Its field supervision is responsible for supervising them as part of the financial institutions' risk assessment indicators.

Disclosure tools represented by the annual report, the board of directors' report, the report on the extent of compliance with governance, the disclosure report, and the website. (The General Authority for Financial Supervision, 2016)

The Stock Exchange has issued new laws on governance and risk management that require institutions subject to its supervision and licensed by it to adopt and establish a formal governance framework, a risk management framework and internal controls, and a remuneration policy.

The main governance aspects that will be focused on in the Egyptian banking sector, protecting minority shareholders, transactions related to stakeholders, and managing enterprise risk.

Immediately after the global financial crisis, the Central Bank of Egypt conducted a proactive assessment of various exposures such as securities and real estate markets in all Egyptian banks according to multiple tolerance scenarios. Accordingly, Egyptian banks were required to establish a reserve to cover unexpected cases in loans with a minimum of 1.5% - 2% after excluding provisions and exposures that are met by cash collateral.

After the crisis, the Egyptian regulatory authorities adopted several regulatory reforms to enhance risk management in banks. In this regard, in 2011, Egypt announced the implementation of stricter legislation on procedures related to granting personal loans, including credit ceilings and time periods, in addition to imposing restrictions on loan transfers. In the same year, new legislation was put in place regarding credit cards, which addressed cash withdrawal ceilings and maximum interest rates. (Central Bank of Egypt, Systemic risks, 2023)

Bank governance benefits Egyptian financial markets in that it increases institutional participation, provides a long-term outlook on market conditions, and encourages the production of more high-quality

research. International investors will be willing to pay a premium in stock prices for improved bank governance standards.

In addition, attention to bank governance, its standards, regulations, and procedures will enhance the role of hedge funds, and better bank governance standards will stimulate foreign direct investment and support the development of debt markets. There is no doubt that awareness of the positive aspects of corporate governance in privately owned financial institutions is growing. Governance priorities in privately owned institutions include succession planning, conflict management, and professional management at the board and senior management levels.

It remains to be said that governance contributes to enhancing financial stability and attracting investments to the country.

IV-3- The role of governance in the stability and efficiency of the Egyptian stock market:

The bank discloses clearly and in a timely manner everything of importance related to the bank in a manner that is commensurate with the size and complexity of its operations and in accordance with its ownership structure and acceptable risk limits. It is necessary for each of the bank's shareholders, customers, creditors, and stakeholders to be aware of the bank's strategies and have the ability to evaluate its performance, through annual reports, reports directed to regulatory authorities, and websites. (National Bank of Egypt, Method of Exercising the Powers of Good Governance in Companies: Corporate Governance, 2012, p. 36)

1) Disclosure requirements in financial statements are considered one of the fundamental pillars of sound regulation, as disclosure serves as an effective mechanism for enabling banks to engage with the market system., while taking into account reasonable limitations on what can be required. Enhanced transparency through improved disclosure can reduce the likelihood of banking crises or contagion effects, as creditors and other market participants will be better able to distinguish between the financial conditions of different institutions.

2) Transparency helps curb the financial markets' tendency to overreact to both positive and negative news, thereby reducing market volatility. It also

contributes to establishing a framework that enhances the quality of decision-making within the public offering sector

3) Applying governance will improve market performance, because applying governance means providing data, information and facts to everyone, thus increasing market efficiency and thus market stability first, as other people benefit from it and it transforms from a speculative market to an investment market. It must be emphasized that the governance system must also be accompanied by transparency and abundance of information and data about the market, market sectors, companies, trades and the economy itself. This is very important and information must be available to everyone at the same time. A governance system without information is questionable. These two elements are important for the development of the market and improving its performance.

IV-4- The reality of applying governance in Algerian banks:

The Algerian authorities have made efforts to establish the proper application of bank governance. The following are the most important laws and legislations that regulate bank governance in Algeria:

a) The Money and Credit Law (Law No. 90-10) serves as the fundamental legislative framework for regulating the Algerian banking sector. It outlines the procedures for establishing and organizing banks, and defines the role of the Bank of Algeria as the primary regulatory authority. The law also governs the issuance of licenses, the conditions for conducting banking activities, and the mechanisms for both internal and external oversight.

b) **Financial Oversight Law for Banks and Financial Institutions:**
The Bank of Algeria issued Regulation No. 02-03 on November 14, 2002.

c) **Laws for combating financial and administrative corruption:**
Algerian law did not directly and explicitly address this phenomenon until 1996, when the Algerian project referred to the sources of this

scourge and the misdemeanors that created.. capital to and from abroad, among others....etc.

- d) Regulations of the Bank of Algeria (instructions and regulations):
The Bank of Algeria issues periodic instructions related to the governance of banks, especially with regard to risk management, transparency rules, and regulatory requirements.
- e) Commercial Companies Law (Law 15-20): This law regulates the rules of good governance of companies, including banks. It stipulates rules related to the responsibilities of shareholders, the board of directors, and general assemblies.
- f) Law No. 23-09 dated 3 Dhu al-Hijjah 1444 corresponding to 21-10 June 2023, includes the Monetary and Banking Law, which includes Chapter Six on the supervision of banks, financial institutions and other subjects within Chapter One on management and internal control - centralization of risks - protection of depositors and the most important points are as follows: (Official Gazette Law No 23-09, 2023, pp. 16-17)

Banks and financial institutions are required to establish internal governance rules that specifically define the powers and responsibilities of the deliberative body and the executive body. Banks and financial institutions must establish an effective internal control system that includes procedures and internal organization that ensures compliance with applicable laws and regulations, and provides reasonable guarantees regarding the following:

- a) Good conduct and optimal realization of operations, - Reliability of financial information, - Security of assets.
- b) The Risk Center is a service of the Risk Center. It is responsible for collecting the identity data
- c) Banks and financial institutions, as well as institutions or bodies that grant issued loans, must participate in the Risk Center and provide it with the information necessary for its good conduct.

IV-5- Obstacles to governance in Algerian banks

Despite the set of laws issued to support the implementation of corporate governance in banks, Algerian banks face difficulties the Algerian banking system, mention: (Mansour & Bouhafs, Volume 3, Issue 5, 2020, p. 65)

- a) Weak transparency and accounting disclosure by Algerian banks.
- b) Failure to publish accounting data and budgets for these banks.
- c) Failure to adhere to publishing obstacles in a timely manner and the noticeable delay in preparing annual activity reports.
- d) Failure of the Bank of Algeria to publish its monthly status, as stipulated in the Monetary and Credit Law 90-10 or the amended and supplemented Order 03-11.
- e) Failure to apply internationally recognized accounting rules in accounting applied in Algerian banks.
- f) Failure to activate the centralization of budgets

Conclusion: The following results were reached:

- . Implementing sound practices in line with governance principles helps organize the management and operations of the bank.
- Paying attention to bank governance helps in providing a business environment characterized by transparency and credibility and contributes to increasing the effectiveness of supervision and its tightening, which helps in achieving the efficiency of the financial market and thus economic stability, especially in a world dominated by globalization.
- Governance in banks is based on basic principles that are primarily based on emphasizing the importance of transparency in order to ensure effective and sound management in banks, respecting disclosure laws, that defines responsibilities and accurately defines tasks.
- The Basel Committee has set standards that enhance governance in banking and financial institutions, while addressing the effectiveness of oversight and management in banks, especially focusing on audit

committees, risk procedures and compliance requirements, with an emphasis on the importance of internal audit operations being efficient and effective, and determining the objectives of audit committees, internal borrowing, conflict of interest and practicing good governance.

- The Basel Committee has approved the principles of bank governance in one of the provisions of Basel 3. These principles require that board members be fully qualified for their positions and have knowledge of governance and the ability to successfully manage banking work, as well as executive managers. Banks must apply the principles of governance while adhering to disclosure and transparency so that the degree of risk is reduced and default is reduced.
- Commitment to the principles of governance in banks local and foreign investments
- The success of governance in Egyptian banks is not only related to setting regulatory rules, but also requires the necessity of implementing them properly. market in Egypt.

For Algeria: To improve bank governance and enhance the efficiency of the stock exchange, it is necessary to:

- Strengthen laws and legislation to ensure the application of modern governance standards.
- Develop disclosure and transparency systems to ensure the flow of accurate financial information to investors.
- Train banking and administrative cadres on best governance practices.
- Strengthen the supervision of the Bank of Algeria and financial market authorities to ensure compliance with governance standards.

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