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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The essence of globalisation leads to a greater deterioration in governmental control, which results in greater need for accountability (Abdullah and Valentine, 2009). Also, the scandals involving firms such as Enron and WorldCom as well as bankruptcy cases raise the importance of having an effective corporate governance practice besides many other issues that are related to the levels of pay of managers and directors (Chen and Lee, 2008). That is why corporate governance receives extensive attention during the previous period by many researchers and it is difficult today to avoid the topic of corporate governance (Detomasi, 2006).

Keasey and Wright assure that corporate governance has been one of the key business topics of the first half of the 1990s and they have expected it will continue to be so for the foreseeable future (Keasey and Wright, 1952:16).

The concept of corporate governance can be traced as back as from the times of Adam Smith when he wrote "wealth of nations". It has since been embraced globally facilitated by internationalization of firms and globalization especially in economic activities and cooperation. Most notably, the Organisation for Economic Co-operation and Development (OECD) countries has embraced this concept in their economic entities. The inception of corporate governance concept occurred in 1998 at the Organisation for Economic Co-operation and Development (OECD) ministerial meeting, which stressed on its importance (Maher and Andersson, 1999). The OECD council was called upon to come up with a set of Corporate Governance guidelines and standards. The OECD was further expected to assess the causes of growth disparities so as to note the factors and policies that could reinforce long-term performance growth (Maher and Andersson, 1999). According to Abdul Shahid (2002) globalisation force many companies to face competition as corporate governance becomes a significant factor to be considered by institutional investors when making investment decisions and ownership stakes. This implies that Corporate Governance therefore has impacts on the functioning and development of capital markets. It also puts a strong influence on resource allocation. Corporate Governance has strong influence on the performance and behaviour of firms, entrepreneurship, innovative activity, and the development of small business enterprises (SME) industry (Maher and Andersson, 1999). Through cooperate governance, transparency, accountability and fairness is ensured in the organization. Through corporate governance, organizations achieve their objectives while at the same time being mindful of the social, regulatory and market environment.

1.2 Addressing the problem of the study

At the OECD Ministerial meeting, the importance of Corporate Governance is stressed (Maher and Andersson, 1999; OECD, 1999c; OECD, 1999b; OECD, 1999a). The OECD council is called upon to come up with a set of corporate governance guidelines and standards. The OECD is further expected to assess the causes of growth disparities so as to note the factors and policies that could reinforce long-term growth performance but still this is associated with firm's ownership structure and Board structure (OECD, 1998e; Maher and Andersson, 1999).

Therefore, the problem of this study is based on the increasing need to develop corporate bodies despite being local, regional or international. From exiting cases, corporate Governance has shown to have this potential. However, being a new concept that incepted about a decade ago (1998), it is still not clear whether the idea can work in other countries outside OECD.

It has been proved that poor Corporate Governance can lead to decreased firm's competitiveness as opposed to good corporate governance though there is no universal model or system of corporate governance (OECD, 1995; Bhagat and Bolton, 2008). In this view, this study perceived that not every guideline set by the OECD at the inception of Corporate Governance idea should apply in all countries outside OECD. Besides, the governance practices differ not only across nations but also across corporate and industries (Bhagat and Bolton, 2008). Hence, this can have great influence on a country's corporate governance systems in regard to ownership and other governance structures.

Moreover, the systems of corporate governance can be differentiated based on the degree of ownership and control as well as the identity of controlling shareholders (Zheka, 2010; OECD, 1997). In as much as some systems are typified by wide dispersed ownership by involving outsider systems, others seem to be typified by concentrated ownership or control by involving insider systems (Zheka, 2010). Therefore, whether concentrated or dispersed, there is still no clear distinction on which system of governance can lead to better corporate performance. In the former systems of corporate governance, the primary conflict of interest exists between strong managers and dispersed weak shareholders. In the later systems the basic conflict exists between controlling shareholders and the weak minority shareholders. However, much of variations in corporate governance are attributed to the differences in countries' institutional, legal, regulatory environments, and historical and cultural influences (Zheka, 2010; OECD, 1996). Therefore, policies promoting the adoption of a given form of governance ought to attempt to account for not only the product and factor market contexts but also other institutional factors surrounding their contemplations. Thus, a study that conforms with such policy frameworks, which considers both factor market and institutional factors on corporate development, is still missing.

From the above discussion this study concentrates mainly on the relationship between board characteristics and ownership structure. Hence this study mainly aims to answer two main research questions about the firms listed in the Egyptian stock exchange:

1.3 Motivation for the study

This study is motivated by the current economic era, which is typified by increased capital mobility, globalisation, and internationalisation of industrial development (Mauro, 2012). Globalization and internationalization have necessitated migration of firm operations across the globe. Corporate Governance has gained an important framework condition that impacts the industrial competitiveness, not only in the OECD countries but also non-OECD countries

(Bhagat and Bolton, 2008). However, in the developing economies, privatisation poses questions about the manner in which private corporate should be governed. Therefore, as a motivation to this study, it is perceived that majority of firms in Arab nations are private-owned with minimal participation of females in the board governing them. Hence, the study is the best way to prove whether these approaches can positively or negatively impact on firm performance. As opposed to developed nations, developing nations including the Arab countries still have low transparency, accountability and fairness. Thus, these factors motivated the study to establish how they have been exercised in the corporate governance, and whether their existence in the corporate board structure and ownership structure can impact further effects on firm's performance. Through corporate governance, it is claimed that organizations can achieve their objectives while at the same time being mindful of the social, regulatory and market environment (Rodolfo, 2012). Thus, this study is motivated by different socio-cultural, economic, regulatory and market environment in developing and Arab states. On this note, there is growing economic opportunities in these countries typified by increased inflow of foreign direct investments, multinational companies, increased exports and movement of human capital across the region. Thus, a study into corporate governance as a global idea in global firms is inevitable. Some of these firms are owned by different shareholders, both foreign and local. Hence, improved performance can signify equitable treatment of all shareholders, including the minority and foreign shareholders (Müller, 2010). In this regard, the study is motivated to establish whether establishing governing structures that equally recognize employees as well as owners can improve performance since shareholders of the same series of a class should be treated equally. Succinctly, the study is motivated by common occurrence of abusive actions against the minority shareholders by, or in the interest of, controlling shareholders.

This thesis therefore is conducted to prove or disapprove early proponent on the relationship between corporate governance and corporate performance. Here, this study took into consideration both exogenous and endogenous effects of governance to establish how the composition of corporate boards of directors as well as ownership structure impact on corporate performance. As a new concept in the non-OECD countries, the study focused on Egyptian firms as a developing economy, whose firm may be effectively or ineffectively applying the concept of corporate governance in day-to-day running of their activities.

1.4 Contribution of the study

This study has two distinct categories of its contribution. First, it would help to bridge academic gaps in relation to corporate governance not only in developing nations but also in Arab states. This will be signified through the use of a representative country with her companies representing the rest of the companies in other regions. As can be noted in the above chapter, corporate governance can be drawn from mixed approaches implying that there is no single approach to achieve good corporate governance. However, strong connection that OECD Council suggests between corporate governance and firm's performance (OECD, 1998d; OECD, 1998c; OECD, 1998b) makes this study add more knowledge in the academic field on how and whether such principles can hold or not hold in African countries, especially the Arab states.

The study expects to reconcile some of the mixed views presented in previous studies in regard to ownership structure and board structure in corporate governance. Hence, it is a study that would create a healthy and prosperous view of this recent idea in regard to nations outside OECD.

Second, this study will be of great significance to the corporate world in regard to managerial and practical implications of corporate governance outside OECD. On accomplishing this study, there will be clear knowledge on how firms operating in the region can enhance microeconomic efficiency (Zingales, 1997). Similarly, the country of study would be able to develop best ways in the governing, functioning and developing of state-owned firms and stock markets. On this note, both state and corporate owners would clearly know how and why to allocate their resources in quest for improved corporate behaviour and performance. Through the use of the implications in this study, countries with similar characteristics and firms, as the one in this study, will be able to achieve improved entrepreneurship, innovative activity, and the development of SME industry (Maher and Andersson, 1999). Moreover, firms in the OECD will be able to understand the feasibility of corporate governance structures in developing and Arab nations. As a result, international firms, from OECD, aiming to migrate to these nations would greatly understand the dynamics in establishing corporate governance that would assist them succeed in their firms' performance.

1.5 Study Approach and Outline

Presented in this thesis are arranged into chapters. Chapter 2 draws on the concepts of corporate Governance. Chapter 2 aims at providing an overview of the corporate governance (CG) concept based on a review of the relevant literature since a good understanding of the corporate governance system is a key to help this study demonstrate whether there is a relationship between CG and a firm's performance. Various issues have been defined in this chapter together with the benefits of corporate governance, participants in corporate governance, and comparisons of corporate governance practices in various nations. On this note, the chapter goes further to address corporate governance in Egypt, which formed the core of this study. Here, the chapter reveals the Egyptian board of directors, ownership structure, and its key institutions associated with corporate governance.

Chapter 3 presents a number of theoretical perspectives, which this study used to understand corporate governance and corporate performance in the context of Egypt. Succinctly, the chapter discusses the agency theory, steward theory, stakeholder theory, resource development theory, the transaction cost theory and the institutional theory. Chapter 4 presents a number of puzzles that comes out from the complexity of the board of directors' characteristics and their effect on corporate performance. Thus, the chapter gives an overview about the board of directors, their duties and responsibilities, then how boards are classified within organizations and finally investigating how some specific board characteristics will lead to certain level of firm performance. This helped the study to develop the hypothesis of the model that is tested in the analyses chapter.

In particular, the hypotheses formed from the existing literature aimed to establish the kind of relationship between corporate performance (Tobin's Q and ROA), as dependent variables and independent variables (board structure).

Chapter 5 presents the diverse classes of ownership. This chapter covered a review about five main types of ownership: State ownership, private ownership, and managerial ownership, employee as a shareholders and block holders and family ownership. At the end of this chapter, the author tries to relate the existing literature about ownership structures with firm's financial performance.

While reflecting on these as the major objectives of the study, the next chapter (Chapter 6) presents the chosen methodology for the study, which stipulates the kind of data used and the analysis approach employed. Key in this chapter is that the analysis and tests are performed with the objective to provide empirical evidence to answer the research question of whether *there a significant relationship between corporate governance variables in terms of board structure and ownership structure and firm's financial performance.*

Chapter 7 and 8 presents the findings of the study. Chapter 7 presents the results obtains from the regression models that relate board structure variables with performance measures. Chapter 8 presents the findings from the regression models that relate different ownership structure with the firm performance measures. Hence, the results are in two main parts: the descriptive statistics and inferential. The study proved majority of its hypotheses as true, which confirmed wide influence of corporate governance on corporate performance. However, the study challenged previous studies on some elements of board structure and ownership structure.

The final chapter is chapter 9. This is the concluding chapter. The chapter includes a summary of the key findings of the study, the academic and the practical implications of the research findings, the limitations of the study and the avenue for future research.

1.6 Chapter Summary

This chapter begins with a discussion of the background about the topic of the study, followed by identification of the research problem, motivation for the research. These were followed by the contribution of the current thesis. Finally the organisation of the thesis was discussed in the penultimate section.