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T3573CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE

CONFERENCE ON
"WHY DO CORPORATIONS FAIL? LESSONS FROM
INTERNATIONAL EXPERIENCE"

WRAP-UP SESSION
DR. JOHN SULLIVAN RECOMMENDATIONS
IN CORPORATE GOVERNANCE

March 30, 2003
Egyptian Center for Economic Studies

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I N T E R V I E W

DR. SULLIVAN: Thanks, Mr. Chairman, and again thanks to all of the support and leadership provided by ECES and our other partner organizations.

Since I don't know the answer to what Egypt's way forward should be, all I can really do is offer a sampling of trends at the international level, which I will try to do very briefly.

You might think of it as a buffet of options. We had a fixed lunch, so you think of the, at least my portion here, as a buffet from which you can choose. And I would have four sections here. And don't worry, I won't do them very long. I can see Dr. Galal already tensing up when he hears "four sections." But I will do them very quickly.

The first is at the international level; the second would be legal and regulatory; the third at the level of the exchanges; and the fourth, internal to the companies.

And there are trends in various countries at all of these levels, and many of these we've already heard about quite a bit, so I will only refer to them briefly.

At the international level, there really is, the approach seems to be in terms of international pressure on

countries and companies to comply. And two of these are the Global Corporate Governance Forum and the Associated, what is called ROSC, Reports on Standards and Codes. And this we've heard Dr. Samira Fazi [ph] give her presentation on Egypt and how it stacks up against some of these. And you saw in my presentation some of what Eastern Europe is doing.

This will come together November 3rd and 4th in Paris, where there will be a presentation on various parts of the world--we hope including the MENAN region--where they will look at not just compliance, but also improvements and suggestions for future standards.

This also feeds very much into the pressure that's now coming from the ratings agencies, whether it's Standard and Poor's, Moody's or some of the national rating systems that are going forward.

I would also say that we have heard at the U.S. Chamber, we have of course affiliated American chambers, not just in Egypt, but in some 90 countries, that not so much the listed companies, but as I think Dr. Fazi was talking about, they do feel a globalization pressure, particularly the family firms--firms who are not transparent and open, but who know that they have to form alliances with

international companies in order to maintain their competitiveness as trade barriers fall and as more and more globalization occurs.

And that is also putting pressure, particularly we've seen this in Brazil, Latin America, and of course in Russia and Central and Eastern Europe.

At the legal and regulatory level, some of the responses to this, of course, have come from the regulatory authorities themselves. But one other response would be in the area of the banking sector, and this is a combination of national response, as well as international pressure, and that's the Basel II. This will require companies, and their banking systems, to improve and to enhance their risk rankings, both operational risk of the banks themselves, but also the risk in their underlying loan portfolios.

And in Basel II, they are looking at corporate governance as one of the underlying risk dimensions by which they can weight the risk of their loan portfolio.

Company law, obviously, the national authorities are looking at changes in the way law, and I would includes countries like Germany in this, where they are making some substantial changes.

Mr. Hassan [ph] told us about the changes that are occurring in the level of auditing practices. In my country, as Steven Davis has said, our auditing profession has lost its standing as a self-regulatory organization. That's a major change for us.

Another major change which is on the horizon, particularly in Europe, but is starting to occur also now we see in Russia and a number of other markets, is the market for corporate control--the merger and acquisition market, which is undergoing some very significant changes.

At the level of the exchanges, the first obvious one is the listing requirements, which we've talked about some length here. Mr. Ibrahim has talked about it, and I presume will maybe have some more to say about listing requirements. The New York Stock Exchange obviously was an example of significantly tightening up.

The United States is somewhat interesting because we don't have a corporate code, a Code of Corporate Governance in our country. It's more a conglomeration. But out of the New York Stock Exchange listing requirements, it looks as though one is being assembled in a more or less ad hoc fashion.

Key here has been the role of independent directors splitting the position of chairman and president or CEO of the company and of course the role of the Audit Committee.

The trend seems to be to adopt the U.K. standard of comply or explain why you're not complying, for listed companies. And by comply, I mean with the Code of Corporate Governance. If you can't comply, then the force is on the company to disclose why they haven't complied.

And then the last area, well, two last areas within the exchange level. One is there is a tendency now to try to develop transparency tiers; tiers within the exchange where a premium is given, and hopefully the companies that are listed there then can reduce their cost of capital, but they need an enhanced requirement.

An alternative to that is the development of a secondary exchange. Brazil has gone in that direction.

At the private-sector level, the big trend now is on application and enforcement, particularly of the codes. One thing I would say in addition on the Codes of Corporate Governance, which is becoming very much of a standard or a fashion internationally, is that our position at CIPE, and

we've worked with market participants in a number of countries, these really should be developed by the private sector in the country.

The OECD principles are fine as a starting point, international examples are fine as a starting point, but you get a lot of unintended consequences if the Egyptian private sector, the Russian private sector or whoever's private sector doesn't step forward and develop their own code that fits their unique conditions and culture of governance.

Internal control issues within companies are another major issue that's moving forward. And we've developed, along with some other organizations, some models, but there are a lot out there.

The investor protection associations are also growing in popularity, and these are different than business associations. The membership of a business association is firms. Here, it's the investors--two tiers, institutional investors, as well as individual participants in the markets.

The most interesting one is the Russian Independent Directors Association, but there's also, at the international level, the International Corporate Governance

Network, which is made up of the large pension funds and institutional investors, is driving a lot of change as well.

The Institute of Directors, which I referred to earlier, is playing a big role in terms of training the company directors, also working on things like corporate codes and ratings from the market side.

Another trend, and sometimes this is coming from the directors' institutes, sometimes from other agencies, is the certification. I think several people have brought up certification. It goes beyond auditors. There is at least a consideration within the U.K. to certify company directors by the Institute of Directors, also the tradition of certifying the company secretary, which is a role we haven't spoken of much, but which is key to the governance dimension and establishing a Governance Committee of the board. All of those are at the firm level.

Within the family firms, we don't really have time to go into the trends there, but there are going to be profound changes, not just in the emerging markets, but especially in the U.K., in Germany and a few other countries.

Another trend is the education of financial journalists. There are a number of programs now where people are, including ourselves, are trying to work with financial journalists to do a better job. Okay, companies disclose, but if the media doesn't have the ability to report what they've disclosed and to be critical about that disclosure, you haven't gotten there yet.

All of this comes together within really two broad trends, which we've talked about, and that is the solution to a lot of governance problems, no matter whether it's at the international level or at the various levels within the country.

It really comes to the point of disclosure, and there are a variety of ways from the smorgasbord that you can pick from as to how you get disclosure, but disclosure seems to be what the market is demanding. And the reason for that is because we don't understand the underlying risks within the company. Without disclosure, you can't possibly know, as we have found out in the United States, to our chagrin, you don't know what you're investing in, and you don't know the risks you're taking.

Thank you.

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