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# CORPORATE GOVERNANCE, SUBSTANTIVE THEORY AND SOCIOLOGICAL INSTITUTIONALISM: THE CASE OF THE EGYPTIAN BANKING SECTOR

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## Abstract

Banking organizations have peculiar characteristics that make it difficult for them to adopt and apply traditional corporate governance models. However, little attention has been given to understanding and theorizing banking corporate governance. Deploying a grounded theory methodology this paper develops a substantive theory of banking corporate governance within Egypt. Subsequently, through sociological institutionalism the substantive theory is further analyzed and assessed; findings indicate that banking corporate governance is an evolving context or contingency based phenomenon. Corporate governance for banks in Egypt involves an institutionalization process based on regulative and normative pressures that looks to ensure legitimacy from shareholders, regulators and depositors. This said, to maintain legitimacy banks either comply or disguise their non-compliance. Overall, this paper contributes to non-traditional corporate governance theorizing and offers policy-makers a distinct in-depth understanding of the phenomenon.

**Keywords:** Corporate Governance, Sustainability Theory, Sociological Institutionalism, Egyptian Banking Sector

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## 1 Introduction

In any contemporary business environment appropriate corporate governance structures and practices are crucial for ensuring effective banking within developing, transitional and developed economies. It has been argued, that weak corporate governance has been a major reason for many banking crises (Barth et al., 2007; Nam and Lum, 2006). Indeed, the global financial crisis of 2007 indicated that appropriate corporate governance measures for financial institutions cannot be compromised (De Larosi re et al., 2009; Kirkpatrick, 2009). Furthermore, because banking has peculiar characteristics that intensify requirements for robust corporate governance (that is, they differ from other organisations) certain commentators consider that the corporate governance of banking has not been given the attention other sectors have experienced (Barth et al., 2007; Caprio and Levine, 2002; De Larosi re et al., 2009; Levine, 2003; Macay and O'hara, 2003; Mullineux, 2006). In short, corporate governance research has paid less attention to banking organizations than it has non-financial institutions (Shleifer and Vishny, 1997; Mulbert, 2010).

The financial crisis emphasized the importance of Bank Corporate Governance (BCG) especially in the context of developing economies given the dominant position of banks in these underdeveloped financial markets (Arun and Turner, 2004; Barth et al., 2007; Capri and Leveine, 2002; Das and Ghosh, 2004; Levine, 2003). Moreover, the recent liberalization of banking sectors in developing countries through privatization and divestment along with the reduction of economic regulation has given bank executives more freedom in determining management practices in setting priorities for interests (Nam, 2007). Fundamentally, analysis of banking collapses in developing economies illustrates close correlation with factors related to weak corporate governance.

The Egyptian Banking Sector (EBS) has specific reasons for necessitating robust corporate governance procedures e.g. the EBS provides over 85% of business financing so of paramount importance to the Egyptian economy (El-said, 2009). Furthermore, banks have been assigned the role of promoting compliance with the Egyptian codes of corporate governance (ECOFG, 2005; 2011) and before requiring full compliance from other organizations

should ensure that they themselves fully adopt corporate governance principles. Overall, weak corporate governance has been seen as a main reason behind Egyptian bank failures during the late 1990s and the associated non-performing loan problem that burdens the EBS today (CBE, 2008). Indeed, in response to corporate governance deficiencies the Egyptian authorities initiated a reform program to address improvements in corporate governance (CBE, 2003; 2009).

This paper queries theoretical perspectives usually used for explaining and analyzing corporate governance and through the development of a substantive theory and Neo-Institutional Sociological Theory (NIST) undertakes a study of Egyptian banking corporate governance. Initially, this paper critiques agency/shareholder and stakeholder theories and considers other frameworks that may provide means of assessing corporate governance procedures in banks. Second, we explain our methodological approach and identify how through data collection and analysis we develop a substantive theory. Third, a substantive theory is developed and through this and NIST issues relating to Egyptian banking corporate governance are further explored and analyzed. Finally, through the development of the substantive theory and analysis through NIST both theoretical and practical conclusions are reached.

## **2 Banks and traditional corporate governance theorizing**

Two principal theories (agency/shareholder and stakeholder) are usually utilized to understand and explain corporate governance (Maher and Andersson, 2000; Chilosi and Damiani, 2007; Carillo, 2007; Freeman and Reed, 1983; Friedman and Miles, 2002; Gamble and Kelly, 2001; Kakabadse and Kakabadse, 2001; Keay, 2010; Letza and Sun, 2002; Letza et al., 2004; Letza et al., 2008; O'Sullivan, 2000; Omran et al., 2002). On one hand, Shareholder theory considers that the purpose of the corporation is to maximize shareholder wealth and identifies the main corporate governance dichotomy as emanating from agency problems which emerge from the separation of ownership and control. Fundamentally, with distinctions between ownership and control comes conflict of interests between the principal (shareholders) and the agent (managers) (Carrillo, 2007; Letza et al., 2004; Letza et al., 2008). On the other hand, the stakeholder perspective argues that the purpose of the corporation is to serve the interests of a number of stakeholders (not shareholders alone) and that corporate governance problems relate to the consideration of non-share owning stakeholder interests and potential conflict of interests between stakeholders per se (Carrillo, 2007; Letza et al., 2004; Letza et al., 2008). As such, the adoption of either perspectives of corporate governance (Shareholder v. Stakeholder) is to a great extent a

decision based on particular conceptions of the company, its purposes and its legal and political foundations (Gamble and Kelly, 2001; Howell, 2007a; 2007b).

However, with their special features banks it is easier for insiders (managers and large investors) to 'exploit private benefits of control rather maximizing value for shareholders' (Zingales, 1994: 4 cited in Caprio and Levine, 2002). As such self-interest and associated short-termism and excessive risk taking will result only in more conflict of interests with shareholders, as well as interests of the fixed claimants (depositors) who are risk averse. This led many researchers to claim that managers of banks have a fiduciary duty to both depositors and shareholders (Barth et al., 2007; Macay and O'Hara, 2003; Mullineux, 2007). Accordingly, adopting the Anglo-Saxon shareholding model based on the agency theory and purpose of shareholder wealth maximisation only is deemed inappropriate in the case of banking organizations, because here corporate governance should look beyond those of the shareholders e.g. depositors (Mullineux, 2007). Macay and O'Hara (2003) recommended that banks should adopt a stakeholder model for dealing with corporate governance problems. However, adopting a pure stakeholder model of corporate governance in banking organization would face the difficulty of stakeholder identification (Phillips, 1997; Howell, 2007b). Therefore, the pure stakeholder model is also deemed inappropriate because it does not provide a concrete identification of stakeholders.

In addition, many researchers have argued that different banking organization have many factors that shape corporate governance practices (Lubatkin et al., 2005; Ratnatunga and Ariff, 2005; Rwegasira, 2000). Moreover, the factors shaping corporate governance in individual states do not necessarily have to be similar from one country to another. Consequently, a universal approach is problematic and issues may only be understood through relativist and empirical corporate governance research (Durisin and Puzone, 2009; Lee and Yoo, 2008; Letza et al., 2008; Ratnatunga and Ariff, 2005; Smallman, 2007). Indeed, it must be noted that the global financial crisis has demonstrated that these traditional corporate governance models (shareholding and stakeholding models) are inappropriate and different perspectives required if new avenues of improvement are to be investigated.

Letza et al. (2008: 22) argued that even though shareholder and stakeholder theories have specific worldviews and perspectives both share a 'normative rational model' when assessing corporate governance procedures. The principal-agent (shareholder model of corporate governance) is based on efficiency theory, while elements of the stakeholder model, despite its focus on corporate ethical behaviour and social responsibility, posits that 'ethical business is more rational and more efficient' (Letza et al., 2008: 23-

24). Interestingly, Freeman et al. (2004:366) acknowledged difficulties with single objective theoretical frameworks for explaining social phenomenon when he argued that ‘the world is complex, and managers and directors are bounded rationally (at least we can meet economists on their own assumptions)’. Indeed, it is argued that both shareholder and stakeholder theoretical perspectives share similar economic efficiency driven foundations and that such a normative stance may be criticized because it ignores social processes related to corporate governance that are embedded in particular contextual factors (Aguilera and Jackson, 2003; Ardalan, 2007; Kirkbride et al., 2005; Letza and Sun, 2002; Letza et al., 2004; Mason et al., 2007; Letza et al., 2008). Contextual factors that encompass crucial determinates relating to corporate governance may include many non-economic and efficiency factors such as ‘power, legislation, social relationships and institutional contexts’ (Ardalan, 2007: 511) as well as ‘politics, ideologies, philosophies, legal systems, social conventions, cultures and models of thought’ (Letza et al., 2004: 258). Moreover, traditional corporate governance theories adopt a closed system approach of institutional analysis, especially the shareholder perspective (Aguilera et al. 2008) which isolates corporate governance perspectives ‘from social and other non-economic conditions’ (Letza et al., 2008:256). Finally, the economic/efficiency perspective looks at corporate governance as a static object which is not ‘compatible with the fluidity and diversity of practical reality’ (Letza et al., 2004: 257). On the contrary, corporate governance is a socially embedded complex phenomenon that requires analysis based on a dynamic process driven basis to be able to explain ‘the temporary, transient and emergent patterns of corporate governance on a historical and contextual basis in a given society’ (Ardalan, 2007: 511). This given, a different approach to assessing and analyzing corporate governance procedures was deemed necessary and a number of researchers have employed New Institutional Sociological Theory (NIST) (for further details see Chizema and Buck, 2006; Chizema, 2008; Judge and Kutan, 2008; Lee and Yoo, 2008; Seal, 2006; Zattoni and Cuomo, 2008). The main focus of this paper is to present a grounded account of corporate governance using a non-traditional theoretical lens. It is an attempt to contribute towards greater understanding of bank corporate governance as a context based or contingent dynamic rather than a static phenomenon. As such, to set the substantive theory and NIST in context, we have opted to initially present, a critical account of traditional theoretical perspectives used for corporate governance theorizing. We then outline data collection procedure and research methodology through which, the substantive theory was developed then further explored using NIST. It is important to identify that the substantive theory is based on Straussian

grounded theory coding techniques (open-axial-selective) and constant comparative method. Coding of data collected from the field eventually leads to the substantive theory of BCG reform in the EBS.

In the following sections of this paper a substantive theory is developed (section 2 and 3), an overview of alternative theoretical framework is presented (section 4) and an example of NIST analysis regarding corporate governance is employed (section 5).

### 3 Methodology and methods: developing substantive theory

Grounded theory research does not normally follow the traditional positivistic paradigm of inquiry and presenting grounded research in its pure form in an article of this type ‘would be neither efficient nor comprehensible’ (Suddaby, 2006: 637). In other words, reporting the detailed analysis of grounded theory research that is based on coding and the constant comparative method (open, axial, selective coding stages) would entail a lengthy and complicated exposition (Suddaby, 2006). In this paper, we outline the theoretical concepts that emerged through coding data incidents into categories which emerged from the both data and existing categories while these and their properties were integrated to identify the developing substantive theory (see Glaser and Strauss, 1967: 101-115)

This paper uses grounded theory methodology to build a substantive theory of corporate governance within the EBS. Grounded theory aims to develop a substantive theory through comparative analysis and coding procedures (Howell, 2000). Glaser and Strauss (1967: 32) argued that substantive theory is ‘developed from a substantive, or empirical, area of sociological inquiry ... such as ... organizations’. Grounded theory ‘is based on the systematic generation of theory from data, that itself is systematically obtained from social research. Thus, the grounded theory method offers a rigorous orderly guide to theory development’ (Glaser, 1978: 2). Indeed, through comparative analysis grounded theory aims to build substantive theory through developing ‘general categories’ (Howell, 2000). It does not assume that the inquirer knows the substantive areas better than those being researched nor does it assume that a theory will be incorporate a finished product (Howell, 2000). Grounded theory attempts to generate theory based on data collected and analyzed simultaneously as the research progresses (Howell, 2000). Grounded theory is an ‘inductive qualitative methodology that allows the researcher to identify the main concern of a group of subjects and the behaviours they use to resolve their main concern’ (Artinian et al., 2009: 3).

In this paper grounded theory methodology is illustrated in the following ways. First, through an application of the comparative method in the open

coding stage based on semi-structured interviews (A) conducted with bank directors and executives, government officials, auditors and central bank officials which developed categories and identified their properties and dimensions. Indeed, the interviews were informed by a survey of BCG practices. Second, through axial coding open categories were subsumed into broader categories, and the relationships among these categories established by means of the paradigm model. This led to the Bank Action Choice Matrix and the Paradigm Model of Evolving BCG in the EBS. The earlier models the relationship between the organizational characteristics of the bank and the choice of its strategic response of either to comply with governance requirements or disguising its non-compliance. While, the paradigm model of evolving BCG links various main categories with the phenomenon of *evolving BCG practices*. Axial coding provided the basis of the substantive theory. Third, selective coding based on a second round of semi-structured interviews (B) identified the core category, verified its relationships with other sub-categories and eventually presented the substantive theory of BCG.

The Survey was sent to senior bankers from 30 commercial banks with a response rate of 70%. The survey is composed of 14 statements that address corporate governance practices quality of banks (see Table 1). The issues that the survey identified were further investigated through the semi-structured interviews (A) which included: shareholder and stakeholder interests, the role of the board in corporate governance practices, transparency, and disclosure and ownership type. 58 semi-structured interviews were undertaken and broken down into categories (A) and (B). Interviews (A) included 44 interviews based on 14 questions as with grounded theory techniques however, as data collection and analysis were in parallel, emerging concepts were taken to subsequent interviews to be verified (see Tables 2 and 3 for interviews questions and statements).

Categories that emerged during open coding can be further arranged and linked together to form a

coherent overall system (Howell, 2000). The Axial coding process developed five main categories developed through axial coding involved: drivers, obstacles, reform strategies, contextual factors and evolving BCG practices. These categories were related together by means of the coding paradigm model which included identifying the phenomenon studied, the context where it is embedded, the intervening conditions, the causal conditions, actions/ interactional strategies and their consequences (Strauss and Corbin, 1990: 1998). More precisely *drivers* are the causal conditions, *evolving BCG practices* is the phenomenon; while *obstacles* represent the intervening conditions; *reform strategies* are the action / interactional strategies that occurred with the consequences of enhancing banks' legitimacy, improved protection of shareholders' and depositors in addition to bringing further corporate governance reform. Indeed the phenomenon represents the category and other components of the paradigm model are sub-categories.

Finally, at the selective coding stage, the Semi-structured interviews (B) contributed towards identification of the core category of BCG reform and verified relationships with sub-categories using Strauss and Corbin's (1990; 1998) paradigm model, and eventually arriving to the substantive theory. Overall, the substantive theory is the result of coding, categorization and comparative analysis of data systematically collected for this study through a survey and the two rounds of semi-structured interviews. It reflects the opinions of bank directors and executives, CB officials and auditors. As such it is grounded on data obtained from substantive area (EBS). The substantive theory exemplify a system of BCG reform, it captures some of the complexities of the real life by accounting for both the structure where the phenomenon of BCG reform is embedded as well as the processes taking place. It shows the interaction and interplay between BCG reform and the banking environment that indeed leads to the evolution of BCG practices in the EBS.

**Table 1.** Grouped Survey Statements

Group	Related Statements
Stakeholders' Interests	<ol style="list-style-type: none"> <li>1. The bank's current corporate governance structures serve the interests of shareholders.</li> <li>2. The bank's current corporate governance structures serve the interests of the following non-share owning stakeholders. <ol style="list-style-type: none"> <li>a. Depositors</li> <li>b. Employees</li> <li>c. Local society</li> <li>d. The Environment</li> </ol> </li> </ol>

<p><b>Board of Directors corporate governance practices</b></p>	<p>3. The banks' board functions include over-sight and approval of corporate governance practices.          4. The Bank's key executives and broad members regularly attend training courses on issues of corporate governance.          5. The board of director's conducts self evaluation or reviews of its effectiveness.          6. The bank's chairman is independent of the CEO.          7. The bank utilized specialized board committees in relation to corporate governance e.g. Audit/ corporate governance, nomination, remuneration committees etc.          8. The specialized committees are composed of independent directors.          9. The banks overall risk strategy requires the evaluation of the clients' corporate governance quality.</p>
<p><b>Communication of Corporate Governance Information to Stakeholders</b></p>	<p>10. The bank's corporate governance structures are disclosed in the annual report along with latest financial results.          11. The bank publishes corporate governance information and announcements on its website.</p>

**Table 2.** Interview (A) questions

<p><b>INTERVIEW (A) QUESTIONS*</b></p> <ol style="list-style-type: none"> <li>1. Does the type of bank ownership affect its quality of corporate governance practices? (Ownership type of the bank);</li> <li>2. Do laws and regulations effectively promote bank corporate governance? (shareholder and stakeholder interests);</li> <li>3. To what extent corporate governance affects competitiveness of the bank?;</li> <li>4. What are the mechanisms used by the CBE to enhance bank's corporate governance practices? (shareholders and stakeholders interests);</li> <li>5. On what basis a bank considers corporate governance reform? (shareholders and stakeholders interests);</li> <li>6. What bodies play an important role in bank's corporate governance? What are these roles? (Bank Corporate Governance);</li> <li>7. Whose interests do banks' corporate governance mechanisms protect? (shareholder and stakeholders interest);</li> <li>8. What role does the board have in the corporate governance of the bank and how effective is this? (The role of the board in corporate governance practices);</li> <li>9. How does the board (in general) ensure that members (of the board) understand their role in corporate governance? (The role of the board in corporate governance practices);</li> <li>10. What are the corporate governance mechanisms that banks utilize? (The role of the board in corporate governance practices);</li> <li>11. To what extent the bank insists on good corporate governance in credit operations and what benchmarks does the bank uses in this respect? (The role of the board in corporate governance practices);</li> <li>12. What impact does the Egyptian business culture have on corporate governance of banks? (Corporate governance culture);</li> <li>13. What is the basis to determine the risk management policy of the bank? (The role of the board in corporate governance practices);</li> <li>14. Have the accounting standards adopted enhanced transparency? (Transparency and disclosure).</li> </ol> <p><i>*The Brackets at the end of each question shows the areas emerged from survey analysis and were further investigated in semi-structured interview (A)</i></p>
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**Table 3.** Interview (B) statements

<ol style="list-style-type: none"> <li>1. Bank corporate governance has witnessed reform due to pressures from the CBE, international organizations and the Egyptian government;</li> <li>2. Bank corporate governance reform aims at minimizing potential conflict of interests between shareholders, depositors and the regulator (CBE); hence better serving their interests;</li> <li>3. Bank corporate governance reform is an ongoing process taking place through the CBE's supervision to enhance the safety and soundness of the banking sector according to the international best practices;</li> <li>4. Variability of bank corporate governance practices is related to the differences in the corporate governance identity of the bank (management control, competence and organizational perception of corporate governance) as well as the limited corporate governance scope of applicable laws and regulations;</li> <li>5. Further reform should address the challenges of boards' ineffectiveness in corporate governance, market myopia (short-termism) and corporate governance cultural immaturity within the EBS.</li> <li>6. Banks respond to evolving corporate governance requirements resulting from reform either by compliance or disguising of non-compliance.</li> <li>7. The outcome of the compliance or disguising of non-compliance strategies in response to corporate governance reform includes enhancing bank's legitimacy towards the regulator and shareholders; improvement in interests protection and further corporate governance reform;</li> <li>8. The impact of corporate governance reform will vary between Foreign, Private Domestic, Arab and State banks within the EBS given their different corporate governance identities and qualities.</li> </ol>
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#### 4 Substantive theory of bank corporate governance reform

The substantive theory can be summarized as follows:

- (a) BCG practices evolve from the on-going process of BCG reform.
- (b) BCG reform occurs due to pressures from various banking sector stakeholders, with the most influential pressure coming from the regulator and shareholders given their respective powers.
- (c) Improving BCG practices decrease potential conflicts of interests between shareholders, depositors and the regulator.
- (d) Contextual factors such as laws and regulations, and BCG culture/identity (degree of management control, employees' competence and organizational perception) are determinates of how banks respond to BCG reform requirements.
- (e) BCG reform faces obstacles that may alter or mitigate its impetus; this includes director's ineffectiveness, short-termism and immaturity of Hawkamat Al-Sharikat culture.
- (f) Banks adopt two strategies in response to BCG reform, either compliance or avoidance by disguising non-compliance.
- (g) The regulator manages BCG reform by the means of the supervision function and on-going updating and improving the function by investing in people and systems and co-operating with other central banks.
- (h) BCG reform is given impetus by feedback regarding the achievement of reform objectives

from both the regulator and recognized stakeholders perspective. As well as feed-forward by the regulator to enhance BCG by implementing internationally accepted practices.

- (i) On-going BCG reform, induce banks to comply. While, supervision scrutinize compliance to address further BCG reforms. Meanwhile, the interplay with obstacles will eventually induce changes to occur, to cross these obstacles; this complex interplay will keep BCG practices evolving.
- (j) The corporate governance model prevailing in the EBS is a pluralistic model that aims to serve recognized stakeholders: shareholders, depositors and the regulator.

As noted, the substantive theory is the result of coding, categorization and analysis of data systematically collected for this study through: a survey and two semi-structured interviews rounds. It reflects the opinions of bank directors and executives, CB officials and auditors. As such it is ground in data obtained from the substantive area (EBS). Finally, as the substantive theory exemplifies a system of BCG reform, it captures some of the complexities of the real life and demonstrates the interaction and interplay between BCG reform and the banking environment that leads to the evolution of BCG practices within the EBS. The next section develops the substantive theory further through using NIST to analyze and consider the issues raised and embed it in an institutional, cultural and environmental context.

## 5 Neo-Institutional sociological theory (NIST)

NIST involves analysis of relationships between institutions and their environments (Sandhu, 2009). Scott (2001: xx) considered that NIST involved a continuation of open systems theory and goes beyond the institution under analysis and concentrates on the 'importance of the wider context or environment'. NIST emphasizes legitimacy and centrality of worldviews, routines, scripts and schema (DiMaggio and Powell, 1983; Meyer and Rowan, 1977) and focuses on the 'deeper and resilient aspects of social structure' (Scott 2005: 460). Meyer and Rowan (1977) stated that institutional adoption of formal structures takes place regardless of the efficiency notion. Fundamentally, NIST can be considered as a departure from interpretations of institutions based on the economic conceptions of rationality and efficiency (Mason et al., 2007).

Because of the behaviour constraining nature of institutions legitimacy is a central concept for NIST; institutions operate through 'defining legal, moral, and cultural boundaries setting off legitimate from illegitimate activities' (Scott 2001: 50). Legitimacy refers to 'a generalized perception or assumption that actions are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions' (Suchman, 1995: 574). Indeed, organizations actively seek legitimacy as they need more than 'material resources and technical information if they are to survive and thrive in their social environments. They also need social acceptability and credibility' (Scott et al., 2000). Furthermore, legitimacy may lead to better access to resources because stakeholders are more likely to provide their resources to legitimate rather illegitimate organizations (Parsons, 1960). Finally, legitimacy affects how people act towards organization and how they perceive them, as such 'audiences perceive the legitimate organizations not only as more worthy, but also as more meaningful, more predictable and more trustworthy' (Suchman, 1995: 575).

### 5.1 NIST and corporate governance

NIST has been used as a theoretical framework by a number of studies on corporate governance (Aguilera and Cuervo-Cazurra, 2004; Ben-Messaoud, 2002; Deo et al., 2007; Enrione et al., 2006; Khadaroo and Shaikh, 2007; Siddiquie, 2010; Yoshikawa et al., 2007; Zattoni and Cuomo, 2008). However, none developed a substantive theory then proceeded to use NIST for further analysis. This paper employs the notion of three institutional pillars (Scott, 1995; 2001). These pillars demonstrate 'different bases of order and compliance, varying mechanisms and logics, diverse empirical indicators, and alternative rationale for establishing legitimacy claims' (Scott,

2005a: 464). Moreover, each of the three pillars offers an ingredient for explaining institutions. Firstly, the regulative pillar gives priority to 'rule setting, monitoring and sanctioning activities' (Scott, 2005a: 52). This pillar utilizes coercion as its primary mechanism, here conformity with rules and laws seek legitimacy (Suchman, 1995). The second is based on 'normative rules that introduce a prescriptive, evaluative, and obligatory dimension in social life' and depends on values and norms as the basis of social obligation (Scott, 2001: 54). The third pillar focuses on the significance of culture as the 'shared conceptions that constitute the nature of social reality and frames through which meaning is made' (Scott, 2001:57). In this context, reality is constructed through interaction of individuals to create interpretations of what is going on in the surrounding environment (Scott, 2005b). This pillar explains how institutional structures and behaviour is shaped by cultural rules promoted within the external environment (Scott, 2005b). Here compliance of institutions with these cultural rules occurs because other types of behaviour cannot be understood (Scott, 2005b).

NIST provides a theoretical framework by which corporate governance phenomenon may be explored and useful for understanding issues such as corporate governance that is affected by the wider social environment (Scott, 2001). It can also be useful when examining the effects of an institution such as corporate governance on organizations within a particular field (Scott, 1987). NIST emphasizes how institutions are embedded in social structures and pays attention to legitimacy as the main reason of institutional change rather than the economic notions of rationality and efficiency (DiMaggio and Powell, 1983; Meyer and Rowan, 1977). Fundamentally, NIST is able to offer a non-traditional avenue for better understanding corporate governance which pays attention to the importance of power and its reflection on actor interests (Scott, 2001; Dillard et al., 2004; Mason et al., 2007; Powell, 2008). Indeed, the concept of power is central to corporate governance as it can be perceived as the 'exercise of power at the level of the corporate entity' (Tricker, 1997: 1). Indeed, legal, organizational, political and cultural factors affect BCG practices of various banking organizations. As such, from a NIST point of view, banking organizations can be analysed from an open system perspective, where their BCG practices are indeed, affected by 'the wider context or environment' (Scott, 2001: xx). Also this agrees with the argument that corporate governance is a social phenomenon that is affected by the institutional and social contexts in which it is embedded and based on non-economic factors such as culture, politics and legal aspects (Ardalan, 2007). Moreover, the institutional context includes human factors (Zingales, 2004). Here, the substantive theory acknowledges that banking organizations seen as firms are composed of



human beings as such directors and executives' competence has an influential impact on BCG practices. The substantive theory sees BCG practices as evolving and in continuous interplay with the environment, this also agrees with the social view of corporate governance that acknowledge that any corporate governance system will continue to evolve (Ardalan, 2007).

## **5.2 Egyptian banking corporate governance: substantive theory and NIST**

According to the substantive theory BCG reform involves a process initiated due to the pressures exerted primarily by the CBE (Regulator). This said, other pressure groups indirectly influence this process such as international organization (World Bank and Basel committee on banking supervision); however these groups are only secondary and do not have the same power as the CBE. At the same time BCG reform is intended to serve and protect particular interests namely: depositors, shareholders, and the regulator. So the substantive theory is about the relative power of particular groups and how they protect their respective interests. Within the context of NIST, the BCG reform process can be considered as an institutionalization process, because 'institutionalization is a political process, and the success of the process and the form it takes depends on the relative power of the actors who strive to steer it' (Powell, 2008: 5). Indeed, the most powerful actors in the process of BCG are the CBE (as the regulator of the banking sector) and shareholders. The power base of the CBE is founded on coercive power and the authority this institution has on various banks. Shareholder power is based on ownership and the high concentration ratio in most of banks, thus shareholders are a powerful actor within this process. In relation to BCG depositor power is opaque however, the CBE protect these interests to achieve its overriding objective of maintaining the soundness and safety of the EBS and avoidance corporate governance related bank failures.

In addition, the substantive theory indicates that the Egyptian BCG reform process has been initiated on the basis of a regulative pillar that involves corporate governance related regulations issued by the CBE. It must be noted that the regulative pillar is accompanied with an informal structure or normative framework that entails obeying the CBE (where all banks agree that the interests of the CBE must be served at all times, indicating that obeying the commands is a binding expectation). This pillar utilizes coercive pressure on banks to comply with related BCG rules and regulations as well as normative pressures. From a NIST perspective this involves a situation where coercive power is legitimated by a normative framework (second pillar). NIST also proposes that the institutionalization process based on the regulative pillar is carried

through symbolic routines and carriers (Scott, 2001). This is commensurable in the substantive theory where BCG rules and regulations included in the banking law 88/2003 as well as the CBE directives represent symbolic carriers. Symbolic carriers denotes 'uniformity and ... consistency of action' (Scott, 2001: 78), which is compliant with BCG rules and regulations; they employ the third pillar of culture and shared ideas. The coercive power associated with these rules and regulations represent relational system carriers. Finally, the CBE enacts two types of routines to scrutinize and verify the compliance of banks with BCG rules and regulations. These routines are the supervision function (on-site and off-site examination) and the external auditing function implemented by auditing firms. Here routines are attempts by the CBE to use various actors to 'formalize processes for checking suitability of governance activity' (Mason et al., 2007: 294).

The substantive theory also indicated that compliance with the BCG rules and regulations is based on seeking pragmatic legitimacy which involved 'self-interested calculations' (Suchman, 1995:578). Pragmatic legitimacy must be perceived as appropriate by the CBE and shareholders and here entails adopting BCG requirements imposed by the CBE. Legitimacy is a principal framework governing banks and identifies the BCG adherence to a regulative pillar. Fundamentally, the substantive theory has indicated that even though normative pressures from the Egyptian Banking Institute (EBI), the Egyptian Institute of directors (EIOD) and international organizations exist the impact of these pressures is not strong enough to initiate change. The substantive theory indicated that the culture of corporate governance within the EBS is at its early stages of formation and that this requires deinstitutionalization of the rejection of corporate governance culture as well as the secrecy culture. Indeed the study acknowledges that this change involves a long term process. However, the NIST acknowledges that institutions and environments can be shaped by different combinations of the regulative, normative and cultural elements that vary from one context to overtime (Powell, 2008). Although currently the regulative element is salient, normative and culture-cognitive components may play a role over the long-term.

BCG reform indicates the institutionalization process within the EBS which is currently based on a regulative aspect. Indeed, institutionalization especially from a social constructivism point of view indicates a process 'by which organizational policies become instilled with value and ultimately taken for granted among external constituents' (Zajac and Westphal, 2004: 440). It entails a 'reciprocal typification of habitualized actions by types of actors (Berger and Luckmann, 1967: 72). However, institutionalization happens to organizations overtime and 'infuse with value beyond technical requirements

of tasks' (Selznick, 1957). This process proceeds till something is institutionalized, this occurs only 'when it is unquestioned and taken for granted' (Hasselbladh and Kallinkos, 2000; Sandhue, 2009:82).

As the substantive theory indicates, the institutionalization of BCG is now derived by a regulative pillar and legitimacy which is based on coercive mechanisms. However, normative pressures do exist, and with greater efforts from professional bodies such as EBI and the EIOD, overtime BCG practices may be adopted by the logic of appropriateness. This can occur because 'professional training institutions are important centres for the development of organizational norms among professional managers and their staff' (DiMaggio and Powell, 1983: 152). Such leads toward isomorphism and the adoption of BCG due to normative pressures. Overtime the wide spread of adoption of BCG practices will be taken for granted within the culture-cognitive institutional structure. Only then will BCG be considered fully institutionalized (Suchman, 1995). This incorporates a type of legitimacy that is neither based on serving particular interests but as an evaluation related to duty and doing the right thing. It is based on 'necessary or ... based on some taken-for-granted cultural account' (Suchman, 1995:582). This type legitimacy reflects 'preconscious standards' related to how organizational activities should be performed (Mason et al., 2007: 293).

The substantive theory developed here also indicated that banking organizations based their corporate governance identity on a compliance or avoidance strategy (by disguising non-compliance tactics) (Oliver, 1991). Organizational responses to external pressures are an important aspect of NIST. Here the substantive theory has shown how some banking organizations adopt arising BCG requirements by real compliance, while other banks comply by appearance only or on 'ceremonial basis' (Meyer and Rowan, 1977). Banks disguising non-compliance do so because they too seek legitimacy, but they have internal organizational characteristics that hinder implementation and are more susceptible to external obstacles. Moreover, as a result of the CBE coercive pressures as well as the EBI and EIOD increasing normative pressures banks will either comply or move to another strategic choice such as 'defiance' which involves openly challenging or lobbying to influence the environment and make it more amenable for their needs (Fiss, 2008). As Carruthers (1995:324) identified 'organizations play an active role in constructing rationalized myths, playing them off against each other, or shaping how they are applied in particular instances, organizations are not only granted legitimacy; sometimes they go out and get it'.

Therefore, the substantive theory can be explained within the NIST framework, but not on the traditional basis of homogeneity of organizational responses, rather on the basis of accepting that

organizations respond to institutional pressures in different ways through various strategies such as acquiesce, compromise, avoid, defy and manipulate (Oliver, 1991: 152). Overall, NIST offers a means of accounting for environmental factors and institutional change relating to the substantive theory.

## 6 Conclusions

Through a grounded theory study of corporate governance of the EBS, this paper has built a substantive theory that identified the drivers for change in Egyptian BCG. The substantive theory also accounted for contextual factors in which the BCG phenomenon is embedded including; management control, competence of board members and employees and organizational perception of corporate governance as well as the legal and regulatory frameworks. It also identified obstacles to corporate governance reform in terms of board of director ineffectiveness, short-termism and immature corporate governance culture in banks. Finally, the substantive theory accounted for the processes for dealing with BCG reform; that is, actions / interactions between banks and CBE. Indeed, the substantive theory identified the outcome of interaction between the structure and processes that lead to the evolution of BCG practices as well as enhanced legitimacy of banks and perceived better protection of stakeholder interests.

Subsequently, NIST was utilized to further explore the substantive theory. This further substantiated that corporate governance involved a social phenomenon that is affected by its environmental context as well as legal, organizational, political and cultural aspects i.e. it is socially constructed. Corporate governance practices evolve and continuously interact with the surrounding environment. Moreover, corporate governance reform involves a process of institutionalization derived from the regulative and normative pillars with the objective of achieving legitimacy. Unlike both shareholder and stakeholder models the substantive theory posits that banks adopt corporate governance practices seeking legitimacy regardless of efficiency. Further assessment of the substantive theory through NIST identifies that Egyptian corporate governance phenomenon involves a social process, embedded and attached to the institutional context; the phenomenon is affected by non-economic factors which incorporates legal, regulatory, human, organizational and cultural factors. Consequently, corporate governance is dynamic and continuously evolving. Organizational responses cannot be regimental because internal characteristics of the affect how corporate governance structures are affected by institutional pressures.

This paper attempted to further corporate governance theorizing and used NIST to explain the heterogeneity of organizational responses to

institutional and environmental pressures. Institutional explanation improves our understanding of the corporate governance phenomenon in general, and provides empirically evidence of the inability of the traditional corporate governance theorizing to capture the complex corporate governance phenomenon.

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