

# Enhancing the NILEX Growth in Egypt: A Study of the Relevant Laws and Regulations

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## Abstract

Access to finance for Egyptian companies through the stock market is hampered by the inadequate institutional, regulatory and legal frameworks. The paper discusses how the NILEX can serve as an alternative to bank lending which can be more attractive to issuers, and how the Egyptian institutions involved in the implementation of policies relating to SMEs can cooperate, not only to encourage firms to be listed on the SMEs exchange, but also to develop simple project ideas into success stories. It studies the capital markets laws and legislation and presents the pitfalls in the regulations and supervision processes that have resulted in a limited number of IPOs, a narrow investors' base, unmaturing equity culture, poor quality of companies, weak supervision and illiquidity. Finally, the paper explains how the NILEX can be rescued by tailoring the appropriate regulations and legislations and illustrates how the careful design of such regulations can be intended to meet only its very particular needs.

## Keywords

Small and medium enterprises; SME; capital markets; listing requirements; legal reform

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**Table of Contents**

<b>Introduction .....</b>	<b>102</b>
1. Overview of NILEX.....	103
1.1 Importance, legal structure, and performance in the market .....	103
1.2 The relationship between NILEX and other relevant regulatory entities .....	105
1.2.1 The Financial Regulatory Authority .....	105
1.2.2 The Micro, Small and Medium Enterprise Development Agency (MSMEDA).....	106
2. The NILEX rules, regulations and working mechanisms.....	107
2.1 Listing requirements.....	107
2.1.1 General provisions .....	107
2.1.2 Listing requirements for SMEs.....	107
2.2 Disclosure and governance requirements .....	109
2.3 The nominated advisor role.....	110
2.4 Annual listing fees.....	110
2.5 Listing requirements for foreign companies.....	111
3. Recommended policies towards promoting the NILEX growth .....	111
<b>Conclusion.....</b>	<b>115</b>

## Introduction

In 2004, Egypt recognized the importance of SMEs, and accordingly, Egypt Law No. 141/2004 on the Small Enterprises Development Law was promulgated. On the 15 July 2020, Egypt enacted the new MSMEs Development Law under Egypt Law No. 152/2020. Egypt Law No. 152/2020 deals with Micro, Small, and Midsize Enterprises (MSMEs), as well as Entrepreneurships. It discusses crucial matters related to Informal Economy Projects (IEPs).

Egypt Law No. 152/2020 defines medium-sized enterprises with an annual business volume of EGP 50 million and not exceeding EGP 200 million, or every newly established industrial project which has paid-up capital or invested capital of EGP 5 million and does not exceed EGP 15 million, or every newly non-industrial project incorporation paid-up capital or the invested capital of which, according to the circumstances, is EGP 3 million and does not exceed EGP 5 million. Egypt Law No. 152/2020 also defines small enterprises with annual business volume of EGP 1 million and less than EGP 50 million, or every newly established industrial project with paid-up capital or invested capital between EGP 50,000 and less than EGP 5 million, or every newly established non-industrial project with paid-up capital or invested capital, between EGP 50,000 and less than EGP 3 million. A micro-project is any project with an annual business volume of less than EGP 1 million or every newly established project whose paid-up capital or invested capital is less than EGP 50,000.

SMEs are considered a priority for the development and growth plan for emerging economies. Ayadi and Gadi noted the difficulty SMEs encounter in obtaining credit compared to larger firms due to the lack of quality collateral and credit worthiness.<sup>1</sup> On the other hand, the credit provided to microfinance institutions is inadequate and unable to meet the capital requirements of SMEs.<sup>2</sup> Consequently, SME Exchanges have emerged to serve as an alternative to banks' lending. Exchanges will provide equity financing for small enterprises that cannot fulfil the exchange requirements listed in the main stock exchanges.

Despite Egypt's efforts to enhance the doing business, SMEs in Egypt still struggle to access finance. Given the numerous studies that show the significant contributions of small local firms as a field of strategic interest to the economy, Egypt must give more attention to encourage small and medium-sized enterprises.

Peter Drucker said in respect of SMEs that 'small businesses represent the main catalyst of economic growth' and that they constitute the backbone of social, economic development.<sup>3</sup> The importance of SMEs is based on the critical role they have in the growth of the economies.<sup>4</sup> According to Dalberg Global Development Advisors, small businesses represent a fundamental part of the economic fabric in developing countries.<sup>5</sup> They play a critical role in furthering growth, innovation, and prosperity in any economy.<sup>6</sup>

In Egypt, SMEs constitute a big part of large national plans. They would help solve the overpopulation problem and the relative scarcity of resources by increasing the inhabited space, consequently reshaping the nature of the economic and social formation in Egypt.

SMEs still face several challenges. Constraints include for example, transportation, conditions of electrical and water connections, internet access, and others,<sup>7</sup> insufficient supply of some essential services like transport, and utilities,<sup>8</sup> high importation tariffs on raw materials, and competition. However, the biggest challenge is access to finance. For instance, Ayyagari, Demirgüç-Kunt, and Maksimovic's work showed that

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<sup>1</sup> Peter F. Drucker (2009), *Innovation and Entrepreneurship: Practice and Principles*, New York HarperCollins Publishers Inc.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid.*

<sup>4</sup> Feeney, L. and Riding, A. (1997), *Business Owners' Fundamental Tradeoff: Finance and the Vicious Circle of Growth and Control. Canadian Business Owner*.

<sup>5</sup> Barbara Johnson, Reichard Angelous Kotey (2009), *The Influence of Small and Medium Enterprises (SMEs) Listing on the Ghana Alternative Market (GAX): Prevailing Factors*.

<sup>6</sup> Dalberg Global Development Advisors (2011), *Report on Support to SMEs in Developing Countries Through Financial Intermediaries*, Geneva.

<sup>7</sup> ChandraiahM, and Vani R. (2014), *The prospect and problems of MSMEs sector in India an analytical study*, International journal of Business and Management Invention, vol.3 Issue 8, p.27 -403.

<sup>8</sup> Nicolescu, O., *Managementul Intreprinderilor mici si mijlocii, Editura Economica*, Bucharest (2001).

finance represents the most constraining obstacle to firm growth.<sup>9</sup> Shinozaki further identifies a gap between the demand for SME finance and its supply.<sup>10</sup>

Nevertheless, other constraints include gaps in the financial system, such as high administrative costs, lack of experience within financial intermediaries, and high collateral requirements.<sup>11</sup>

In Egypt, the burden of obtaining finance, primarily through bank loans, has been reduced due to the Central Bank initiative that aimed at facilitating access to bank financing for MSMEs.<sup>12</sup> However, SMEs in Egypt continue to be plagued by the long, complex, and very bureaucratic administrative aspect of the lending process. Some SMEs have reported that the amount of forms required is very excessive and hard to fulfil.

This research addresses how the NILEX can serve as an attractive alternative method to access to finance instead of bank lending for issuers. The paper also explains how Egyptian institutions involved in the implementation of SME policies can cooperate not only to encourage firms to be listed on the SME exchange but also to boost the firm's growth to become a significant global competing corporation listed on the mainboard.

## 1. Overview of NILEX

### 1.1 Importance, legal structure, and performance in the market

An SME Exchange is a market created to trade securities of SMEs that are too small to be listed on the main board. SME Exchanges help small enterprises to get credit to facilitate their investments and growth to contribute towards job creation and economic development by being listed as a public company.

Companies may list on an exchange for several financial and non-financial reasons. A report from the Milken Institute Centre for Financial Markets showed that Bombay Stock Exchange (BSE) firms get listed to improve their access to finance, directly and indirectly. In contrast, SMEs in South Africa and Jamaica are most strongly motivated to get listed to position themselves for higher growth and visibility. South African firms were especially encouraged to be listed for reasons other than raising new capital; they mostly wanted to provide exit opportunities for early investors.<sup>13</sup>

While most SMEs list to obtain financing, many others list to increase their visibility, advertise their products, and gain credibility. Some SME exchanges have a particular focus, such as technology or high growth companies, so SMEs win customer recognition by being listed. The 'JSE AltX'<sup>14</sup> and 'WSE NewConnect'<sup>15</sup> highlight these as drivers for listings by SMEs on their exchanges.<sup>16</sup>

Moreover, listed companies understand that they will be able to get funds from other sources more easily compared to their similar unlisted firms upon listing, because the listing process demands firms meet strict financial reporting and corporate governance requirements. By applying those standards, firms improve their accounting practices and financial management, increasing their transparency, credit rating, and creditworthiness. Moreover, by decreasing their leverage ratios consequently, firms can obtain credit on more favourable terms. As a result, the listing will encourage firms to grow, develop and create jobs, thereby

<sup>9</sup> Ayyagari, Meghana, Asli Demirgüç-Kunt & Vojislav Maksimovic (2008), 'How important are Financing Constraints? The role of finance in the business environment', World Bank Economic Review 22(3), 483-516.

<sup>10</sup> Shinozaki (2014), 'Capital market financing for SMEs: A growing need in emerging Asia', Working paper series on Regional Economic Integration, Asian Development Bank, Issue 121.

<sup>11</sup> Dalberg (2011), op. cit.

<sup>12</sup> Central Bank of Egypt (2016), *Economic Review*, Vol. 57 No. 2.

<sup>13</sup> Jacqueline Irving, John Schellhase, & Jim Woodsome (2017), 'Can Stock Exchanges Support the Growth of Small and Medium-Sized Enterprises? Lessons from India, South Africa, and Jamaica', Milken Institute Center for Financial Markets.

<sup>14</sup> AltX, the alternative exchange, is a division of the JSE Limited in South Africa. AltX is a parallel market focused on small and medium sized companies.

<sup>15</sup> NewConnect is an organized market; it is operated by the Warsaw Stock Exchange outside the regulated market as an alternative trading system for financing the growth of young companies

<sup>16</sup> Alison Harwood & Tanya Konidaris (2015) op. cit.

emphasising the relationship between stock market development and economic growth, especially in developing economies, within which economies consider SMEs to be the most significant contributor to employment and economic fundamentals. Peterhoff et al. estimated that increasing SME access to capital markets financing could increase SMEs' contributions to the GDP by 0.1 to 0.2% and generate hundreds of thousands of new jobs.<sup>17</sup>

Throughout the world, exchanges only dedicated to SMEs have become a common phenomenon. They are known as 'Alternate Investment Markets (AIM),' 'Growth Enterprises Market (GEM),' or 'Alternative stock markets.' Nevertheless, emerging market economies observed a difficult challenge in the development of SME exchanges given the small sizes of SMEs. However, some have been very successful. Some of the most successful include GreTai Securities Market' in Taipei and 'Warsaw Stock Exchange (WSE), Hong Kong's Growth Enterprises Market (GEMS), and Japan's Market High-growth and Emerging Stocks. Believing in the vital role of the SME exchange in providing funds, increasing the corporate governance and creditworthiness of the listed SMEs promotes the idea that equity financing must be an attractive potential source for SMEs' existence and growth.<sup>18</sup>

SME exchanges can be a separate board or market housed under the primary market. Examples include the 'Korea Exchange (KRX)', which has a very successful and dedicated SME market (KOSDAQ), the 'Bombay Stock Exchange (BSE)' which established its SME platform in 2012, and the 'Euronext' which established SME market, 'Alternext,' in 2005.

SME exchanges can also be a part of the mainboard. An example is the 'Australian Securities Exchange (ASX),' which doesn't have a separate SME board. The rules only change according to the company's size.

Finally, SME exchanges can be stand-alone markets, such as the 'GreTai Securities Market,' one of the very few SME exchanges that is not linked to the Taiwan Stock Exchange. However, such structure will not motivate SMEs to graduate to the main market, given that it will leave this exchange and become listed on a completely different one.

In Egypt, on 3 June 2010, trading started to be executed in a new sub-market established for companies from any country or industrial sector with issued capital of less than EGP 50 million. That is the NILEX – the Egyptian SME exchange, the first market in the Middle East and North Africa region for the listing and trading of small and medium-sized companies. This market is subject to the same trading rules as the main market. However, only the listing requirements differ.<sup>19</sup> In 2010, NILEX market recorded a trading value of EGP 199 million and reached a market capitalization of more than EGP 1 billion at the end of the year.<sup>20</sup>

In early 2014, the EGX has introduced the Nile Index to increase the investors' interest in this sub-market. The number of listed companies reached 33 companies at the end of 2014, with nine new companies getting listed in 2014, which is one of the highest records attained since the launching of NILEX.<sup>21</sup>

In 2015, the number of listed companies decreased to 31 companies. However, the total market capitalisation reached EGP 1 billion by the end of the year 2015 similar to 2010 five years previously. Consequently, Egypt took steps to promote the NILEX, such as the signing of an MOU with the General Authority for Investment (GAFI) to promote the role of NILEX and raise awareness, especially in Upper Egypt. Furthermore, the Egyptian Stock Exchange signed an agreement with the American University in Cairo to help develop the SMEs' capabilities and access to finance.<sup>22</sup>

In 2016, three new companies got listed, so that the total number of listed companies reached 32 companies. Additionally, EGX continued its efforts in promoting the NILEX through establishing meetings with promising companies and conducting workshops with related working organizations, such as the Rotary Club

<sup>17</sup> Daniela Peterhoff, et. al. (2014), 'Towards better capital markets solutions for SME financing', Oliver Wyma.

<sup>18</sup> Alison Harwood & Tanya Konidaris (2015) op. cit.

<sup>19</sup> Oxford Business Group, 'The Report Egypt 2014', Oxford Business Group.

<sup>20</sup> Research & Markets Development Dept. (2010) Annual Report. The Egyptian Exchange (EGX).

<sup>21</sup> Research & Markets Development Dept. (2014) Annual Report. The Egyptian Exchange (EGX).

<sup>22</sup> Research & Markets Development Dept. (2015) Annual Report. The Egyptian Exchange (EGX).

and Egyptian Women Association, to raise their awareness and to encourage women to have access to finance through NILEX.<sup>23</sup>

In 2017, the value traded reached EGP 677 million compared to EGP 894 million in 2016 and the total market capitalisation reached EGP 1.2 billion.<sup>24</sup>

In 2018, in cooperation with the European Bank for Reconstruction and Development (EBRD), workshops were held to develop the capacity of NILEX listed companies.<sup>25</sup> In the third quarter of 2019, the value traded reached EGP 230 million with a market capitalization of EGP 1.2 billion with around 31 listed companies.<sup>26</sup> In the fourth quarter of 2019, the value traded decreased to EGP 151.5 million.<sup>27</sup>

EGX was keen to develop its SME platform in 2020 in cooperation with the European Bank for Reconstruction and Development (EBRD) and assigned experts from Madrid Stock Exchange (BME). Based on this, the Egyptian Exchange (EGX) launched its program for the restructuring of the SME market. Restructuring steps are as follows: filtering nominated advisors, raising listed companies' capabilities, marketing and promotional activities and communicating with investment banks to boost liquidity. The total value of trading during 2020 reached EGP1.3 billion.<sup>28</sup>

In the second quarter of 2021, the NILEX trade value decreased by 27% compared to the first quarter of 2021.<sup>29</sup> The above figures and data show that development of NILEX is very slow. Consequently, investors do not make profits from their investment, and some can no longer even exist the market. Therefore, the NILEX reputation has been badly affected, making investors very reluctant to put their money in this market. This warning alarm cannot be ignored; actions must be taken, reforms must be made, and amendments must be drafted to develop and promote this market. This market is essential not only for SMEs but also for the entire economy.

## 1.2 The relationship between NILEX and other relevant regulatory entities

### 1.2.1 The Financial Regulatory Authority

The issuance of Egypt Law No. 10/2009 introduced the Egyptian Financial Supervisory Authority, which replaces the Egyptian Insurance Supervisory Authority, the Capital Market Authority, and the Mortgage Finance Authority in enforcing Egypt Law No. 10/1981, Egypt Law No. 95/1992, and Egypt Law No. 148/2001, respectively as well as any other related laws and decrees that are part of the mandates of the above authorities.<sup>30</sup>

The authority mainly aims at regulating and supervising the non-banking financial market activities by establishing systems and issuing policies to promote the efficiency of the market and to guarantee transparency to protect the investors and the entire network of participants in this market. Furthermore, the authority ensures the continuous development of the non-banking financial industry, improves its soundness and promotes an enabling environment for a fair, competitive, and attractive financial system that allows firms, especially SMEs, to operate on a more significant scale.

The Financial Regulatory Authority shall encourage firms to transfer their start up project ideas to employment opportunities that will no doubt serve the developmental objectives in Egypt.<sup>31</sup>

<sup>23</sup> Research & Markets Development Dept. (2016) Annual Report. The Egyptian Exchange (EGX).

<sup>24</sup> Research & Markets Development Dept. (2017) Annual Report. The Egyptian Exchange (EGX).

<sup>25</sup> Research & Markets Development Dept. (2018) Annual Report. The Egyptian Exchange (EGX).

<sup>26</sup> Research & Markets Development Dept. (2019) EGX Quarterly Report 1/7/2019 – 30/9/2019. The Egyptian Exchange (EGX).

<sup>27</sup> Research & Markets Development Dept. (2019) EGX Quarterly Report 1/10/2019 – 31/12/2019. The Egyptian Exchange (EGX).

<sup>28</sup> Research & Markets Development Dept. (2020) Annual Report. The Egyptian Exchange (EGX).

<sup>29</sup> Research & Markets Development Dept. (2021) EGX Quarterly Report 1/4/2021 – 30/6/2021. The Egyptian Exchange (EGX).

<sup>30</sup> About the Financial Regulatory Authority – FRA retrieved from [http://www.fra.gov.eg/content/efsa\\_en/efsa\\_pages\\_en/main\\_efsa\\_page\\_en.htm](http://www.fra.gov.eg/content/efsa_en/efsa_pages_en/main_efsa_page_en.htm).

<sup>31</sup> Sahar Naser (2007), 'Access to Finance and Economic Growth in Egypt', Middle East and North African Region World Bank 41305.

In November 2017, the Egyptian Financial Supervisory Authority announced that it had changed its English-language name to Financial Regulatory Authority (FRA). Only the name has been modified, but still it has future ambitions to achieve its aims .

### 1.2.2 *The Micro, Small and Medium Enterprise Development Agency (MSMEDA)*

The MSMEDA was established by Egypt Prime Minister Decree No. 947/2017 and amended by Egypt Decree No. 2370/2018 to be directly affiliated to the Prime Minister. The MSMEDA has replaced the Social Fund for Development established in 1991<sup>32</sup>, and subsequently Egypt issued Egypt Law 152/2020.

MSMEDA mainly aims to set general policies and strategies to develop projects in all sectors of the economy. Therefore, the MSMEDA must cooperate and coordinate with all relevant Ministries, related agencies, and independent regulatory bodies, notably the Central Bank and the Financial Regulatory Authority, to ensure effective implementation of public policies and action plans of the MSMEs. Moreover, the agency has the right to express its opinion on drafted laws and regulations in the areas that relate to its work fields.<sup>33</sup>

The MSMEDA is concerned with the development of medium, small and micro enterprises and entrepreneurship, either directly or through coordinating the efforts of all agencies, NGOs, and initiatives working in the field of those projects or through the companies that establish or contribute to it. The role of the agency is not limited to funding only. Still, it also helps in marketing the products of the MSMEs, developing the capabilities and skills of human resources working in these projects, along with developing MSMEs' capabilities in the field of research, innovation, development, and in preparing feasibility studies. MSMEDA works on encouraging small and medium enterprises to export their products abroad by providing incentives and financing opportunities to participate in exhibitions abroad.<sup>34</sup>

Accordingly, the agency works through several axes. The first axis is a house of expertise and a knowledge centre for projects to develop policies, strategies, enhance coordination, and impact assessment. The second axis is the business environment; it works to provide a supportive work environment that facilitates the implementation of legal, legislative and regulatory reforms for project growth and contributes to improving the standards of living. The third axis is project development, aiming to enhance competitiveness and connections between projects, whether directly or indirectly.

To further emphasise the MSMEDA's role in developing the human resources who are responsible for the MSMEs' success in the first place, some entities were integrated into the agency, such as the Industrial Training Council, which is related to the Ministry of Commerce and Industry. That council has been fully integrated into the agency, mainly providing technical and crafts training, entrepreneurship, and training for operation. Nevertheless, all the initiations announced by the MSMEDA were targeting training for project establishments. Still, none of them influenced pre-existing listed SMEs that suffered from a lack of efficient management that could cause losses and, accordingly, bankruptcy. In reference to the agency's announced role in helping projects through developing policies and strategies to facilitate its growth and improve its competitiveness and therefore promote its quality and survival, this emphasises the significance of the MSMEDA's impact on listed SMEs.

Consequently, the role of the MSMEDA is not only providing finance to the SMEs but also providing a supportive working environment and a project development strategy to help the project succeed and gradually move from being small to medium to a listed corporation in the main market. On the other hand, the FRA establishes regulations to supervise the listed SMEs to facilitate their access to finance through the stock exchange after fulfilling the listing requirements.

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<sup>32</sup> About the Agency MSMEDA retrieved from <http://www.msmeda.org.eg/AboutUs.html>

<sup>33</sup> Egypt Law No.152/2020.

<sup>34</sup> Moha Mohamed Al Shal, 'The Establishment of the Small and Medium Enterprises Agency', Institute of National Planning issue 18, 11/3/2017.

Therefore, cooperation between the FRA and the MSMEA is a must; such integration plays a vital, significant, and monumental role in the growth of not only NILEX's credibility and liquidity but also the entire SME industry.

## **2. The NILEX rules, regulations and working mechanisms**

### **2.1 Listing requirements**

Egypt has issued several requirements to facilitate the listing of SMEs in the exchange. The listing requirements in accordance with the latest amendments issued on 21 March 2021 are classified into two types of requirements. The general provisions that apply to both EGX and NILEX and specific rules that are applicable only to NILEX in terms of SMEs. A detailed distinction between these two types of rules is provided hereinafter.<sup>35</sup>

#### **2.1.1 General provisions**

For a primary listing to take place, the company must comply with the following.

The shares of the company must be deposited with the Ministry for Central Clearing, Depository and Registry (MCDR).

The company's authorised capital shall not exceed five times the issued capital and the articles of association shall not include any conditions or restrictions on the trading of securities without violating the regulations governing certain activities or specific geographic areas.<sup>36</sup>

Articles of incorporation of the issuing entity must stipulate the obligation to use the cumulative voting method in the appointment of the board members, which allows for proportional representation in the board of the issuing entity (if applicable).<sup>37</sup>

The company must develop a website to include financial statements and footnotes prior to the trading. The company must publish its financial statements, footnotes and the auditor's report annually on the website. It is forbidden to combine the position of the Chairman of the Board of Directors and the Managing Director or CEO of the company.<sup>38</sup>

In July 2021, the Egyptian Financial Regulatory Authority has issued Egypt Decree No. 17/2021, which states that female representation in the boards of directors of companies listed on the EGX and non-banking financial services companies should not go under 25%, or the board must be composed of at least two women.<sup>39</sup>

#### **2.1.2 Listing requirements for SMEs**

The company should present financial statements for the two fiscal years before the listing request. In case only one financial statement is issued for a full fiscal year, it shall submit a three year future business plan that includes the expected profits approved by the nominated advisor or a financial consultant accredited by FRA.<sup>40</sup>

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<sup>35</sup> Listing and Delisting Requirements in the Egyptian Stock Exchange, Capital Market Egypt Law No. 95/1992 on Capital Markets, in accordance with the amendments issued on 21 March 2021.

<sup>36</sup> *Ibid.*

<sup>37</sup> *Ibid.*

<sup>38</sup> *Ibid.*

<sup>39</sup> Egypt Decree No. 17/2021, FRA.

<sup>40</sup> Listing and Delisting Requirements in the Egyptian Stock Exchange, Capital Market Egypt Law No. 95/1992 on Capital Markets, in accordance with the amendments issued on 21 March 2021.



The shareholders' equity for the last annual financial statements or the periodical one before the listing request date should not be less than paid-in capital.

The listed shares should not be less than 25% of the total company's shares or a quarter of a thousand free floating capital and not less than 10% of the company's share. The number of shareholders should not be less than 100 shareholders.<sup>41</sup>

The number of issued shares should not be less than 100 thousand shares. taking into consideration that allotment of shares should be made as per the regulations to be set by the Exchange, to ensure that the offering is not fictitious.<sup>42</sup>

The percentage of free-floating shares shall not be less than 10% of the total company's shares, or 1/8 per thousand of the free market capital above 5% of the company's shares.<sup>43</sup>

The issued capital should be fully paid. The issued capital should not be less than 1 million EGP and not more than 100 million EGP, and less than 100 million EGP, as reported in the last annual or periodic financial statements. These statements must be accompanied by a comprehensive audit report drawn up by the company's auditor and approved by its general assembly.<sup>44</sup>

The percentage of retention of the founders and board members should not be less than 51% of their shares in the company's capital with a minimum of 25% of the shares issued and for not less than two fiscal years from the listing date.<sup>45</sup>

In accordance with the Executive Regulations of Egypt Law No. 95/1992 on Capital Markets, the authorised capital may be increased by decision of the extraordinary general assembly and upon the proposition of the board of directors or the partner or the managing partners in partnerships limited by shares. The board of directors or the managing partner(s), as the case may be, should include in their proposition regarding the increase of authorized capital, all the information related to the reasons for such an increase, and attach to it a report on the work progress of the company during the year in which such a proposition is presented, as well as the approved balance sheet of the preceding year. Attached to the board of directors' report shall be another report from the auditor affirming the accuracy of financial information included in the board of directors' report.<sup>46</sup>

Any company intending to issue securities should notify the FRA of such intention. If the FRA does not object within three weeks from the date of receiving such a notification, the company may proceed with issuing arrangements for such securities. The notification should include the share's value for the capital increase and the auditor's report thereon in accordance with the provisions of Article 17 of these Executive Regulations, if these shares are offered to someone other than company shareholders. It must also include the types of shares to be issued and the terms of their offering to the public, the distribution of shareholdings and whether the company is listed on the stock exchange as well as the type of schedule it is listed on, and the issue charges in case it is specified and the basis of their calculation. Finally, a certificate from the concerned administrative area notifying the payment of the legally required percentage of capital increase and a receipt of fees paid to the authority is required.<sup>47</sup>

Minimum shares to be held by the founders and board of directors and the company's major shareholders is 51% of the company's capital for a period of two fiscal years with a minimum of 25% of the required listed shares. In all conditions, the 25% is to be held for the next fiscal year, provided that the same retention conditions apply to any subsequent increase in the company's capital, except for the free shares' distributions.

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<sup>41</sup> *Ibid.*

<sup>42</sup> *Ibid.*

<sup>43</sup> *Ibid.*

<sup>44</sup> *Ibid.*

<sup>45</sup> *Ibid.*

<sup>46</sup> Executive Regulations of Egypt Law No. 95/1992 on Capital Markets.

<sup>47</sup> *Ibid.*

After the approval of the FRA and the general assembly, these shares can be transferred if the buyer was a bank, insurance company, direct investment fund or any specialised person or entity with previous experience in the company's activities, provided that they pledge to keep the shares until the end of the term.<sup>48</sup>

From the above requirements, when comparing the listing requirements of SMEs with the main market, distinct key parameters are capital, the number of shareholders, and the number of listed shares, which are the parameters that differentiate the two markets by definition.

Meanwhile, there was no reference as to whether SMEs with high growth forecasts but made net losses in their first year or two could be listed in the exchange or not. However, Egypt Law No. 95/1992 showed that companies presenting one-year financial statements must provide a three year future business plan that includes the expected profits. Consequently, firms operating in innovative sectors, mainly with intangible assets incurring high costs in their first years of operation, will not have their chance to be listed on the NILEX. SMEs that can be listed accordingly are the sufficiently institutionalised companies that can handle the adequate requirements demanded by the legislation. This is a minimal subset of SMEs.

As a result, tailoring the listing requirements is important to include a larger sector of SMEs in a way that motivates firms to be listed and at the same time preserves the market stability and investor protection considerations. The unfortunate consequence of the imprecise listing requirements that are not carefully studied is that companies will choose to switch the home market, opting to be listed in a global foreign market. The foreign market will help firms enjoy a faster admission procedure, more straightforward listing requirements, government subsidies, and a reduced administrative and procedural burden. As a result, NILEX now struggles with low listing, small market capitalisation, and illiquidity.

## 2.2 Disclosure and governance requirements

The main listing documents include legal documents proving the company's legal entity, documents associated with the listing request, and documents related to the financial status of the company. The prospectus must also include general data about the company, company's contact details, central depository and stock exchange listing details, board members and their participation data, the number of shareholders and the percentage of their equity participation, founders and shareholders who hold 1% or more and associated groups, the percentage of the free float, IPO data, shareholders who are offering their shares, equity positions in terms of data freezing, the name of the financial auditor and their data, a summary of the company's financial statements if any, and a summary of the last financial auditor's report if any. Additional disclosures can be included, if particularly the company had not published financial statements for at least one fiscal year. The legal representative, auditor, legal advisor and financial consultant should approve each page of the disclosure report.<sup>49</sup> The legal representative of the company shall submit the disclosure report before the commencement of trading after the approval of the authority to the listing department in the Egyptian exchange. An attachment must also be provided that proves its publication in newspapers (for companies other than SMEs) along with a copy of the fair value study, the auditor's report and the minutes of the competent authority. Lastly, a clearing company letter that includes the percentage of shares retained and any additional disclosures that need to be published is required.

For the shares of Egyptian companies (established through public or private subscription or subsequently offered by the company through a public or private offering which has been listed before issuance of financial statements for one financial year before the commencement of trading), they must submit the study conducted by an approved financial advisor registered in the FRA and publish it on the FRA website, as well as two official newspapers widely circulated within a week at most. SMEs shall publish this on the trading screens and the Egyptian exchange websites. For SMEs, dividends are announced (cash coupon, free stock, or dividend distribution) on the stock exchange trading screens and its website. In contrast, the main market companies publish their dividends distributions in two daily newspapers after being handed over to the Department of Disclosure in the exchange.

<sup>48</sup> Listing and Delisting Requirements in the Egyptian Stock Exchange, Capital Market Egypt Law No. 95/1992 on Capital Markets, in accordance with the amendments issued on 21 March 2021.

<sup>49</sup> *Ibid.*

All companies list on the Egyptian stock exchange face the same filing requirements for the quarter periodic disclosure report, the annual corporate disclosure report, the disclosure of decisions and minutes of the general assembly, the disclosure of board decisions, and material information. However, the existing literature supports the recommendations that SME boards should reduce the disclosure frequency rather than content.<sup>50</sup> Reducing the frequency would save costs to SMEs, and preserving the same content will make firms meet the corporate governance standards that increase their transparency and improve their management.

The unfortunate consequence of strict reporting requirements is that issuers may choose to delist themselves as the cost of listing exceeds its benefits. The data shows that the number of listed companies reached 33 companies at the end of 2014, and five years later, in 2019, there were only around 31 company listed in the NILEX.

Consequently, the NILEX is now suffering from illiquidity, and new IPOs are rare. As a result, only a few companies acquire the most significant percentage share of the total trading value with a weak daily turnover. To flourish the market initially, the benefits from SME listing must outweigh the costs. Then, the balance between adequate investor protection and affordable SME costs to access exchange markets must be attained. Furthermore, liquidity of the market must be the top priority for legislators and regulators.

### 2.3 The nominated advisor role

A contract should be signed with a certified nominated advisor who shall guide the company through the listing process, do the necessary research, and help the company follow the disclosure requirements for a period not less than two years from the listing date.

The EGX Chairman issued Resolution No. 918/2020 governing nominated advisors performance. The resolution commits nominated advisors management to have investor relations for the companies they consult, as well as their commitment to provide research coverage to boost the growth of listed companies as well as attract more investments to the market to enhance liquidity and stimulate trading. The European Bank for Reconstruction and Development (EBRD) register nominated advisors on its records, as well as develop a program for the capacity building of nominated advisors in matters related to rules of registration and disclosure and investor relations, accounting and financial issues.

### 2.4 Annual listing fees

Listing fees include annual listing fees paid according to Egypt Prime Minister Decree No. 2125/2018 and administrative fees to be paid according to EGX Board of Directors' decrees. Every listed issuing company should pay for publishing its financial statements on the EGX website according to the brackets of the company's listed capital, as follows:

- from EGP 5 million up to EGP 20 million = EGP 3,000;
- more than EGP 20 million and up to EGP 40 million = EGP 5,000;
- more than EGP 40 million and up to EGP 60 million = EGP 7,000; and
- more than EGP 60 million = EGP 10,000.

In case of capital increase, the company will be subject to the higher bracket of fees and hence should pay an additional fee representing the difference between the two brackets of fees for the remainder of the current year.<sup>51</sup>

<sup>50</sup> Jacqueline Irving, John Schellhase, & Jim Woodsom. *op. cit.* 7

<sup>51</sup> EGX Listing Fees, [https://www.egx.com.eg/en/Listing\\_fees.aspx](https://www.egx.com.eg/en/Listing_fees.aspx).

## 2.5 Listing requirements for foreign companies

In order to list foreign shares in the Egyptian stock exchange, the foreign company's shares should be listed in one of the international stock exchanges, subject to the jurisdiction of an authority that exercises the competencies executed by the FRA. If the foreign company has no shares listed abroad, it can list its shares in the Egyptian stock exchange only if 50% of its equity, assets and revenues were derived from a subsidiary Egyptian company. It also must present the consolidated financial statements for the two fiscal years before the listing request. After the listing, the company must present its financial statements according to the Egyptian accounting standards.<sup>52</sup>

Foreign SME's capital shall not be less than USD 10 million. In addition, foreign companies must have a legal representative in Egypt.<sup>53</sup>

## 3. Recommended policies towards promoting the NILEX growth

Egyptian companies' access to finance through the stock market is hampered by the inadequate institutional, regulatory, and legal frameworks. To reform the overall financial sector, attention must be paid not only to issuers and investors but to the entirety of market participants who constitute the tiny puzzle pieces of the larger picture, without which the accurate capital market reform picture cannot be seen. Such reform is essential to the NILEX and the growth and development of all micro, small and medium enterprises.

Accordingly, to flourish the market, issuers must understand the motives for listing and its benefits.<sup>54</sup> The disconnect and the absence of two-way and ongoing communications between policymakers and SMEs is the main reason that firms do not correctly perceive the different benefits they should expect from listing. Benefits include, among others, diversifying the investor base, easier access to other sources of finance compared to the unlisted firms, and higher growth and visibility.

Addressing the theoretical benefits of listing to the issuers by providing education and awareness campaigns must be done alongside implementing an overall SMEs capital market development strategy. Policymakers must develop such a strategy by studying the market conditions and communicating with the listed and unlisted SMEs to enhance the regulatory capacity and legal framework starting with the primary market.

In regards to the listing and delisting requirements in Egypt and its executive regulations, for a company to be listed in the Egyptian stock exchange, it must submit legal documents proving the company's legal entity, documents associated with the listing request, documents concerning the nomad, documents related to the financial status of the company and its prospectus, a financial advisor study of the fair value of the company, and the IPO prospectus.<sup>55</sup> Consequently, micro firms and start-ups are not suitable for being listed in this market because the costs are too high, and they will face difficulties coping with the ongoing listing requirements. By all means, allowing the listing of start-ups to in an emerging market is not an easy decision as the market must be deep enough to be able to face the failures that could result.

On the other hand, regulations that make all companies fulfil the exact listing requirements are not effective. One size fits all regulations are not fair for either market. Given that SMEs are small in size compared to the main market companies, a proportionate approach could better serve the SMEs,<sup>56</sup> taking into consideration the money and time that those companies cannot afford. Without forgetting the necessity of protecting the investor, a regulatory balance must be attained to decrease the issuance, legal, transaction, administrative and intermediary charges without reducing the prudent elements such as transparency, corporate governance, and disclosure. As a result, the NILEX listing requirements should be different from the main market to encourage issuers but not necessarily lower the protection offered to investors.

<sup>52</sup> Listing and Delisting Requirements in the Egyptian Stock Exchange, Capital Market Egypt Law No. 95/1992 on Capital Markets, in accordance with the amendments issued on 21 March 2021.

<sup>53</sup> *Ibid.*

<sup>54</sup> Jacqueline Irving, John Schellhase, & Jim Woodsom. op. cit. 7

<sup>55</sup> Listing Guide in NILEX Stock Exchange, The Egyptian Exchange retrieved from [www.NILEX.com.eg](http://www.NILEX.com.eg)

<sup>56</sup> OECD Report to G20 Finance Ministers and Central Bank Governors, 'Opportunities and Constraints of Market-Based Financing For SMEs', Submitted to the G20 IIRWG meeting in Berlin on 20-21 August 2015.

In this context, regulations should streamline the legal and listing procedures<sup>57</sup> to reduce the issuance costs while asking the issuer to provide more specific information to improve transparency. Legislation in Egypt concerning the details included in the legal documents associated with the listing request, the prospectus, and the financial advisor study of the company's fair value must be revised. In addition, the requested documentation regarding the estimated financial statements (five years) must be amended to do away with the five-year timeframe. Instead, legislation should define a list of types of information an issuer might need to disclose.

Moreover, policymakers should streamline any increased disclosure requirements by revising the regulations to develop a proportionate approach between the small and large listed firms regarding the disclosure frequency. Decreasing the reporting frequency will reduce some of the costs that companies find to be higher than they had estimated before going public. Regarding the financial reporting requirements mentioned in the listing and delisting executive legislations (Article 64 and 65), the exchange should publish a comprehensive summary for the annual and the periodic (quarterly) financial statements of the SMEs in addition to the footnotes, the auditor's report, the FRA remarks and the entire list of documentation required by the legislation on the Egyptian exchange's website. Consequently, making all these submissions quarterly decreases the issuers' incentives in the listing. Furthermore, this diminishes transparency in the market, as issuers lose interest in the quality of information submitted.

In this respect, the legislation needs to be more flexible to tailor the listing standards according to the quality of the firms being listed. Consequently, and to balance the costs for the issuer and the investor protection standards, legislation should allow that SMEs be audited on an annual basis and include the auditor's report in a publicly available yearly report. Concerning the periodical disclosures, SMEs should provide at least semi-annual updates on their performance, financial conditions, and a list of types of information clearly defined by the legislation to ensure that investors understand the quality, risk, and performance of the listed companies. Besides, any material information must be disclosed immediately. Getting the right regulatory balance is rather an art. Accordingly, the Egyptian legislation should revise the disclosure frequency, differentiate between the annual and quarter disclosures, and ask companies to submit a list of updates to ensure transparency and efficiency.

To enhance the public equity offering and encourage firms to be listed on the NILEX, the FRA should communicate with the market participants to find a way to reduce the transaction costs, the amount of time firms devote to consider listing and work on amending the listing procedures and disclosure frequency to decrease the unnecessary regulations. On the other hand, policy makers such as the FRA and the Ministry for Central Clearing, Depository, and Registry (MCDR) can review the fee structures of the exchange. Encouraging competition between underwriters and intermediary market participants could provide a healthier competitive environment with lower costs, improved efficiency, and more innovations.<sup>58</sup>

Following the public equity offering and to sustain the capacity to take SMEs public and through the secondary market, such operation needs to be supported by a healthy ecosystem. Such a system consists of investment banks, specialized banks, auditors, financial advisors, research analysts, sales, brokers, market makers, legal advisors, and others who support SMEs by enhancing market transparency and confidence.<sup>59</sup>

Moving forward to the secondary market and increasing the transparency and investor confidence to operate in a healthy ecosystem, policy makers should reform the financial reporting environment to improve the quality of the accounting and auditing regulatory framework and its enforcement. Investors in Egypt generally make their investment decision according to the company's reputation, its major stakeholders and qualitative factors due to the lack of confidence in the reporting quality.

Therefore, Egypt needs legal and institutional reforms integrated under legislation that comprehensively supervise and regulate the accounting and auditing practices. In this regard, there should be a supervisory

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<sup>57</sup> Sahar Naser. op. cit. 11

<sup>58</sup> Sahar Naser. op.cit. 11

<sup>59</sup> OECD Report to G20 Finance Ministers and Central Bank Governors. op. cit. 18.

body that monitors auditors' working practices and enforce disciplinary actions. Moreover, the Egyptian Accounting and Auditing Standards should be continuously updated to restore confidence. Finally, litigations must ensure auditors empowerment, independence, and professionalism, in addition to, setting the rules of confidentiality.

For SMEs to be listed on the NILEX according to Article 9 of the listing and delisting rules, firms must appoint a nominated advisor to guide the company for a period not less than two years through the listing process. In addition, the advisor is responsible for following up with the company's commitment to the listing and disclosure requirements and submitting the company's research coverage.<sup>60</sup>

Given the importance of the nominated advisor role in guiding the company to be listed, in addition to the critical role the advisor plays in helping SMEs to comply with the ongoing listing and disclosure requirements. The FRA must license the advisors in Egypt and yet they lack the needed the education and professionalism to complete their tasks thoroughly. Instead, advisors in Egypt bring too many poor-quality companies to market.

One of the main elements that stunt the development of the NILEX is the lack of high-quality data regarding the financial performance and track record of the listed companies. However, the availability of quality information can positively influence the behaviour of the issuer and investor on the market's overall condition. Therefore, it will facilitate listing for companies in the primary market and enormously enhance the secondary market's liquidity. Besides, Egypt suffers from a declining provision of equity research, which is the advisor's responsibility according to the legislation. Equity research assists investors in making informed investment choices, providing an evaluation of the attractiveness of an individual stock, industry, or market, and expected future performance.

According to the law, nominated advisors should assist firms in the listing and the ongoing listing requirements after the listing. They should appropriately assist SMEs to meet listing requirements, disclosure requirements, and governance requirements. Their role is to approve and prepare the information documents and provide a stamp of approval for an SME's suitability to access the market. Advisors should support successful companies to maintain their livelihood and reputation.<sup>61</sup> As a result, if the nominated advisor did the quality of work alluded to in the provisions of law, this would be reflected in improving the quality of listed firms, enhancing public awareness, increasing confidence, and promoting the market to institutional and foreign investors.

Advisors are essential to the Egyptian market, as the market is not mature enough. Consequently, policymakers should develop a capital market strategy that creates regulation against conflicts of interest between advisors and the SMEs they bring to the market. The company pays the advisor, and at the same time, the advisor is responsible for assessing their readiness for market and ongoing disclosure.<sup>62</sup> Regulations should vigorously supervise and regulate the nominated advisor and enforce disciplinary actions against any violation in which they can lose their licenses if they support too many unsuccessful companies.

The regulatory capacity in terms of regulating and supervising the advisors in Egypt is fragile. Consequently, the NILEX lacks the quality of well-regulated authorised advisors, which is the most important factor in any capital market without which the market will suffer from reluctant issuers and investors as well.

Another important factor that stimulates liquidity in the secondary market is the market maker. Unfortunately, the market maker legislation is not yet activated in Egypt. The inadequate regulations and legislations concerning market makers undermine the ecosystem. Market makers are the catalysts to the provision of liquidity, and driving them away will deprive the marketplace of liquidity, particularly for SMEs, given that those stocks are not easy to match and impede their price discovery.<sup>63</sup>

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<sup>60</sup> Listing and Delisting Requirements in the Egyptian Stock Exchange, Capital Market Egypt Law No. 95/1992 on Capital Markets, in accordance with the amendments issued on 21 March 2021.

<sup>61</sup> Alison Harwood & Tanya Konidaris, *op. cit.* 5

<sup>62</sup> *Ibid.*

<sup>63</sup> OECD Report to G20 Finance Ministers and Central Bank Governors. *op. cit.* 18

In their studies, Grose and Friedman pointed out that a weak secondary market is a key constraint on primary market activity.<sup>64</sup> Illiquid markets are not attractive to issuers or investors, as issuers will not find such markets an efficient source of capital. Issuers will therefore continue to search for bank financing.<sup>65</sup>

To protect the NILEX, regulations should strongly stipulate the prerequisites for an SME market, addressing the roles of the mandatory partners such as the auditors, advisors, and market makers. The supervision of their commitment to the laws and regulations is as necessary as defining their role appropriately in the legislation. An ICSA study on the financing of SMEs through the capital market confirms that a market-making system is instrumental for improving liquidity and that dedicated equity markets that have market advisors developed faster after introducing the market advisor system.<sup>66</sup>

Despite substantial efforts that Egypt exerts to develop the capital market in Egypt, unfortunately, the market still suffers from inadequate legal frameworks, weak regulatory and supervisory frameworks, and staff who do not have the proper skills to regulate and supervise the industry. As a result, SMEs have difficulties accessing the market and even more challenges in surviving in the market. These results are reflected in the investor base of the NILEX.

The Egyptian stock market lacks active domestic financial institutional investors. According to the EGX report summary of the 2018 market performance, domestic institutional investors accounted for 14% of the total transactions executed on the market. Egyptian retail accounted for 50%, foreign institutions for 30%, and foreign persons for 6%.<sup>67</sup>

Such data rings a loud alarm to policy makers in Egypt - why are domestic financial institutional investors investing in the market with such poor figures?

In this essence, policymakers should revise the investment constraints defined in legislation and investment policy statements of the domestic financial institutional investors, analyse the retail investors' investment behaviour and develop programs to promote the long-term holding of securities. Additionally, competition should be announced among brokerage firms while improving the supervisory framework.

Even if public markets are not suitable for all types of SMEs or investors, the promotion of a public SME market will help foster innovations and job creations, affecting not only the capital market but also the entire economy, welfare, employment rates, and standards of livings. Accordingly, governments and policymakers are required to promote public awareness.

SMEs face an educational gap due to their lack of awareness about the means of finance. Their limited information discourages seekers of finance and drives down the demand for capital market products. Moreover, they cannot market their projects effectively to garner adequate supply. Consequently, MSMEDA, EGX, and FRA must induce further participation of SMEs by bridging the educational gap, raising awareness of public financing options, and building the needed skills for SMEs to overcome this academic gap.

The Egyptian exchange along with the Financial Regulatory Authority within the overall capital market development strategy that the government must develop should enhance the equity culture of the public. Campaigns must be held to raise awareness regarding financial consumer protection explaining the risk of such instruments and the benefits of diversified saving portfolios.<sup>68</sup>

Considering the limited number of IPOs, the narrow investors' base, the lacking equity culture, the poor quality of companies, the weak supervision and illiquidity, the NILEX should be rescued by tailoring the

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<sup>64</sup> Grose, C., Friedman, F.B. (2006), *Promoting Access To Primary Equity Markets: A Legal And Regulatory Approach*, Policy Research, Dostupno na: [http:// dx.doi.org/10.1596/1813-9450-3892](http://dx.doi.org/10.1596/1813-9450-3892).

<sup>65</sup> Aljoša Šestanović (2016), *SME Stock Exchanges - Should They Have a Greater Role?*, University College EFFECTUS - College for Finance and Law, Vol. 4.

<sup>66</sup> ICSA Emerging Markets Committee (2013), *Financing of SMEs through Capital Markets in Emerging Market Countries*.

<sup>67</sup> Research & Markets Development Dept., 2018 Annual Report, The Egyptian Exchange (EGX)

<sup>68</sup> OECD Report to G20 Finance Ministers and Central Bank Governors. op. cit. 18

appropriate regulations and legislations designed carefully to meet only its very particular needs. One size fits all regulations and disclosure requirements can never be fair. Designing regulations is rather an art that needs focus and contemplation to be carefully designed as issuer friendly, while still comprehensive and strict to protect investors.

## **Conclusion**

The regulatory and supervisory system in Egypt should be aware of its critical role in delivering efficient financial services to the public. However, from the data analysis of the market performance, it was clear that the regulations and supervision in Egypt are facing difficulties in promoting a deep, efficient, liquid, and attractive market to the most critical industry in Egypt - the SMEs. Accordingly, a financial sector development strategy must be initiated to rescue the SMEs capital market by strengthening the capacity of the supervisory bodies, supporting the market infrastructure, encouraging research and easily accessible information. In addition to bridging the educational gap, we must also raise awareness of the capital market financing benefits and options. Moreover, the development strategy shall provide SMEs with the needed training and skills and promote the underdeveloped investor base. Furthermore, this will strive towards catalysing long term institutional and retail investor participation, streamlining the unnecessary regulations and legislation, and developing new regulations tailored specially to meet the SMEs' specific needs and conditions.

To provide such a broad and deep SMEs capital market, the efforts of all the interconnected parties involved in the SMEs financing environment must be coordinated to create financial stability in a healthy financial ecosystem, which is both a target and, at the same time, a reason for the market's growth and efficiency.

Although the Financial Regulatory Authority is making progress in developing several legislations and decrees to introduce new financial products and services to the market, further streamlining and more market-based measures targeting the NILEX are necessary to be considered in cooperation with the MSMDA.

Eventually, financial restructuring and institutional reform will enhance the benefits from the opportunities that could be achieved from the SMEs capital market. Such reform will ultimately be reflected not only in a well-functioning financial system but also in Egypt's economic growth and development.