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SMALL INDUSTRY IN THE EGYPTIAN ECONOMY

REPORT OF THE SMALL BUSINESS TEAM SURVEY

AS PART OF THE INTERAGENCY TASK FORCE

REVIEW OF U. S. ECONOMIC ASSISTANCE TO EGYPT

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## Introduction

As part of the Interagency Task Force review, a Small Business Team (SBT) consisting of 7 members (plus a representative from the Overseas Private Investment Corporation) was created for the purpose of conducting a survey of the private small industry sector in Egypt. 1/ The SBT visited Egypt from December 3-12, meeting with representatives from a number of political, financial, and industry organizations, including firms, for the purposes of determining the present state of the small industry sector, its opportunities and prospects for future development, and the problems which it currently faces. 2/ This report 3/ sets forth the observations and recommendations of this team.

The problem of size, or "how small is small?" poses some difficulty in the Egyptian context due to the diversity of private enterprises operating, and the degree of expertise and experience which they have. The members of the SBT were drawn from U.S. firms with sales of approximately \$10M. A firm of this size in Egypt would clearly be considered of medium size, or possibly even large-scale, depending upon the type of industry. For purposes of definition of the assignment, the figure of LE 150,000 in assets (exclusive of land and buildings) -- approximately \$215,000 at the parallel rate of exchange -- was used as a minimum. In most instances, this amount would accord with a realistic level of small industry operations in the country. Employment levels of such firms would be in the neighborhood of from 50-150, depending upon the technology being used and allowing for disguised unemployment.

The scope of private operations in some industrial lines, e.g., agribusiness or textiles, can be and often is considerably larger. Hence, team members surveying these areas were dealing with firms with assets or sales considerably in excess of this minimum figure. The order of magnitude of the surveyed firms, then, fell between \$200,000 and \$3M (and up to 500 employees). While those of larger size might be termed medium-scale, they are treated here as being at the top end of the scale of "small".

Members of the Team were requested to make recommendations consistent with expanding the contributions of the private small industry sector to the economic development of Egypt. The recommendations included in

- 1/ See Annex I for a list of the names and organizations of Team members.
- 2/ See Annex II for the Team agenda.
- 3/ This report was compiled by Dr. Delwin A. Roy, Consultant. In formulating the text of the report, Dr. Roy had at his disposal the written comments of each of the team members. In addition, a draft version of the report was formally reviewed by the Team members and their comments and suggestions incorporated in this final version.

this report are, therefore, not necessarily confined to support activities which the Agency for International Development, and other U.S. Government agencies, might choose to undertake to further the development prospects and growth of the small industry sector. Rather, the recommendations encompass a range of activities thought to be necessary for the growth of this sector, some of which it would be appropriate for USAID to pursue--either solely or in concert with other international donor organizations.

Finally, it should be stressed that while the Small Business Team believes that the present policies of the Government of Egypt are supportive of private small industry expansion, there are many difficulties yet to be overcome. An expanded role of private sector contribution to industrial development is envisaged by the government. However, the SBT wishes to note that the opportunities for expansion are not unlimited, and that developing the present, rather limited capabilities of the private small industry sector is a long-term proposition requiring major institutional changes. Hence, many of the recommendations included in this report are long term in character and intent.

#### I. Summary of Recommendations

To encourage the further development of the private small industry sector in Egypt, the U.S. Agency for International Development-sponsored Small Business Team makes a number of recommendations. As these recommendations involve both immediate and long-term considerations, they are organized accordingly:

##### Recommendations for Immediate Support Programs

1. Joint Ventures: Recognizing that the use of joint ventures as a means of developing the Egyptian small industry sector may have limitations, it is recommended that they be encouraged since they offer an opportunity for the potentially expeditious infusion of technology, management and production skills, and externally-originated investment funds into the Egyptian small business sector. The formulation of effective "pioneer project" incentives will be required in order to involve appropriate firms as joint venture partners. These incentives should include the provision of:

a. Feasibility study and pilot project funds for individual projects. Such funding is essential to the establishment of the first few, precedent-setting or "model" small business joint ventures.

b. Project loans (structured to recognize the real asset value of the respective partner commitments) sufficient to implement successfully small business joint ventures.

Small foreign firms often do not have the financial or managerial capacity to undertake joint ventures nor are they always interested in developing them. Therefore the Team does not wish to confine the encouragement of joint ventures on a "small-to-small" enterprise basis, but believes that medium-, and even large-, size foreign firms should be included in any program to promote the examination of Egyptian small industry opportunities.

2. Finance: Development of the small industry sector requires the availability of both equity (seed capital) and industrial credit funds. The present base of financial intermediation, while probably sufficient for the moment given the availability of sound and bankable small industry projects, will need to expand considerably in the future. The base is composed of a single government-owned industrial bank, the national commercial banks, and more recently, the foreign joint venture and offshore banks, and it is not well geared to the provision of term loans and venture capital. In the case of government banks, there is considerable disinterest on the part of the commercial banks in making term loans available to the private sector and, in the case of the industrial bank, inordinate delays are often involved in gaining access to funds. It is recommended that sources of new funds for industrial credit, and ultimately, equity--both local and foreign currency--be established and made available on terms less conservative (in terms of risk evaluation) than those currently being offered. Coupled with a program of limited investment guarantee, such funds can be channeled effectively through existing financial institutions.

3. Income Tax Reform: The present corporate income tax policies of the Egyptian Government as presently constructed act as a disincentive to private investment. The basic tax rate of 41.5% is supplemented with an excess profits provision, the basis of calculation of which has not changed in the past decade. While it is possible to escape some of these taxes by allocating private assets to different family members, the net effect is to produce disincentive and an inefficient system of private corporate taxation. It is recommended that the U.S. Government seek to encourage the Egyptian Government to revamp the present tax policies as they apply to the private sector.

4. Raw Materials Shortage: As many small businesses in Egypt continue to rely on the public sector for their raw materials, production and managerial inefficiencies of this sector create serious materials shortages. In some instances (e.g., textiles), private businesses are precluded by law from producing their own raw materials (i.e., from vertically integrating their operations). While it is possible in some instances to import raw material needs,

significant bureaucratic delays, transportation bottlenecks, and usually higher costs make this an impractical alternative. It is recommended that the U.S. Government seek to encourage the Egyptian Government to review existing laws and pricing procedures which prevent private sector production or efficient allocation of raw materials with a view to liberalizing these laws and procedures where it is feasible.

5. Facilitating Imports of Equipment: FCIA and EX-IM Bank facilities should be extended for qualified transactions between qualified U.S. exporters and Egyptian customers.

6. Technical Assistance: Egyptian small businessmen will require new skills and attitudes to fully develop the current and future opportunities available to them. The effective linking of funds and viable projects will require the provision of direct technical assistance to small industries. It is recommended that programs offering such assistance be considered. It is also recommended that, where financing is provided, technical assistance be packaged with it as is feasible. In addition, more extensive use of organizations such as the International Executive Service Corps, or comparable private or public sector groups of professionals, should be encouraged.

7. Facilitating the Flow of Investment and Business Opportunity Information:

The closed character of the Egyptian economy over the past decade has resulted in the private industry community being shut off from international business and commercial affairs. There is a considerable need for the formation of information linkages between the private sector and the outside business world. It is recommended that investment survey missions, possibly conducted by an organization such as the Overseas Private Investment Corporation, be promoted. It is also recommended that the U.S. Government consider the establishment of business information centers and, possibly, a U.S. Trade Center to facilitate the flow of communications.

#### Recommendations for Long-Term Support Programs

1. New Financial Intermediation Vehicles: Recognizing that creating new or improved financing vehicles is a long and arduous process, these will, nevertheless, need to evolve in the Egyptian context. One particular need at this stage of development is a financial organization capable of marketing and providing venture capital. It is recommended that the U.S. Government encourage and participate with the Egyptian Government in examining the present financial system with

a view to: a) introducing new incentives to, and competition among, existing organizations in meeting the long-and-short-term lending needs of the private sector, and b) encouraging the development of a new prototype joint venture equity investment company to stimulate development of medium and smaller private businesses, and c) explore other approaches to meeting the comprehensive financing needs of a potentially expanding small industry sector.

2. Bureaucratic Delays and Business Confidence: The Egyptian bureaucracy continues to pose serious problems for the further development of the small business sector in a variety of ways. The Government has not been concerned with the smaller private projects and as such, has been somewhat indifferent to the problems which they face. While small business confidence is more buoyant today than at any other time in the past decade-and-a-half, there is still the need for a clear indication of good faith and interest from the Egyptian Government. The U.S. Government should encourage the easing of bureaucratic constraints currently acting upon the small business sector, particularly in such areas as the importation of raw materials needs, the provision of financing of plant and equipment, and exportation of finished products. In addition, it needs to promote an understanding on the part of Egyptian policy makers as to the relationship between the success of large-scale foreign private investments and the need for the development of a viable and dynamic small industry sector to act in support of such large-scale industrial activity. At present, this relationship is not well understood or recognized.

3. Legal Reforms: Members of the Small Business Team have observed that, in a number of specific instances, the legal context in which small industry must develop continues to be overly restrictive. In a more general sense, the laws, codes, and regulations that have evolved in the past two decades--having as a major premise the establishment of state control over virtually all aspects of economic life--are not conducive to the re-establishment of private sector economic activity, large or small. Because such laws proliferated in the early 60s--hundreds of restrictive laws were passed--codification has lagged with the result that there are very few legal experts fully knowledgeable of all of the potential legal roadblocks to private projects. In addition, the present system of legal administration is far too cumbersome and antiquated to deal with what will most probably be an upsurge in cases involving litigation between foreign and domestic investors. It is recommended that the U.S. Government consider a project the goals of which would be to a) assist the GOE in codifying existing economic, commercial, and trade laws, b) examine the present judicial administrative system with the purpose of recommending changes and reforms as required, c) develop the Egyptian system of legal education in order to provide a more relevant form of subject matter given the

emphasis on private enterprise, both foreign and domestic, and d) assist the GOE in undertaking to reform all economic laws as they pertain to the implementation of the policy of liberalization. This would be a key project, one definitely critical to the successful reorientation of the Egyptian economy.

4. Entrepreneurial and New Management Skills Development: Joint ventures will, to some extent, initiate the process of re-educating and re-orienting the Egyptian private small industry sector managers and entrepreneurs. However, such ventures are unlikely to occur in sufficient quantity to meet the broad needs in developing a more modern managerial class. It is therefore recommended that general and sectoral managerial, commercial, and technical training and education programs be initiated. In addition, seminars, conferences, and forums, bringing together Egyptian businessmen with their international counterparts, should be encouraged. Where feasible, such programs should make use of the existing education and training institutions which have the capability and desire to initiate new and innovative programs of instruction. U.S. and other institutions that can demonstrate the competency to conduct effectively management development programs should be surveyed and the most qualified given support in implementing programs in Egypt.

5. Establishing A Small Business Administration: The Team believes that in the long-term, an organization comparable in purpose and function to the U.S. Small Business Administration, will need to be established in Egypt to lend support to the development of the small industry sector. It is recommended that this concept be explored with the appropriate offices and authorities to determine its feasibility. If the government is receptive to the concept, then it is recommended that the U.S. Government consider providing the requisite assistance necessary to create such an organization.

6. Developing the Arts and Handicrafts Industries: It is believed that this industry has sizeable and immediate opportunities, especially in terms of export markets. At present, government support is rather weak and ineffective. It is strongly recommended that the government be encouraged to: a) review present government policies with respect to the arts and handicrafts industry, b) consider some of the more successful efforts of other developing countries in preserving this art form and enhancing the collective marketing of art and handicraft products with a view to tapping more effectively its export potential, and c) provide this industry with continuing skills training and the basic techniques of marketing and management. In addition, it is recommended that special funds be set up for the purpose of assisting this industry in expanding its operations and the marketing of its products.

## II. General Observations on Small Industry in Egypt

The prospects for private small industry development in Egypt, much as in the case of foreign investment, are conditioned by a number of basic facts:

-- The Government, in recent years, has had no experience in promoting private investment. On the contrary, its experience lies largely in diminishing and controlling private sector influences in the economy.

-- The bureaucracy created to control the economy is large, complexly organized, and not terribly efficient. It is difficult to work through it, even for the purpose of dealing with fairly routine matters.

-- The economy continues to labor under a number of poorly conceived and administered policies, many rooted in the need to control and direct a war-time economy and achieve some minimal level of social justice. Implementation of administrative controls on the economy, relying as it does upon a bureaucracy that is relatively ill-equipped and prepared for such a task, is inefficient and often counter-productive.

-- There remains disagreement--and hence, some confusion--over the issue of to what degree private enterprise, either foreign or domestic, should be allowed to flourish. Liberalization has wide acceptance as a general philosophy, but in practical application there are serious impediments not the least of which is the legitimate desire to preserve the greater social equity achieved since the Revolution in 1952.

Bringing about change in a society with such a complex recent history is not easy, especially when the changes implicit in the Open Door Policy indicate a degree of reordering in who will profit and, ultimately, who will control, the Egyptian economy. It is in this context that one must view the transition of the Egyptian economy, and the problems which beset this transition.

The Government has shown an increasing ability and willingness to come to grips with the problems of implementing liberalization. It is proving more successful in dealing with the impediments to attracting foreign (as opposed to stimulating domestic) investment, and it has been more concerned with large private joint ventures (linking public sector firms with Western firms) than with small industry. There is a trend toward improvement although the pace of this movement is not satisfactory to many potential investors (particularly foreign firms who often have no historical understanding of, or appreciation for, the complexities of

Egyptian society). The incentives in the Foreign Investment Law No. 43 (1974), as amended by Law No. 32 (1977), are accorded to qualified domestic investors, large or small. Other legal changes permit the private sector a range of activities (e.g., holding foreign exchange, importing raw materials and goods, etc.) that it has not had for over a decade.

As a matter of policy and law, the incentive structure is there basically, although a number of laws remain in effect that represent continuing constraints to private sector development. Implementation of this incentive structure is less than satisfactory, but not particularly less than could be expected given the government controls on the economy exerted through the bureaucracy since 1961.

The SBT, in its survey of small industry in Egypt, saw evidence of both the positive results of the Government's active efforts to stimulate private investment, and the continuing constraints in such key areas as access to raw materials, financing on acceptable terms, adequate infrastructure, technical and managerial expertise, and the bureaucracy's inclination to impede and delay action. On balance, the general impression is one of guarded optimism with many private entrepreneurs acknowledging that the environment for private sector expansion and growth is "markedly improved and improving".

The problems that persist are indicative of any economy that is trying to "change gears":

-- The bureaucracy is ill-suited to promote private sector initiatives and is no more efficient in this respect than it has been in establishing effective government controls over the economy in the past.

-- There is inconsistency in the interpretation of the new policies and laws. This inconsistency arises out of a) a logical desire of bureaucrats and politicians to avoid the possibly adverse effects growing out of any attempt to implement decisively a controversial liberalization policy, b) a desire, in some instances, to preserve existing bases of power and influence (e.g., the public sector companies), and c) a lack of understanding as to what precisely one's management responsibilities are with respect to implementation. That is, delays occur because of imprecise definition rather than pre-meditated opposition to liberalization.

-- The decision of the Government to attempt to stimulate the economy (through appeal to the private sector) without addressing directly the basic problems of the economy. Contradictory signals ensue, and projects based on existing distortions, inefficiencies

and inequities in the economy run the risk in the long-run of turning unprofitable as economic policies change (as they must ultimately). This, in addition to the lack of business confidence, creates an attitude of short-term, in-and-out, profit taking which is not conducive to the long-term, capital producing pattern of investment that is needed.

-- The private small industry sector has survived by feeding off the inefficiencies of the public sector companies, filling supply gaps that this sector has been unable to fill, or indifferent to filling. It has been low-profile, survival oriented, and has had little access to the newer technologies and equipment. As such, given the possibilities of expansion that now exist (inconsistencies in government policies aside), it is not well equipped managerially or technologically to spearhead growth and change in the economy. It is inward-looking and conservative, has not had to deal in a highly competitive environment, and will need to learn new skills.

What the SBT has concluded then is that, although the small industry sector continues to be confronted with difficulties, it is nevertheless also confronted with opportunities. Assuming that the Government continues to attempt to deal with the impediments to the implementation of the liberalization policy, and experiences a measure of success in this regard, then with proper assistance, this sector should be able to assume a more prominent and productive role in the industrial development of the country.

The potential for expansion into domestic and international markets is difficult to assess precisely. Contacts with small businessmen have led the SBT to conclude that they represent a potentially energetic and dynamic source of entrepreneurship. Abilities vary a good deal from one industry line or activity to another (e.g., there appear to be stronger and more developed abilities in the textile industry), but on the whole the impression is that small businessmen have a reasonably good understanding of market opportunities, production technique (although the equipment is often outmoded), and how one can make a profitable operation. In order to further develop the potential of the small industry sector, assistance will have to be provided in the following areas:

1. Management/Entrepreneurship: Small industry owners are not well versed in the modern techniques of management nor have they had to operate under highly competitive conditions. There is recognition of this short-coming, and small businessmen have indicated that they will need to acquire this new knowledge relatively quickly if they wish to expand their operations.

2. Production Technology: Given the disincentives to private industry growth in the past, the closed nature of the Egyptian economy, and the shortage of foreign exchange or access to foreign equipment suppliers, the equipment found in the small industry sector is often crude, primitive and/or obsolete. A particularly encouraging factor is that even where such poor equipment exists, the owner is able to turn out a product on a profitable basis. Nevertheless, there will need to be acquisition of the newer production technologies and the management skills necessary to use it efficiently.

3. Marketing: Although the SBT has concluded that many small businessmen have marketing skills, these tend to be rather imperfectly applied and exploited. Very few have operated in export markets and their experience is confined to relatively limited development of their domestic market opportunities. Assistance in the form of identifying market opportunities will be required in addition to developing an understanding of how effectively to tap them.

4. Profitable Operation: It has already been noted that private small businesses have been able to compete profitably with an inefficient and indifferent, monopoly-oriented public sector. It would be a mistake to assume that this has prepared them to deal with a potentially stronger competitive environment that may evolve in Egypt in the next few years. Many small businessmen acknowledge this as a main problem. They are willing to enter into such competition actively and run the risks involved, but they also feel that as managers they do need exposure to the newer methods of achieving higher productivity at lower costs.

The SBT has concluded that a considerable amount of re-education and re-orientation of the small industry sector management is going to be required. The basic skills exist, but they will not suffice given the orientation toward increasing growth and expansion with the competition, both domestically and internationally, that exists (in the case of international markets) or will exist shortly (domestic markets).

Business confidence is increasing, but it would be too presumptuous to assume that the policies of nationalization and sequestration pursued in the decade of the 60s could so easily be dismissed. Guarded optimism has led to guarded moves. Investments being made are not long-term, are heavily commercial-trade oriented, and no one wishes to be exposed for any length of time. Encouraging signs exist: firms are applying for loans to expand plant and equipment, and those applying for such loans complain about the delays involved; they complain of the failure of the Government to give them more incentives, more financing; they complain of the shortage of qualified workers; and they complain of the shortage of raw materials. But these are the complaints of businessmen who

are hard at trying to expand and grow and who are trying to take advantage of new opportunities, not of those demoralized or lacking in confidence to the extent that they are not willing to invest. The SBT therefore concludes that business confidence is growing albeit in an atmosphere of some skepticism and suspicion.

The Egyptian Government has indicated on a number of occasions that it feels that the private sector can best serve the industrial expansion envisaged by servicing the needs of the larger private joint venture and public projects. As feeder industries and subcontractors they have good opportunities. This logic also permits the Government to avoid the political risks of more direct confrontation between an aggressive private sector, trying to operate on a large scale, and the entrenched public sector companies. It is argued, rather persuasively, that the public sector is much more experienced in operating the larger and more sophisticated industrial operations than the private sector. Hence, even if the Government wished to promote large-scale, private domestic industrial activities, the private sector could not, at present, accomplish such a task.

There is little to debate here, and many of the opportunities identified by the SBT for the small industry sector obviously exist in playing such a role. However, the Government is not, as already noted, providing all of the incentives necessary to develop the small industry sector to the point that it can act as a viable feeder base for the larger industries. It is felt that the Government is relying too heavily upon the potential foreign investor to develop this second-tier of industry and failing to recognize that foreign investment is often attracted to those situations in which the second-tier already exists. They would like to take advantage of the existence of a well-developed small industry base rather than develop it themselves. Cost/benefit calculations are, in any event, very much affected by such considerations. The SBT has therefore concluded that a more decisive display of the Government's intent to seriously encourage small industry development is required. Evidence would include a continued reduction in bureaucratic delays and truculence, the provision of additional financing, and the further reform of laws and regulations restricting private sector activities (especially in such areas as raw materials production).

The general picture of the small industry situation in Egypt, like the transition of the economy itself, is mixed. Continued effective pursuit of liberalization by the Government should result in a greater easing of the constraints currently acting on the investment climate. Business confidence should, correspondingly, rise as the Government continues to provide evidence of its good faith and intent, even if it does this somewhat imperfectly. To realize the development potential that will ensue, the small industry sector will need increasingly large amounts of risk capital and technical assistance. It would of course be premature, or possibly even be a mistake, to assume that the development potential of the small industry sector, or the private sector in general, is infinite.

The Government has consistently reiterated its position with respect to maintaining the basic needs and materials production of the economy in public hands. It also maintains a continuing commitment to social justice, however this commitment is likely to be expressed in the future. It would not be unfair to state that, at present, the Government does not know precisely how far it is ready to go in privatizing the Egyptian economy. Much will depend on many other factors: peace in the Middle East, domestic political stability, the degree of responsibility with which the private sector acts in taking advantage of the new policies, and the manner in which the economy grows and changes during the next decade. Allowing for all of these considerations, the SBT believes that opportunities for the small industry to grow and develop do exist and with the proper assistance in the critical areas of financing, technology, and management, this sector can assume a growing importance in the industrial development of the country.

### III. Specific Observations on Small Industry Operations by Type

The SBT members visited a number of small industry operations in areas of their own expertise (e.g., textiles, construction materials, etc.). The observations included in this section of the report pertain to specific issues encountered in their discussions with Egyptian businessmen.

#### A. Textiles

1. The development potential for textile manufacturing in the private sector is, in general, excellent as proven by its current relatively advanced state.

#### 2. Current capabilities in:

##### a) Management/Entrepreneurship.

Top management in the textile private sector is impressively capable. Entrepreneurship is demonstrated in the very existence of enterprises of considerable size (several with assets of approximately LE 1 million). All managers complained of absence of an adequate source of talent at every level below them in their operations.

##### b) Production Technology.

Textile manufacturing equipment in use is remarkable in that it is functioning long after its normal useful life, often locally fabricated from parts designed for other use, and extremely diverse in origin. In those cases where new equipment is in use, production efficiency is reasonably high. There is good evidence that current technology, equipment and supplies and normal (by U.S. standards) training for operators would result in textile production

efficiency and product quality of international standards.

Consumable supplies in the form of machinery parts, processing chemicals, dyestuffs, etc., must be imported presently. Although some dyestuff manufacturing capacity exists in the public sector, due to absence of adequate indigenous technical expertise and of on-going technical assistance from outside, usable production is nil.

c) The private sector textile industry is operating on the fringe and in the shadow of the public sector industry which produces a limited variety of mostly subsidized goods, and has a marketing program distorted by this anomaly. There is no significant export orientation of the industry since the domestic market has tremendous absorption capacity for high style fabrics.

d) Operations in the private sector textile industry appear to be profitable given the expansion programs many are attempting. Profit taxation as practices is a major deterrent to demonstration of profitability, however.

3. Current attitudes and confidence in present private business environment, willingness to invest.

The private sector textile industry shows a unified urge to expand, and many operations have top management fully capable of handling major expansions. The primary deterrent to more rapid expansion is inadequate availability of foreign exchange financing. Additionally, significant expansion would place a corresponding demand on the strictly controlled yarn market.

4. Current relations with existing large public sector companies.

a) Simply stated, if the private sector textile industry were freed from prohibition on spin yarn from fiber available in a free market, or given free market access to yarn at non-subsidized prices, given no further restrictions, and given access to expansion financing facilities commensurate with creditworthiness, it would take over those areas of the total industry not heavily subsidized in the public sector; i.e., the high technology, high style, high quality areas.

b) Presently, the private sector represents for the public sector a dumping ground for yarn of such poor quality that it could not be woven with any reasonable efficiency in the inherently inefficient public sector. It must also be stated that there is strong circumstantial evidence that certain elements of the public

sector are profiting unethically and not in the general public interest by the black market created for textile yarn. This is an outgrowth of a policy of strict control of availability (not supply, since there are usually large surpluses in the public sector warehouses, 15,000 tons reported currently).

c) Both the public and private sector suffer from the lack of a supporting textile service and supply industry in the areas of spare parts, and processing consumable supplies, all of which are presently imported with very substantial impact on exchange balance.

## B. Construction Materials

1. The greatest opportunities for the small businessman in Egypt are for contractors who undertake specialized activities such as plumbing, electrical works, painting, plastering, carpentering, flooring, roofing, and sheet metal work. It must be emphasized that the expeditious development of these activities is critical to the successful completion of large public and private projects. Other, significant opportunities exist in:

a. Special trades such as structural steel erection, glass installation, excavation and foundation work, and repair services.

b. Installation of prefabricated building equipment and materials where small businessmen can fill a significant gap in wholesale distribution, construction, and installation of equipment manufactured locally or imported from external suppliers.

c. Renovation and repair of buildings.

d. Retailing of construction materials such as brick and tile, flooring, mill work, windows and doors, paint, glass and other hardware items.

2. The shortage of construction materials is the single most important problem in the construction sector in Egypt. Materials breakdown in three broad categories: (a) locally produced, (b) imported materials for stock, and (c) imported materials by contractors for a specific project. Of the basic materials, cement, structural steel, rod reinforcement and timber, too little is produced domestically for the small businessman to have an opportunity to buy them at reasonable prices since black market rates have pushed up prices beyond his reach.

3. The availability of credit and the possibility of obtaining credit is the second most important factor for the small businessman in construction materials. Private banking is limited to the Development Industrial Bank and 100% guarantees make borrowing uninteresting. Lag in infrastructure, problems in transport, communications add to the problems confronting small business operations.

4. Non-confidence in government and fear for government take-over are prevalent attitudes among Egyptian entrepreneurs. The good ones leave for greener pastures outside Egypt, especially to Arab countries, creating a shortage of skilled and semi-skilled labor.

5. The lack of modern technology and new construction methods hampers progress in the development of small industry operations.

C. Engineering Industries and Services

1. Most private sector engineers are involved in engineered products or operating small, non-engineered related businesses. Production technology and equipment is fairly primitive in most cases.

2. Because of the shortage of replacement parts for virtually all types and vintages of mechanical equipment, the opportunities for the engineered products small business sector are extensive and diverse. However, there is a definite lack of confidence on the part of entrepreneurs, and the Egyptian Government needs to make a clear demonstration in the form of direct incentives and financial support to encourage small business development.

3. Most private sector industry is too small and under-capitalized to permit extensive use of private sector engineering services. Engineering services are, in general, currently provided by a government operation, the Engineering Industrial Development Design Center. This acts as a disincentive to the development of engineering services on a private basis.

4. At present, most engineering operations (both product-and service-oriented) exist on a relatively small scale. Future development will depend upon creation of greater demand for private engineering services, credit, and the transfer of more modern technology and the availability of capital equipment to enhance the quality and design of engineered products.

D. Export/Import Services

1. Small businesses operating in importing and exporting generally suffer from a lack of confidence in the Egyptian Government and a deep-seated suspicion that "liberalization" may be revised or abolished by simple enactment of a "new" law. Opportunities, especially in imports, are at present considerable, but most firms take a very short view in capitalizing upon these. Exports, hampered by excessive government restrictions and "red tape" are less attractive.

2. Financing of trade activities is a very slow process, and the terms and conditions for it are not particularly good among the Egyptian commercial banks (some importers having access to the foreign banks have decidedly different experiences). There is no such thing as cash against invoice documents nor is Egypt on the list of the FCIA or the U.S. Exim-Bank.

3. Export and import quotas are highly restrictive, and the procedures required are excessively bureaucratic. The result is that substantial delays occur making private sector export-import activity unattractive.

4. There are potentially good export opportunities for Egyptian handicraft and art objects. To realize these, much more government support of the handicrafts industry is required. Present efforts are diffuse and relatively inefficient. There is a ready market for such products (suitably certified as to origin and quality).

5. An export expansion program, supported by the Egyptian Government, coupled with an educational program of export awareness should be instituted to realize export opportunities. Such a program could operate with the cooperation of the U.S. Egypt Business Council.

#### E. Finance and Venture Capital

1. Although the Government is, in general, supportive to expanded private sector activity, there are substantial internal obstacles. These obstacles create unusual risks and difficulties that are not easily dispelled or overcome. In addition, the macro political complications of the Mideast (i.e., the continuing prospect of war) increase already high risks for investment capital and business in Egypt.

2. For the present private investor (foreign or domestic), Egypt is attractive for only abnormally high return projects. These are few and far between and not likely to be sufficient to impact Egypt's plans for attracting substantially new investments. Egypt needs investors who will be satisfied with more normal returns and whose investments will stimulate the economy and also bring with them new technology and management to the business sector. Initial seed capital and modern management and technology are key missing ingredients.

3. Current AID programs address in a limited way the need to directly provide such funds or technology into private, small or medium sized business. If the U.S. Government wishes to assist Egypt in this part of their program additional solutions will need to be found. The solution should couple initial (seed) investment equity

and project financing with management, technology and know-how. Any U.S. participants should be protected for their costs and given the opportunity for long term profitability.

4. Egyptian Governmental support and private Egyptian management participation should be continuing ingredients in each packaged project. Foreign equity participation should eventually be reduced (if not limited initially) to a minority position. The investments should be economically productive, per se, and should also encourage the growth of the private equity and debt investment market in Egypt.

#### F. Agri-Business Industries

1. The agricultural sector in Egypt must expand in order to a) feed an expanding population, b) cater to local hotels serving tourist trade which is scheduled to greatly expand, and c) export in order to obtain greatly needed foreign exchange. Expansion of agriculture has not kept pace with this growing demand and, unless outside technical and financial assistance is forthcoming, it will not.

2. Very few U.S. companies have shown an interest in Egypt. Those that have are from medium to large companies that, generally speaking, have limited and special interests. Very few small U.S. companies have considered investments or operations in Egypt.

3. The Agri-Business Council, Inc. (ABC) has been active in trying to promote U.S. investor interest in Egypt, again among those firms that are either medium or large scale. No similar effort has been targeted toward small U.S. agribusiness firms and this will need to be done if joint ventures are to be explored at the small industry level.

4. U.S. investor interest has lagged for a number of reasons: the continued threat of war; lack of information and knowledge on Egypt; more attractive investment opportunities elsewhere; laws that discourage or make impossible sales to the local market; the necessity of carrying out agricultural projects on high cost and high risk desert land reclamation projects; and, the Egyptian bureaucracy.

5. Egyptian businessmen also have shown a lack of interest due to: serious land fragmentation through the Islamic law on inheritance; continued political instability and a general lack of confidence in the government; the Egyptian bureaucracy; lack of adequate financing; inadequate technical assistance, especially from the Ministry of Agriculture; and, a lack of personal capital due to prior naturalizations.

6. Egyptian businessmen have no way of making contact with potential U.S. joint venture partners nor do they have sufficient contact with the rest of the world to learn of the potential which may exist. As peace prospects grow, this situation will change, but it appears that only the large companies will be able to take advantage of the opportunities.

7. In order to facilitate the expansion of small agribusiness interests USAID should finance an agricultural development bank with provision for appropriate technical assistance. In general, USAID should facilitate U.S. small business exploration of the opportunities in Egypt.

#### G. Tourism Industry

1. Egypt has major advantages in tourism and the opportunities for the expansion of private business activity, both small and large, are extensive.

2. The GOE currently is expanding tourist facilities and service with no apparent master-plan. As a result, over-expansion--particularly in luxury class accommodations--may be inevitable. More importantly, an immediate threat in Egypt is the encroachment and destruction by commercial development of some of its principal tourist attractions and natural and historic resources. Immediate attention and funding should be given to the development of an overall plan to protect these vital landmark resources.

3. An obvious tourist attraction, the Egyptian Museum, is in a woeful state. Aside from its obvious importance as a tribute to the Egypt civilization, it is--more practically speaking--one of the first sites which tourists visit. At present, it is a sorry introduction to the historical riches of this country. USAID should use its good offices to stimulate other donor or institutional interest in modernizing and expanding the present facilities of the museum.

4. Small-business development in tourism is hampered by inadequate financing, a tendency for the government to stress facilities construction to the exclusion of all else, considerable bureaucratic delays in the obtaining of finance and needed permissions for construction and equipment purchase.

5. Any development plan for the expansion of tourist facilities and services will need to address the issue of an appropriate small industry and service sector to act in support of larger projects.

#### IV. Conclusions and Recommendations

The Government of Egypt has more or less consistently stated that much of the private sector development that is to occur should take place at the level of the small-to-medium-sized firm that can then service the auxiliary and subcontracting needs of the larger public or joint venture industrial projects. A good deal of effort of the Government to date has been

directed toward paving the way for the large foreign investor. It has encouraged joint ventures with the public sector firms, and top government officials have been engaged in the direct negotiation of such projects. Delays and problems in promoting these large projects are gradually being overcome. Hence, one could assume that in the relatively near future, Egyptian efforts to attract foreign investment might begin to bear fruit.

While the Foreign Investment Law No. 43 (1974), as revised by Law No. 32 (1977) does accord many benefits to the purely domestic investor, the SBT survey demonstrates rather clearly that the government remains somewhat indifferent to the difficulties which the small-industry sector is facing. To date, there has been no major government effort to ease the bureaucratic delays nor to demonstrate clearly to this sector that it is indeed anticipated that it has an important role to play, a role that the government can and will facilitate.

It is not surprising that this is the case. The government, logically, places higher priority on the larger projects and wishes to link up its major public corporations with reputable Western firms in the hope that the former can be modernized and made more efficient and internationally competitive. Although the potential importance of small industry is recognized, little direct government initiative has taken place to provide it with the proper developmental incentives.

Even so, it is fair to say that the private small industry sector is considerably more active today than it has been for many years. Confidence in the government and the new economic policy of liberalization is definitely lacking, but many entrepreneurs are moving to take advantage of this policy even if they are adopting a relatively short-term, risk-minimizing position in the type of investments they are willing to make. It is generally conceded that the prospects for the private sector appear quite good. Investor response is guarded, but there is response.

There is definitely a role that the U.S. Government can play in stimulating further growth and development of the small industry sector in Egypt. The review of the present state of private small industry by the SBT has indicated that there are a number of areas where additional or new initiatives by the U.S. Agency for International Development appear warranted:

### Joint Ventures

There appears to be a general consensus among Egyptian Government officials and small industry entrepreneurs that the use of joint ventures may be the most expedient method by which to rapidly develop the small

industry sector. It is not anticipated that joint ventures ought to supplant the long-term development of indigenous entrepreneurial effort. Rather, it is seen as an effective way in which to transfer much needed modern skills in management, production/technology, product development, and domestic and international marketing skills in the short-to-medium term. As U.S. (or other Western) small-to-medium business firms often do not have the funds to undertake extensive feasibility and market studies and lack knowledge of the Egyptian environment and potential opportunities therein, it is necessary to develop a program which will generate appropriate information. It is recommended that USAID consider the funding of feasibility studies and develop a suitable information flow system that can bring foreign businesses into more direct contact with small business joint venture opportunities in Egypt.

### Finance

One of the major gaps in effecting Egyptian liberalization is the lack of an extensive base of financial intermediation. Large amounts of money are available but good, sound projects do not exist in abundance. As in the case of the private businessman with his own equity to invest, the banks -- both public and private -- in Egypt are very conservative as to the terms under which they are willing to lend. Some medium term financing is taking place and the government-owned Development Industrial Bank (DIB) is providing limited financing to private small industry. However, significant bureaucratic delays are involved in tapping into the funds provided through government banks and foreign banks and investment companies tend to look at only the very large private investment projects or have rather stringent risk-avoidance criteria when looking at smaller projects. As such, there is both a shortage of risk, or venture, capital, and well-developed institutional base through which to channel it. The government-owned financial institution-to-private sector channel poses a number of serious difficulties which may, in part, be resolved if the privatization of the Development Industrial Bank moves ahead as planned. Even a privatized DIB will most probably not alter the risk-valuation loan criteria considerably. In the long term, new vehicles will be needed that will be venture capital oriented basically and can assist in the identification of profitable and feasible projects. In addition, they must also act at the very least as one of the conduits through which managerial, production, and marketing expertise can flow to the small entrepreneur.

It is recommended that USAID consider providing additional financing for projects in the small industry sector and undertake to guarantee the risk factor in such projects. As an immediate solution, such funds could be channeled through the foreign joint venture banks and possibly more could be handled by the DIB. It is also recommended that USAID

explore with the Egyptian Government possible new institutional arrangements for the channeling of funds to this sector. In addition, it is recommended that any program of project financing should include investment guaranties.

#### Technical Assistance

It has already been noted that there are serious lacks in the knowledge and experience of small businessmen in such critical areas as management, production technology, and marketing. To some extent, the promotion of joint ventures will resolve this. However, given the degree to which broad based private small business development is desirable, it would be a mistake to assume that joint ventures will occur in sufficient number to provide all the technical assistance necessary for this sector's future development. As such, other forms of technical assistance should be made available. It is recommended that this assistance be offered in conjunction with any financing scheme and that, where possible, it be conducted on a private institution-to-private sector basis.

#### Income Tax Reform

Although there are many loopholes available to Egyptian businessmen to escape full payment of corporate income taxes, in general the present tax basis is inappropriate for promoting private sector investments. As such, it neither serves the need to provide incentives to the private sector, nor does it achieve equity as far as the country as a whole is concerned. Because many businesses keep two sets of books, only one of which probably reflects accurately existing assets -- and this is not shown tax collectors, problems arise in the collateralization of loans to the private small industry sector. Banks use the asset values set forth for tax purposes with the result that established industrial plant is markedly undervalued. Hence, businesses often cannot gain additional loan funds as existing assets are already being used as collateral.

The asset valuation problem of collateral is not solely due to the present corporate income tax structure, but it is representative of the kind of practical issue that ensues. The use of the Excess Profits Tax, which relies on income brackets established over a decade ago, is simply not realistic and needs to be adjusted. It is recommended that USAID encourage the Egyptian Government to review its present system of corporate taxation with a view to making it more consistent with the goals of economic liberalization and the need to provide incentives to the private industry sector.

### Raw Materials Shortages

This problem has a number of facets. In some industrial lines (e.g., textiles and construction materials), the private sector has to rely almost exclusively on the public sector as its main supplier. In these instances private businesses are prevented by law from manufacturing raw materials, either for their own use or for resale. While they are now permitted to import their raw material needs as an alternative, the higher costs and delays in receipt of shipments do not always make this practical. Public sector inefficiencies often lead to shortages, poor quality, and indifference to user needs. Many businesses depend upon the black market for their raw materials as a matter of course. It is recommended that the U.S. Government seek to encourage the Egyptian Government to review this situation carefully. Where feasible, the need to reform laws prohibiting the production of raw materials should be stressed.

### Facilitating Imports of U.S. Equipment

If joint ventures are to be pursued with the resultant equipment transfers that would be taking place, Foreign Credit Insurance and Export-Import Bank facilities would be useful. At present, Egypt is not on the list of eligible countries. USAID should review this situation to determine if eligibility can be established.

### Entrepreneurial Development

In discussions with Egyptian entrepreneurs it became evident that most of their experience in the past decade has been obtained under artificial circumstances. Many have been quite successful in capitalizing on the inefficiencies of the public sector or the indifference and disinterest of that sector in pursuing certain product lines. They have not had to compete in an open market situation. Considerable effort has gone into simply remaining in business given a complex and comprehensive system of government controls. The notion that one must begin to think in terms of expansion and growth is relatively new to many in the private sector. Re-education, and the introduction to new concepts of entrepreneurship and management, is necessary. It is recommended that USAID encourage and finance forums, seminars, and technical training programs in order to enhance the growth climate for small businesses. In addition, existing technical assistance services such as the International Executive Service Corps should be used where feasible. Other private or public associations of professionals should be tapped as well.

### Bureaucratic Delays and Business Confidence

The Egyptian bureaucracy will continue to pose difficulties for the private sector, but changes are taking place. Much of the present complaining about this is caused as much by the continued uncertainty

about the intent of the Egyptian Government toward the private sector as it is by actual "red tape." The more enterprising businessmen have the patience to continue to pursue expansion and growth in spite of bureaucratic delays. Nevertheless, business confidence is directly proportional to the government's willingness to do away with controls and regulations that are inimical to private business development. There does need to be a more decisive indication that the government sees -- and will promote -- a new role for the private sector in future economic development. The U.S. Government should continue to encourage the easing of bureaucratic constraints. In addition, it should stress the relationship between private small industry development and the viability of the larger private and public industry projects already in existence or anticipated. Economics of scale will very much depend upon the development of the small industry sector as a subcontractor producing the quality and quantity necessary for efficient large scale operations.

### Legal Reform

Many of the problems identified by the SBT are rooted in the present system of laws and regulations. Reform of some of these laws has already begun, but the practical problems of dealing with the hundreds of laws passed in the decade of the 60s -- almost all of which were designed to extend State control over all aspects of the economy -- are considerable. Many of these laws have not been codified and relatively inexact knowledge of them exists. There are very few legal experts who are acquainted with the full range of laws which now confront the private investor. It is recommended that USAID consider undertaking a project which would assist the Egyptian Government in reforming the economic laws, commercial and trade laws and codes, and review the present system of legal administration to determine if new methods and organization may be necessary in view of the potentially growing importance of the private sector.

There are additional recommendations more pertinent to specific industry situations that are included in the body of these reports. In general, what has been related here is a synthesis of the basic, major issues that appear to be confronting small industry development as a whole.

### Institutional Support for Small Industry

The present government organizations which have the responsibility for overseeing private industry sector activities, including the Federation of Industries, the General Organization for Industrialization, and the Ministry of Industry's, Private Industry Licensing Office, have had predominantly regulatory functions in the past. In some respects, these organizations are not well-suited to assume promotional tasks necessitated by the advent of liberalization and it is evident that there needs to be a review of the present government administration of private sector activities. In the long term, the SBT believes that an organization

similar in function and purpose to the U.S. Small Business Administration is needed. It is recommended that the feasibility of establishing such an organization be discussed with the appropriate Egyptian officials. If the concept is received favorably, the U.S. Government should then consider the provision of the technical assistance necessary to create an Egyptian equivalent of such an organization. It may be useful for the GOE to examine and review the results of other developing nations in this regard.

#### Supporting the Arts and Handicrafts Industry

This industry sector represents an immediate and unique opportunity for development. The SBT believes that there are substantial export market opportunities for Egyptian art and crafts and that this industry, because of its particular nature and structure, requires different forms of assistance than do other industry situations. At present, the government support for this industry is not extensive nor particularly effective. It is recommended that the U.S. Government encourage the GOE to review its present policies with respect to supporting the crafts industry, and consider developing an active marketing support program, perhaps through cooperatives or some other collective organization. In addition, in order to preserve this unique ethnic art form, it is recommended that programs designed to impart craft skills and management and marketing basics be initiated where feasible. Finally, because of its unique character, it is recommended that consideration be given to establishing a separate fund for expansion of this industry and the financing of exports.

ANNEX I

SMALL SCALE PRIVATE SECTOR TEAM

Dr. Delwin Roy (Team Coordinator)	USAID Consultant
Luke Bruggeman (Team Leader)	Construction Materials (Allis Chalmers Corp.)
Claude Mayfield	Textiles (Seydell Companies)
Charles Berthy	Import-Export (Ledex, Inc.)
William Ogden	Banking and Venture Capital (International Finance and Management Group)
Michael Bosch	Tourism (Portal-Albertson, Inc.)
Forrest Wallace	Agri-Business Systems (DMJM Agrisystems)
Ernie Merck	Engineering Services (Piedmont Engineers)
Brooks Browne	Overseas Private Investment Corp.

ANNEX II  
SMALL INDUSTRY TEAM  
AGENDA and SCHEDULE

Saturday, Dec. 3

6:15 Team Arrives

Sunday, Dec. 4

Free Day

Monday, Dec. 5

- 9:30 Welcoming - Mr. Donald Brown, USAID Director;  
Conference Room - U.S. Embassy
- 10:00 Discussion on Egypt Liberalization policy and implications  
for private sector; Roy to chair
- 12:00 Luncheon with representatives from various banks hosted by  
Mr. Donald Brown, USAID Director; Kursal Restaurant
- 7:30 Meeting with representatives of the Egyptian contingent of  
the Egypt-U.S. Business Council

Tuesday, Dec. 6

- 8:00 Meeting with Dr. Youssef Mazar, Director, Engineering and  
Industrial Design Center, and Small Industries Institute
- 10:00 Meeting with Minister of Industry
- 12:30 Meeting with Mr. Gamel El Nazer, Director, General Authority  
for Foreign Investment and Free Zones
- 2:00 Luncheon, Mena House, hosted by Dr. Youssef Mazar, with  
representatives of Arab Conference on Small Industry

Wednesday, Dec. 7

- 9:30 Meeting with representatives of Development Industrial Bank,  
hosted by Mr. M. H. Shenouda, General Manager
- 1:00 Individual industry visit schedule begins

Thursday, Dec. 8

Continuation industry visits

7-9 pm Evening: USAID Director, Mr. Donald Brown, Reception

Friday, Dec. 9

Free Day

Saturday, Dec. 10

Continuation industry visits

Sunday, Dec. 11

- 9:00 Meeting with A.D. Little group conducting USAID Industry Survey
- 12:00 Meeting, small industry team for discussion of impressions;  
formulation of outline of report - Roy to chair
- 2:00 Continuation individual or group schedule as required

Monday, Dec. 12

Departure for U.S. per individual plans