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DEVELOPMENT INDUSTRIAL BANK OF EGYPT

**EVALUATION OF AID LOAN PROGRAM
AND ASSESSMENT OF FUTURE ASSISTANCE FOR
INDUSTRIAL PRIVATE SECTOR DEVELOPMENT**

EXECUTIVE SUMMARY

OF

FINAL REPORT

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**Coopers
& Lybrand**



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BY

COOPERS & LYBRAND

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F O R E W O R D

In January 1981, at the request of AID/Cairo, Coopers & Lybrand began an evaluation of AID's loan program with the Development Industrial Bank of Egypt (DIB). In addition, Coopers & Lybrand was asked to identify other areas in which AID could assist in the development of the Egyptian industrial private sector.

This report, comprised of two volumes, presents our findings, conclusions and recommendations. The first volume evaluates the results of AID's DIB loan program (Loan No. 263-K-035) based on objectives established for that program. The second volume reviews the continuing development of the private sector, the sources of investment capital available to it and development banking as currently practiced in Egypt. Furthermore, it suggests several program alternatives for AID's consideration in the future.

Coopers & Lybrand expresses its appreciation to AID/Cairo and the management and staff of the DIB for the cooperation and assistance extended to us throughout the course of the study.

EXECUTIVE SUMMARY

During the first quarter of 1981, Coopers & Lybrand, at the request of AID/Cairo, evaluated the AID loan program with the Development Industrial Bank of Egypt (DIB) and assessed future AID assistance for industrial private sector development.

The DIB was established in 1975 and commenced operations in 1976. Its objective has been to promote industrial and related activities in Egypt by extending financial assistance for the establishment of new productive enterprises and the modernization, expansion and improvement of existing ones. The DIB provides medium and long term financing in local currency and foreign exchange primarily to private firms. It serves clients operating in several economic sectors, mostly small scale industries in the Cairo and Alexandria metropolitan areas.

Since 1976, DIB's financial position has grown impressively. Between 1976 and 1980, total assets have increased at an average annual rate of 65%, from L.E. 16.6 million to L.E. 124 million. Operating income for the same period followed a similar pattern with an annual growth rate of 77%, from L.E. 349 thousand to L.E. 3.4 million at year-end 1980. Long-term liabilities of the Bank have shown a more pronounced growth rate of 123%, from L.E. 3.5 million at year-end 1976 to L.E. 86 million at year-end 1980. The capital account, however, has only increased to a current level of L.E. 25 million from the initial subscribed capital of L.E. 5 million.

Since 1976, the DIB has received foreign exchange funds from several international lending institutions and other foreign banks through sub-lending agreements with the Government of Egypt. Under this arrangement, the DIB sub-lends foreign exchange funds to its clients who, in turn, repay in local currency. DIB repayments of principal and interest to the GOE are also made in local currency. As of the end of 1980, the Bank had received

\$232.3 million in foreign exchange with repayment periods ranging from 5 to 20 years.

DIB institutional and organizational characteristics generate certain advantages for the DIB over other banks but also some disadvantages. Major advantages include the Bank's capability to provide long term financing at rates more favorable than other banks and to extend foreign exchange loans with repayment in local currency. On the other hand, because the DIB is a public sector bank closely supervised by the Central Bank of Egypt, it has limited flexibility with respect to the scope of its lending activities, internal organization and management.

The DIB is a successful enterprise performing an important function in Egypt's financial community. However, it can improve its efficiency and effectiveness in several areas, especially in reaching a greater number of potential investors, in allowing its clients to take full advantage of its services and in undertaking a more active and direct role in Egypt's economic development.

The AID/DIB program began in 1976 with a \$32 million loan to the Egyptian Government to be relent to the DIB for extending foreign exchange financing to its clients. Terms to the DIB were set at 20 years maturity, with 3 years grace and 8% annual interest rate. Principal objectives of the AID/DIB program were:

- . Increase industrial production
- . Supplement the resources of the DIB
- . Respond to private sector needs
- . Encourage private sector development
- . Strengthen the DIB as an institution.

The program has, for the most part, utilized AID funds in a manner consistent with stated objectives. However, utilization has occurred at a pace considerably slower than had been anticipated. Originally, funds were expected to be fully disbursed by

the end of 1978 but the final disbursement date was later postponed to December 31, 1979 and again to December 31, 1981. As of March 1981 only 83% of the funds had been authorized and 50% disbursed.

An important cause of the slow utilization rate has been the large number of cancellations of loans after they had been approved by the DIB. Some cancellations were initiated by AID because projects did not meet eligibility criteria. Most, however, were initiated by the investors especially after a change in the U.S./L.E. exchange rate, which in effect increased the borrower's debt liability by 75%.

Another reason has been AID procurement regulations which require investors to use AID/DIB funds exclusively for the purchase of U.S. equipment to be shipped to Egypt in U.S. vessels covered by U.S. insurance. Many Egyptians, however, have traditionally dealt with European suppliers and are not as familiar with U.S. products. Furthermore, the higher cost of U.S. freight and insurance significantly raises the price to be paid by the Egyptian investor. In addition, the moderate promotional effects by the DIB along with lending policies which raise the effective cost of borrowing have also contributed to a slow pace of AID/DIB fund utilization.

The AID/DIB program to encourage private sector industrial development came at a time when private investment in Egypt had started to increase as a result of the Open Door Policy. However, the majority of foreign investment has not been in manufacturing but in services such as banking, tourism, and others. Although the availability of foreign exchange funds in Egypt is considerably greater today than a few years ago, it is still not adequate if Egypt is to achieve a 6 to 7 percent growth in GDP during the eighties as projected by the Government of Egypt. Major reasons for the shortage are the low level of savings, the preponderance of short term bank deposits, the inactivity of the

stock exchanges, the scarcity of financial instruments and the perception of high risk associated with long term investment in Egypt.

Public sector firms obtain most of their investment financing from the recently established National Investment Bank or through short-term loans from commercial banks. Private sector firms obtain their financing primarily through the banking system. Another important source of funds is the "own exchange" market which consists of foreign exchange held by private citizens and which, therefore, cannot be accurately estimated. Our study indicated that the total demand for foreign exchange for medium and long term investment is expected to exceed supply during the next five years.

Since 1973 the banking sector has grown and diversified considerably. It includes a broad array of domestic, foreign and joint venture banks and investment companies. The DIB is the officially designated development bank but the Misr Iran Development Bank also provides long term financing. Although the DIB serves a large number of small scale enterprises it does not operate as a true development bank because it finances project exclusively on the basis of expected project profitability and not on the basis of both developmental criteria and profitability.

Within the operational framework defined by the GOE and the Central Bank the DIB is, overall, a successful operation. However, neither the DIB nor other banks have the capability or flexibility to satisfy several important investor needs throughout Egypt, which are summarized below:

- . To relax eligibility requirements in financing investment projects.
- . For banks to assume greater risks.

- . Provide technical advice to potential investors for utilizing financial resources and assist them through the loan approval process.
- . For the banking system to be more aggressive in seeking out first time investors.
- . For the GOE to improve the business climate in Egypt and to assume part of the risk of long term investment.

AID can assist in meeting these needs through an integrated approach consisting of program design, funding and technical assistance aimed to increase the flow of investment funds through the Egyptian financial institutions to the private industrial sector.

In our report we have briefly described several methods for AID's consideration which may be used to address the needs of Egyptian industrial investors. These methods are listed below:

- . Loan Guarantee Fund
- . Loan Reimbursement Program
- . Loan Blending Program
- . Establishment of a New Development Bank
- . Encouragement of U.S. Investment in Egypt
- . DIB Subsidiary for Equity Participation Financing
- . Technical Assistance Grants to the DIB.

These methods should be studied further to determine which may be suitably employed in addressing Egypt's development needs within the framework of the AID program.

