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UNITED STATES AGENCY
FOR INTERNATIONAL DEVELOPMENT

DEVELOPMENT INDUSTRIAL BANK OF EGYPT

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

FINAL REPORT

VOLUME I

AUGUST 1981

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Coopers
&Lybrand

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

FINAL REPORT

BY

COOPERS & LYBRAND

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VOLUME I

EVALUATION OF AID/DIB LOAN PROGRAM
(Loan No. 263-K-035)

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FOREWORD

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.

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A. DEVELOPMENT INDUSTRIAL BANK

1. The DIB's History and Organization

The Development Industrial Bank of Egypt (DIB) was established in 1975 as a public sector institution by Ministerial Decree No. 65. However, it was not until June 1976, that it formally commenced operations by assuming the functions and responsibility for the portfolio of the Special Services to Private Industrial Sector (SSPIS) Unit of the Bank of Alexandria.

The DIB is wholly-owned by the Ministry of Finance and the Central Bank of Egypt (CB) is responsible for monitoring DIB's activities for the Ministry. While it is not represented on the DIB's Board of Directors, the CB exercises a large degree of control over the management and operations of the DIB. The CB reviews and approves all major policy decisions regarding future direction, expansion, strategy, etc. Like other public sector banks in Egypt, the DIB's annual revenue and expenditure budgets, financial results, salary and incentive systems and distribution of profits also require review and approval by the CB.

The DIB is headquartered in Cairo, with three branches in Cairo, Tanta and Alexandria. The Branch in Tanta is not yet fully operational but is expected to be by the end of 1981. A fourth branch office in Ramadan City is also scheduled to open this year. The main responsibilities of DIB headquarters are: project appraisal; planning and budgeting; mobilization and management of resources; and supervision of branch operations. DIB branches are responsible for customer relations, demand deposits and other accounts and disbursement and collection of funds. Currently, only the Cairo branch makes loans in foreign currency. To our knowledge, there are no plans to change this practice.

The organizational structure of the DIB is shown in Exhibit I-1. DIB operations are highly centralized. More than two-thirds of the 392 employees of the Bank are located in the head office in Cairo. The remainder are primarily in the Cairo branch office with only a small staff in Alexandria and Tanta.

DIB headquarters is divided into seven major divisions which supervise seventeen "general departments." At the general department level, the DIB employs 106 professionals supervised by managers who are assisted by deputy managers. With few exceptions, the divisions are headed by general managers and assisted by deputy general managers. The general managers report directly to the Chairman or the Vice Chairman.

The staff of DIB has grown at an average annual rate of approximately 16%. Initially, the Bank experienced high employee turnover -- 15% in its initial year of operation -- but by 1980 turnover had decreased to 3% per annum.

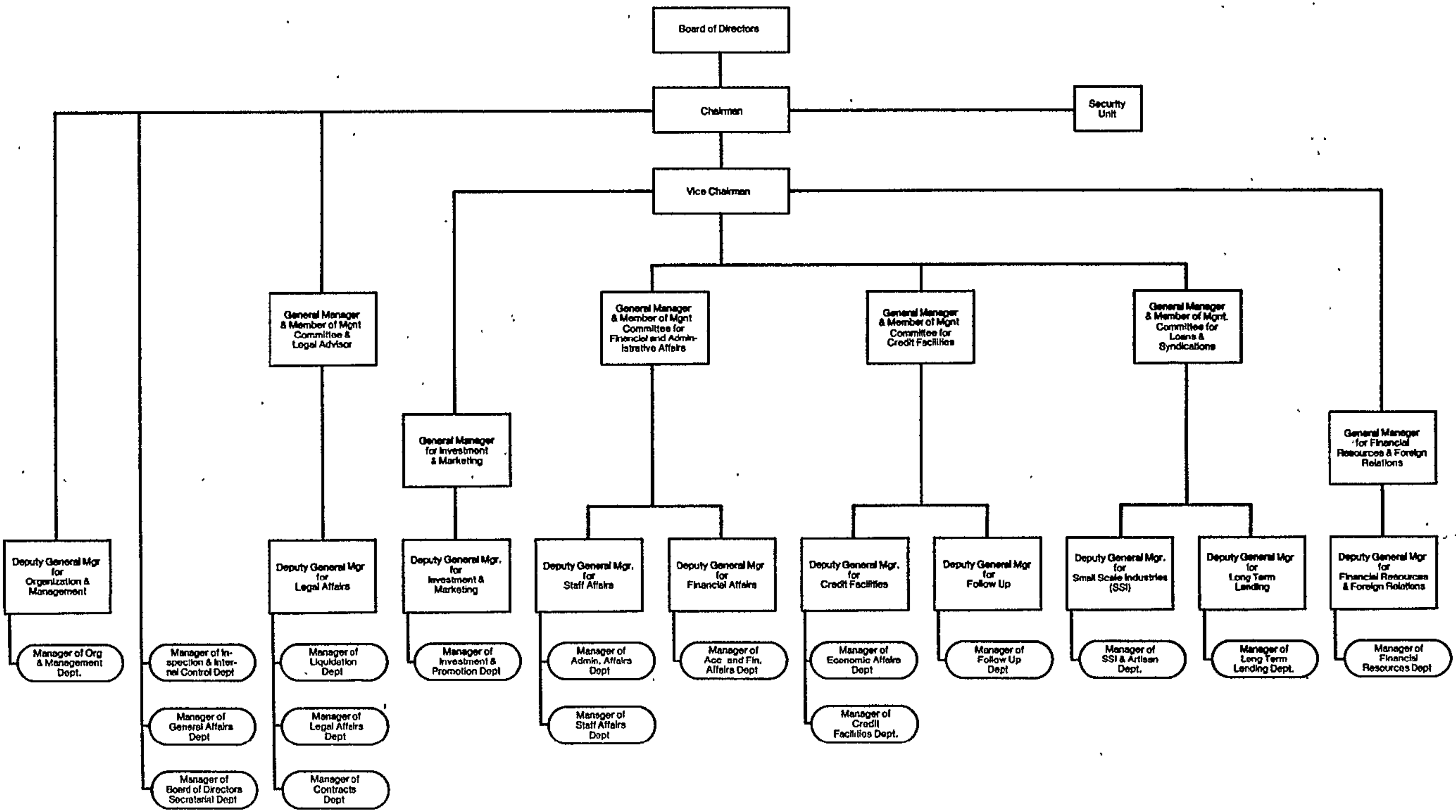
The lending activities of the Bank reside with the Credit Facilities Division and Loan and Syndications Division. They, in turn, supervise the activities of six departments of which the Long Term Lending, Small Scale Industries and Credit Facilities Departments are the major lending arms of the DIB. Whereas the Credit Facilities Department provides only short term credit in local currency, the Long-Term Lending Department extends both medium and long term loans in local currency and foreign exchange. These departments also conduct project appraisals and provide technical assistance to clients.

In 1979, the Small Scale Industries Department was established to assist small scale industries (SSI) and artisan businesses obtain credit. Currently, this department is responsible for all the SSI loans made by the Bank.

Exhibit I-1

DEVELOPMENT INDUSTRIAL BANK OF EGYPT

ORGANIZATION STRUCTURE
As of October, 1980



Source Development Industrial Bank

Members of the Board of Directors of the Bank are appointed by Presidential Decree. They include the five most senior members of the Bank's management -- the Chairman, the Vice Chairman and three General Managers -- and two external directors. An advisory committee was established in 1978 to assist DIB's management in formulating the Bank's overall policy and strategies. The committee is composed of private industry businessmen and professionals. In October 1980, the DIB formed another committee composed of four General Managers of the Bank. The main function at this "Management Committee" is to analyze and recommend on matters to be presented to the Board of Directors.

2. Overview of Current DIB Operations

- Lending and Other Activities. The DIB provides medium and long term financing[1/] primarily to the industrial sector of the economy, but also to non-industrial projects in tourism and other service industries. It is the only public sector bank that provides long term financing to private sector enterprises.

  A distribution of DIB's outstanding loans to private and public businesses is shown in Exhibit I-2. Most of DIB's outstanding loans have been made to privately owned firms (86% of the total). Emphasis has been given to the food and the spinning and weaving sectors, which together comprise 43% of the Bank's portfolio. The remainder is fairly evenly distributed among the other industrial sectors. As of December 31, 1980, outstanding loans

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1/ Short term financing is of 12 months duration or less; medium term financing is of 13 to 36 months; and long term financing is of more than 36 months. For the sake of brevity "term financing" in this report means "medium and long term financing".

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Exhibit I-2

DEVELOPMENT INDUSTRIAL BANK
OUTSTANDING LOAN PORTFOLIO
As of Dec. 31, 1980
in (LE 000)

Type of Industry	Short Term		Medium Term		Long Term		All Loans	
	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.
Weaving and Spinning	180	3018	316	6388	28	11601	524	21007
Engineering and Metal	250	3423	1383	8726	17	981	1650	13130
Chemicals	85	3963	208	5016	28	4742	321	13721
Building and Construction	36	1378	76	2855	20	8421	132	12654
Hotel and Tourism	44	258	67	4775	39	10539	150	15571
Paper and Printing	30	416	102	2912	17	1100	149	4428
Leather	74	1960	53	753	1	608	128	3322
Food	90	2413	151	6492	48	22702	289	31607
Wood	46	211	89	1166	7	2346	142	3723
Others	136	536	106	1717	6	324	248	2577
Transportation	1	10	2	78	-	-	3	88
Total	972	17586	2553	40878	211	63364	3736	121828
Sector								
Public	10	39	3	294	26	16484	39	16817
Private	962	17547	2550	40584	185	46880	3967	105011
Total	972	17586	2553	40878	211	63364	3736	121828

Source: Development Industrial Bank of Egypt

totaled LE 121.9 million consisting of LE 40.9 million in medium term loans and LE 63.4 million in long-term loans. Short term loans (i.e., one year or less) for working capital, import financing and other commercial activities totalled LE 17.6 million, or 14.4% of the total outstanding. Since its creation, DIB loans have increased at an average annual rate of 75%.

The DIB lends in both local currency and foreign exchange (FX); however, short term loans are made in local currency only. Foreign exchange loans are provided exclusively for the purchase of imported equipment, machinery and related services. Local currency term loans are made for construction and for purchasing locally supplied goods and services. Exhibit I-3 shows the distribution of DIB's outstanding loan portfolio between 1976 and 1980 by currency and time period. At the end of 1980, foreign exchange term loans amounted to LE 41.5 million or 35% of the total DIB loan portfolio.

The DIB has recently initiated equity participation and equipment leasing. However, such activities are relatively minor in comparison to the Bank's more traditional lending programs. As of June 30, 1980, the Bank had taken four equity positions totalling LE 1.3 million; or 1.1% of its total portfolio.

- Size of Clients Served. The Bank serves a wide range of clients. Small scale industries make up the largest number of DIB borrowers while medium and large scale firms receive the largest amount of funds lent.

Exhibit I-4 shows the distribution and average loan size of short, medium and long term loans approved by the DIB in 1980 according to the size characteristics of borrowers.

Exhibit I-3

DEVELOPMENT INDUSTRIAL BANK
DISTRIBUTION OF LOAN PORTFOLIO
BY CURRENCY AND TERM

(In LE)

LOCAL LOANS	1976	1977	1978	1979	1980
Short	5,785,067	5,296,497	7,645,606	10,096,111	17,339,797
Medium	4,136,280	7,080,305	12,471,300	19,686,567	30,392,303
Long	2,910,105	8,064,693	13,165,768	19,494,146	32,370,880
Doubtful Debts	46,248	67,342	222,285	228,099	248,001
Total Looal Loans	12,877,700	20,508,837	33,504,959	49,504,923	80,350,981
FOREIGN LOANS					
Medium	-	1,344,242	2,505,450	4,976,820	10,485,027
Long	-	7,233,673	10,086,104	20,577,964	30,992,453
Total Foreign Loans	-	8,577,915	12,591,554	25,554,784	41,477,480
Total Loans	12,877,700	29,086,752	46,096,513	75,059,707	121,828,461
Less Provisions	128,934	1,390,710	2,413,500	2,463,339	4,932,919
Total All Loans	27,748,766	27,696,042	43,683,013	72,596,368	116,895,542

Source: Development Industrial Bank of Egypt

DEVELOPMENT INDUSTRIAL BANK
DISTRIBUTION OF DIB LOANS APPROVED IN 1980
BY SIZE OF FIRM

	SHORT TERM		MEDIUM & LONG TERM				TOTAL		AVERAGE LOAN SIZE (in L.E.)			
	Local Currency		Local Currency		Foreign Exchange		Local and Foreign Exchange		Short Term	Medium & Long Term		Total
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	LC	LC	FX	
APPROVALS FOR ALL FIRMS (in LE 000)	472	20814	921	26761	164	46299	1557	93874				
% of Gross Approvals	30.3	22.2	59.2	28.5	10.5	49.3	100.0	100.0	44097	29056	282311	60292
SIZE OF FIRM												
By Assets	%	%	%	%	%	%	%	%				
From LE 0 to 100,000	84.1	40.1	87.9	35.2	46.3	7.5	82.5	22.6	21003	11646	45921	16571
From 100,001 to LE 200,000	4.7	6.0	4.1	8.5	12.2	4.3	5.1	5.9	57364	59579	98650	68738
From LE 200,001 to LE 1,000,000	7.6	28.3	5.8	23.6	22.6	17.1	8.1	21.4	163556	119189	214027	159714
Over LE 1,000,000	3.6	25.6	2.2	32.7	18.9	71.1	4.3	50.1	313294	437350	1061838	691029
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0				
By Total Employment												
From 1 to 9 workers	58.9	13.7	66.6	16.6	27.4	2.9	60.1	9.2	10237	7228	30089	9221
From 10 to 100 workers	35.8	51.1	30.0	51.3	46.3	21.1	33.5	36.4	62917	49560	128539	65383
Over 100 workers	5.3	35.2	3.4	32.1	26.3	76.0	6.4	54.4	293400	277484	818047	516292
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0				
By Sector												
Public	0.4	7.2	0.1	2.7	4.3	23.2	0.6	13.8	750000	712000	1537571	1297500
Private	99.6	92.8	99.9	97.3	95.7	76.8	99.4	86.2	41094	28314	226343	52294
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0				
By IBRD Definition												
To SSI [a]	94.1	66.5	94.5	54.2	61.0	13.4	90.8	36.8	31185	16680	62040	24443
To SSSI [b]	82.0	45.0	79.4	34.6	48.8	7.4	76.9	23.5	24183	12657	43000	18407

[a] Small Scale Industries (SSI) are defined as enterprises having fixed assets excluding land and buildings not greater than LE 200,000.

[b] Small Small Scale Industries (SSSI) are defined as enterprises having fixed assets excluding land and buildings not greater than LE 100,000.

Source: Development Industrial Bank of Egypt.

- Small Scale Enterprises. Most DIB borrowers are classified as small scale enterprises. 2/ Of the total loans approved during 1980, approximately 1,414 or 90.8% went to this group. However, in terms of volume of funds, the SSI share was only 36.8%. Most loans authorized to small scale industries were in local currency. Only 13.4% of the total LE 46.3 million in FX loans approved in 1980 went to SSI's. Companies with over LE 1 million in assets, and with more than 100 employees, received the largest share of FX financing.

  Based on 1980 authorizations, the average loan size to SSI's was LE 24,443. The average size of local currency short term loans was LE 31,185 and of local currency term loans was LE 16,680. The average size of FX term loans was LE 62,040.

  Since 1977, the DIB has increasingly shifted from short to longer term maturity loans to small scale enterprises. It has also increased the absolute amount of long term financing made to this group. However, between 1977 and 1980, the total SSI share of the DIB portfolio dropped in favor of larger size enterprises. In 1977 firms with fixed assets of LE 170,000 or less received 47% of total loans. In 1980, the SSI's share of total approvals was 36.8%.

- Medium and Large Scale Firms. Medium and large scale firms received the larger share of DIB financing. During 1980, firms over the SSI fixed asset limit were granted

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2/ According to the IBRD definition, small scale industries (SSI) are defined as enterprises with fixed assets not greater than LE 200,000, excluding land and buildings. Small small scale industries (SSSI) are defined as industries with fixed assets, excluding land and buildings, not greater than LE 100,000.

71.5% of the total. This corresponds to 12.4% of the total number of loans made by the Bank. Additionally, medium and large scale firms were the chief recipients of medium and long term local and foreign exchange loans. Term financing in local and foreign exchange approved to these firms amounted to 45.8% and 86.6% respectively of total DIB approvals for 1980. An analysis of prior years' loans, shows that large and medium scale firms have been gaining a larger share of the DIB portfolio. For example, firms with over LE 1 million in assets have increased their share from 30.7% in 1977 to 50.1% in 1980. The average size of loans of the same group increased from LE 588,000 in 1977 to LE 691,029 in 1980. Loans approved to public sector companies in 1980 were the largest in size, averaging LE 1.3 million. Long term FX financing to public sector firms averaged LE 1.5 million.

Although larger firms have received most of DIB's funds, the Bank's lending limit to any one borrower is currently LE 5 million. Consequently, the Bank is not in a position to meet funding requirements for large scale projects. This is evidenced by the fact that in only very few cases has the DIB financed projects requiring a total investment over LE 10 million.

An assessment of the DIB's ability to serve client groups, such as SSI's, is difficult because of the limitations of locally developed operational definitions used to classify firms by size. These definitions are based on the value of fixed assets, excluding land and buildings. Thus, labor intensive firms may be termed "small scale" even though they may have sizeable productive capacity.

Even if the operational definitions are appropriate, they may not necessarily be applicable to investment financing activity. This is especially evident when the financing of projects is undertaken by new firms. An enterprise which is already in operation may be defined as small scale based on the number of employees or the total amount of assets. However, a company which has just been formed may have only a few employers at that point in time but its future plans may call for a large scale of operations which would not fit in the SSI classification.

3. Financial Performance

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 LE 16.6 million to LE 124 million. Operating income for the same period followed a similar pattern with an annual growth rate of 77%, from LE 349 thousand to LE 3.4 million at year-end 1980. Long-term liabilities of the Bank have shown a more pronounced growth rate of 123%, from LE 3.5 million at year-end 1976 to LE 86 million at year-end 1980. The capital account, however, has only increased to a current level of LE 20 million from the initial 1976 subscribed capital of LE 5 million. 3/

The asset structure of the DIB is comprised mainly of local and foreign exchange loans. At year-end 1980, excluding provisions for doubtful debts, loans totalled LE 116.9 million or 94% of the total assets. Equity participations of the Bank for the same period were LE 1.5 million. Most liabilities of the Bank are long-term borrowings, of which LE 43.6 million are local currency borrowings from the Central Bank, and LE 39.9 million are foreign exchange borrowings from international lending agencies and foreign banks. Combined, these comprise 80.5% of DIB's total liabilities at year-end 1980. The DIB also accepts deposits from its customers which at the end of 1980 totalled LE 8.2 million or 8% of total liabilities.

3/ In May 1981 paid in capital of the DIB reportedly increased to LE 25 million.

A source and application of funds and retained earnings statement of the DIB for the period from January 1, 1977 through June 30, 1980 is presented in Exhibit I-5. Some of the key points of this statement are summarized in the following paragraphs.

Lending and other operations in foreign currencies have resulted in an increase of funds of LE 5.34 million, of which LE 3.35 million are accounted for by earned financial income [4/] and the balance, LE 1.99 million, by a net increase in liabilities. Actually, the repayment in Egyptian pounds of foreign currency borrowings by the DIB has exceeded the repayment of principal by sub-borrowers by LE 2.65 million. This net reduction of liability, however, is less than the net increase in liability because of the LE 4.75 million in compensating balances (cash cover) required from sub-borrowers and other foreign currency deposits of LE 0.07 million. Therefore, the cash cover money held for foreign currency loans is being used by the DIB to reduce the financial cost of the funds borrowed from the lending agencies and to increase funds available for operations in local currency.

During the same period (January 1977 through June 1980), loans and other operations in local currency have contributed LE 9.52 million to DIB's financial income. This contribution is nearly three times as large as the contribution derived from foreign currency operations. This profitability has, to some degree, been enhanced by making local currency loans out of the cost-free cover money generated as part of the foreign currency operations. This, as shown in Exhibit I-5, amounts to LE 1.23 million by which outstanding loans in local currency exceed the sum of the outstanding borrowings and financial income derived from local currency operations.

4/ Financial income is defined as earned interest, commissions, and commitment fees from DIB loans, less interest and other financial charges on DIB borrowings before deducting operating costs.

Exhibit I-5

DEVELOPMENT INDUSTRIAL BANK

SUMMARY OF FINANCIAL AND OTHER OPERATIONS

(Sources and Application of Funds and Retained Earnings)
From January 1, 1977 Through June 30, 1980
(LE 000)

	Sources & Application of Funds		Balance Sheet Accounts Debit/(Credit)	(Income) Expenses
I. SOURCES OF FUNDS				
1. Financial Operations in Foreign Currencies (FC)				
Total drawings on Credits in FC	39,154.2			
Less: Drawings treated as grants	(1,652.5)	37,500.7	(37,500.7)	
Less: Repayments of principal (in LE)	(4,245.6)		4,245.6	
Payments of interest on FC borrowings (in LE)	(4,040.2)	(8,285.8)		4,040.2
Net		29,214.9		
Add: Deposits received in FC	72.3		(72.3)	
Deposits in LE to cover loans in FC [a/]	4,572.2	4,644.5	(4,572.2)	
Less: Total drawings by sub-borrowers in FC	(37,500.7)		37,500.7	
Less: Repayment of principal (in LE)	1,590.2		(1,590.2)	
Interest earned on loans in FC (in LE)	5,898.5			(5,898.5)
Commissions and other earnings from loans in FC	1,496.3	(28,515.7)	-	(1,496.3
Funds derived from financial operations in Foreign Currencies (A)		5,343.7	(1,989.1)	3,354.6
2. Financial Operations in Egyptian Pounds (LE)				
Net increase in free deposits in LE	1,471.6		(1,471.6)	
Net increase in drawings from CB	37,574.6		(37,574.6)	
Net increase in other borrowings in LE	2,555.0	41,601.2	(2,555.0)	
Less: Interest on drawings from CB	(2,910.9)			2,910.0
Less: Interest on time deposits and other borrowings.	(569.1)	(3,480.0)		569.1
Funds available from deposits and borrowing in LE		38,121.2		
Add: Interest earned on bank balances		430.4		(430.4)
Less: Net increase in loans in LE	(52,351.4)		52,351.4	
Less: Interest earned in loans in LE,	11,464.2			(11,464.2)
commissions, other earnings from loans in LE	1,102.6	(39.784.6)	-	(1,102.6)
Funds Derived from Financial Operations in Egyptian Pounds (B)		(1,233.0)	10,750.2	9,517.2

Exhibit I-5
(Continued)

DEVELOPMENT INDUSTRIAL BANK

SUMMARY OF FINANCIAL AND OTHER OPERATIONS
(Sources and Application of Funds and Retained Earnings)

FOR THE PERIOD FROM JANUARY 1, 1977 THROUGH JUNE 30, 1980

	Sources & Application of Funds	Debit/(Credit B/S Accounts	(INCOME) Expenses
Funds Derived from All Financial Operations (A-B)	4,110.7	8,761.1	(12,871.8)
3. Funds derived from other sources:			
Capital increase	10,000.0	(10,000.0)	
Grants in current liabilities	1,653.5	(1,653.5)	
Increase in current liabilities	3,111.8	14,765.3	(3,111.8)
Total		18,876.0	
4. Deduction:			
Operating Costs	(3.634.2)		3,634.2
Less: Non-cash charges:			
Depreciation of fixed assets	122.6		(122.6)
Allocations to provisions	713.1	(2,798.5)	(713.1)
[Net Income before tax]			(9,237.6)
Income Tax, paid or provided for			
[Net Income after Tax]	(3,132.3)		3,132.3
Distributions of net income, paid out or provided for:			(6,105.3)
To employees	(317.2)		
To shareholders	(951.8)		
To others	(96.7)	(1,365.7)	1,365.7
INCREASE IN FUNDS FROM ALL SOURCES RETAINED FOR INTERNAL USE	11,579.5	(4,739.6	
II. APPLICATION OF FUNDS			
Repayment of debentures outstanding as Jan. 1, 1977		3,500.0	3,500.0
Purchases of investments		1,335.3	1,335.3
Purchases of fixed assets		127.4	127.4
Increase in current assets (Including 5,000 unpaid capital increase)	5,298.2	5,298.2	
Increase in cash funds.		1,318.6	1,318.6
Total Uses of Funds	11,579.5		

a/ Includes a minor portion of deposits to cover guarantees, some of which are in local currency.

Total operating costs, in relation to funds handled, are somewhat higher than would be expected. Most of this high cost can be attributed to start up activities as the trend has been decreasing during the last twelve months.

Out of the net income after tax of LE 6.1 million, LE 1.36 million has been distributed to employees, shareholders and other participants and the balance of LE 4.74 million, represents an increase in retained earnings as shown in Exhibit I-6.

Operating income of the DIB increased from LE 349 thousand in 1976 to LE 3.4 million in 1980. Return on total assets and equity (before taxes and provisions) has also steadily improved to a point where at year-end 1980, they were 2.7% and 17.1% respectively.

Total revenues during 1980 amounted to LE 7.6 million, of which 64% were derived from interest earned from local currency loans, 27% from interest earned on foreign exchange loans and 8% from commissions and other fees.

The DIB currently charges fixed interest rates on all its loans. Interest rates on local currency loans are set by the CB and currently range from 13% to 15%. An exception is made for local currency loans to small scale industries which may be charged as little as 6%. Interest rates on most foreign currency loans are currently 12%, however, exceptions are made for small scale firms which are charged 8%; and to DIB borrowers financed under the AID's Commodity Import Program (CIP). In both, exceptions are made at the prerogative of management and relate for the most part to the cost of the loan money.

Since 1976, the DIB has received foreign exchange from several international lending institutions and other foreign banks through sublending agreements from the Government of Egypt. Under this arrangement, the DIB sublends FX to its clients who,

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Exhibit I-6

DEVELOPMENT INDUSTRIAL BANK
SUMMARY OF FINANCIAL AND OTHER OPERATIONS
(Assets, Liabilities and Net Worth)
From January 1, 1977 through June 30, 1980

Increase in Assets		in Million LE
Increase in Cash Funds		1.32
Net Increase in Loans Over		
Borrowing and Deposits	8.76	
Less: Increase in Provisions	0.71	8.05
Increase in Other Current Assets		
Including LE 5 Million		
Unpaid Capital Increase		5.30
Increase in Investments		1.33
Purchases of Fixed Assets	0.13	
Less: Depreciation	0.13	---
Subtotal		16.00
Plus: Decrease in Liabilities		
Debentures Outstanding at June 1, 1977, Repaid		3.50
Less: Increase in Current Liabilities		3.11
Subtotal		0.39
Total Increase in Book Value of Net Worth		LE 16.39
Accounted for as follows:		
Increase of Share Capital		10.00
Grants Received from Lending Agencies		1.65
Retained Earnings		4.74
Total (as above)		LE 16.39

Source: Development Industrial Bank.

in turn, may 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 potential FX resources with repayment periods ranging from 5 to 20 years. Exhibit I-7 shows the current status of these resources. As shown, 70.7% have been approved, 52.7% are committed and 40% have been disbursed.

The average cost of FX resources to the DIB is currently 9%, ranging from 6% under the Swiss Mixed Loan facility 5/ to 9.25% under the African Development Bank II loan. DIB has been able to sustain a spread on loans ranging from 1% to 4% except for loans under the USAID Commodities Import Program (CIP) where DIB's terms are passed directly to the borrower. In addition to the spread, DIB earns an additional 1% on FX loans through a commitment fee.

4. The Role of DIB in Financing Private Sector Enterprises

Since 1975, the banking sector in Egypt has grown and diversified substantially. For at least two decades prior to the Open Door Policy, the banking sector in Egypt consisted of four public sector commercial banks (Banque Misr, Bank of Alexandria, Banque du Caire and the National Bank of Egypt) and two other public sector real estate banks (Arab Land Bank and Credit Foncier Egyptien). Today 42 public and private banks are registered with the CB. Additionally, several others operate as offshore banks.

Banks registered with the CB have rapidly increased the financing of private sector enterprises. Between 1975 and mid-1980 outstanding loans and advances to the private sector have grown from LE 233 million to LE 1.9 billion. Since most

5/ Consortium of Swiss Banks and the Swiss National Bank.

Exhibit I-7

DEVELOPMENT INDUSTRIAL BANK
STATUS OF FOREIGN RESOURCES
as of Dec. 31, 1980
in ($000)

SOURCE	PROVIDED	APPROVED	COMMITTED	DISBURSED
IDA I	$ 15,000	$15,000	$15,000	$14,700
IDA II	25,000	25,000	25,000	24,700
USAID (263-K-035)	32,000	26,675	21,300	15,300
USAID (263-K-052)	5,000	5,000	3,400	2,500
Afr. Dev. Bank I	6,000	6,000	5,800	5,500
OPEC Fund	8,750	7,210	5,800	4,600
World Bank (1533)	40,000	40,000	39,100	20,500
World Bank (1804)	50,000	33,257	6,700	4,000
European Investment Bank	20,000	1,882	300	300
IBRD Loan for Agro Industries	8,000	1,356	----	----
Afr. Dev. Bank II	14,000	----	----	----
USAID (263-K-054)	5,000	1,020	15	----
Swiss Mixed Loan	3,500	1,798	----	----
Total	$232,250	$164,198	$122,415	$92,100

Source: Development Industrial Bank of Egypt

financing is of a short term nature, several banks have been established in response to a need for term project financing. The DIB and Misr Iran Development Bank (MIDB) were, until recently, the two banks involved in this area. In 1980, the National Bank for Development (NBD) was also established and is showing signs of rapid penetration of this market. International offshore banks not registered with the CB such as the Arab African Development Bank and the Arab International Bank are also showing signs of becoming active in the area of investment financing. A few private banks, particularly Cairo Barclays, are beginning to finance private sector industrial projects. However, only the DIB and the MIDB regularly provide financing for periods over 5 years in duration.

The DIB has played a major role in providing term financing to industrial private sector companies. DIB's emphasis has been on small and medium size projects, primarily intended to expand and upgrade the capacities of existing domestic firms. As of 1980, total outstanding medium and long-term loans to private sector firms amounted to LE 87.5 million. Based on information furnished by the Central Bank of Egypt, it is estimated that, as of mid-1980, the DIB had made half of the total term loans extended to industrial private sector companies by banks registered in Egypt. However, because several major offshore banks which are actively involved in this market are not included in the Central Bank's statistics, DIB's share is probably somewhat less than indicated.

In comparing DIB's project financing activities to MIDB's (the most suitable bank for comparison with the DIB), we found that while there is some overlap, the two banks, for the most part, complement one another. Whereas the DIB emphasizes financing of small and medium scale projects, the MIDB actively pursues projects requiring large capital investments. DIB's loans are to individual companies whereas MIDB deals with joint ventures. Furthermore, the MIDB is active in syndicating loans and in taking equity positions. Most DIB projects are independently financed through debt. The two also differ in that the MIDB primarily finances new investments. DIB's inactivity in some of these areas is not necessarily attributable to DIB policy but is, in some cases, due to constraints imposed by the CB, GOE regulations or by the donors of funds.

As of January 1, 1981, the MIDB's outstanding term loans totalled \$15.7 million. Other medium term facilities and equity positions of the MIDB are, respectively, \$7.7 million and \$6.8 million. Since it began operations in 1976, the MIDB has been most active in syndicating investment projects. To date, it has either managed or participated in 24 syndications across several industrial and nonindustrial sectors. The largest project financed by the MIDB amounted to \$186 million. The MIDB has participated in financing projects amounting to a total investment of \$532 million.

While the MIDB lends for longer periods than other private banks, loan maturities have usually not exceeded 7 years. Recently the MIDB received FX funds from the World Bank which enables it to offer terms similar to those of the DIB's. No indication was found that MIDB is prepared to extend its terms, however.

The National Bank for Development (NBD) registered with the CB on July 1980 with an initial subscribed capital of \$50 million. After 7 months of operation, this bank is planning to increase its capital to \$150 million. A review of NBD's current and projected activities indicates an increasing similarity to MIDB's activities with emphasis currently being given to the financing of very large investment projects. However, because of NBD's plans to establish branches in all governorates in Egypt, it can be presumed that it will also actively promote investment financing to smaller scale investment projects. Since its inception, the NBD has approved loans in local currency of LE 4 million, and foreign exchange loans of $2.8 million. Approvals for equity participation in local currency and foreign currency were LE 26 million and $17.5 million respectively.

Cairo Barclays, along with several other private sector banks, has also participated in financing investment projects. Cairo Barclays, at year-end 1979, showed total term loans outstanding of $11.5 million and investments of $1.9 million. This bank focuses on medium size investment projects and plans other forms of credit in the future. Currently, maturity on project financing is normally not more than 5 years; usually ranging between 3 to 5 years. It charges interest at LIBOR 6/ plus a spread of 1% to 2%.

Although all public sector commercial banks extend financing to small scale industries, the DIB is the only bank that actively extends it for investment purposes. The National Bank of Egypt and the Nasser Social Banks have developed a reputation for financing the small scale sector, but their financing is mostly short term and commercially oriented.

5. Factors Affecting DIB's Role and Competitive Position

DIB's strengths and weaknesses are to a large extent a result of various institutional and organizational factors. A brief discussion of these factors is presented below:

- Institutional Factors. Institutional factors are defined as those related to the DIB's charter as a public bank. Through its charter, the DIB has been directed to engage in a wide range of financial activities to support Egypt's industrial sector. It is to serve both public and private sector firms through a number of financing instruments.

6/ London Inter-Bank Offering Rate.

In support of its objectives, the Bank has received, through the GOE, large sums of foreign exchange on soft terms from several international lending institutions. Because of the favorable terms of these loans, the DIB can offer borrowers several lending features which significantly enhance its competitive position. These include:

.. Financing on a long-term basis of up to 15 years maturity plus grace periods of up to 3 years. Other banks, due to the structure of their liabilities, may offer only a maximum of 7 years maturity on loans. However, while available, this is still relatively rare.

.. Foreign exchange financing at fixed interest rates, usually below the prevailing international market rate.[7/] Other banks offer market rates tied to the London Inter Bank Offering Rate (LIBOR) plus 2%.

.. Foreign exchange financing with repayment of principal and interest in local currency. No other bank offers this.

Just as the Bank's institutional charter has provided unique advantages, it has also limited its effectiveness in several ways in the investment financing market. As a public sector organization, wholly-owned by the Ministry of Finance, the DIB is subject to controls not imposed on private sector banks. Like all public sector companies in Egypt, it is subject to labor regulations which prescribe salaries, incentive systems and employment practices. DIB management has little discretional authority over profits which are allocated according to a process common to all public sector companies. The Central Bank has final approval on budget allocations.

7/ Public and some private sector banks under the AID CIP program offer fixed interest rates currently between 6% and 10% with maximum maturity of 3 years. Also borrowers repay in Egyptian pounds. CIP funds are primarily for public sector companies although private enterprises have also used CIP financing.

The Bank's public sector character also makes management personally responsible for safeguarding GOE funds. Management may be held personally liable for any negligence resulting in misappropriation. This, coupled with the Central Bank's expectation that the DIB be profitable, has caused it to follow a very conservative lending policy.

With respect to its lending activities, the Bank has to abide by certain lending limitations and other controls on equity participations. These include:

.. Financial exposure on loans, guarantees and equity participation to any single enterprise is limited to 20% of DIB's unimpaired paid-in capital.

.. Equity participation may not exceed 25% of the enterprise's equity, and total equity investment of the DIB may not exceed its unimpaired paid-in capital and reserves.

.. Debt may not exceed seven times the amount of DIB's unimpaired paid-in capital and reserves.

These restrictions can be viewed as beneficial in the sense that they are designed to ensure that the DIB maintains a sound financial position. However, unless the capital account is raised significantly, these limitations may hinder the potential growth of the Bank.

In addition, the DIB is unable to pursue equity positions in foreign exchange because all of its FX resources to date have been restricted to lending programs. Also, equity positions are very costly to the DIB because such funds must be placed in noninterest-bearing accounts before the company is formed. In view of these limitations, the Bank is unable to independently participate in investment projects that require large sums of capital financing and has discouraged the Bank's involvement in equity participation.

Because all of DIB's FX resources belong to the GOE, its clients are subject to surcharges based on the value of the FX loan made for importing equipment and machinery. These surcharges (about 2% of the value of imports) are levied by the Misr Import/Export Company.

While these institutional restrictions are meant to safeguard the Bank, they may at the same time restrict activities more closely associated with the role of a development bank. This point will be developed later in this report.

- Organizational Factors. Organizational factors which affect a firm's competitive position are, in most private sector enterprises, under the control of management and are removed from policies, practices and operations. However, because of the DIB's institutional characteristics and the degree of control exercised by the CB, management often has a limited capacity to shape and adjust the Bank's organization. In turn, the Bank's ability to serve its clients, as well as its competitive position, may be negatively affected.

- Overall DIB Policy Strategy and Objectives. DIB operations are guided by several important policy statements summarized below:

  - Promote industrial and related activities in Egypt through financial assistance for the establishment of essentially industrial new productive enterprises and for the modernization, expansion and improvements of existing ones.

  - Productive private cooperative enterprises including artisan small scale industries are mainly eligible for this assistance.

  - Financial assistance may also be offered to public industrial enterprises on a selective basis.

.. Promote contacts between Egyptian and foreign investors and assist them in establishing joint venture projects.

These policies have enabled the DIB to broaden its activities to different sectors of the economy and to provide an array of financial services to a wide range of clients, whether they be small, medium or large firms. Yet, with such broadly defined objectives, a specific direction, based on clear priorities for financial and investment strategy, has not been taken. Without a structured plan and market strategy, the DIB may be overextending its capabilities by attempting to cover too wide a market base.

. Lending Policies and Practices. The DIB has adopted conservative lending policies and practices. Despite the ability to offer more attractive terms than other banks in Egypt, Bank policies have reduced its competitiveness by raising the effective cost of its funds. The DIB adopted from the SSPIS the practice of requiring borrowers to deposit an equivalent of usually 20% of the loan in a noninterest-bearing account.[8/] This practice is costly to borrowers because they are normally required to maintain this account until the loan has fully matured. The unwillingness of some investors to seek financing on a long term basis may be partly a result of DIB's requirement for compensating balances which increases the effective cost of borrowing in direct proportion to the duration of the loan.

The DIB does not extend the full benefits of its FX donor loans to borrowers. Although it is able to offer term loans in both local and foreign exchange of up to 15 years, very few loans beyond 10 years have been made. Of

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8/ According to the DIB recent practice has been for the deposits to average about 10% of the loan. (June, 1981.)

the total loans authorized between 1977 and 1980 in the medium and long term category, only 1.1% in number and 19% in volume were loans with maturities greater than 10 years. All of these loans were made to public sector companies. The majority of the balance of the portfolio are from 5 to 7 years. In addition, the DIB has the ability to offer grace periods on principal repayment of up to 3 years. However, actual grace periods usually do not exceed 2 years.

- Project Appraisal Process. Over the last two years, the DIB has steadily improved its capacity to process loan applications. However, the project appraisal process is not fully standardized, which can lead to bottlenecks and delays. Problems arise primarily between the time investors initially apply for financing and the time they have all the documents assembled for loan consideration. While many of the steps involved are not within DIB's control, standard procedures may alleviate some of the current difficulties encountered.

- Marketing and Promotion. The DIB has committed a limited amount of its resources to marketing and promotion. It is mostly done through participation in trade fairs and through such organizations as the Engineering Industrial Design and Development Center (EIDDC), the Productivity and Vocational Training Department of the Ministry of Industry (PVTD) and the Handicraft and Industries Productive Cooperative Organization (HIPCO).

  The promotion campaign of the DIB is primarily targeted to small scale industries even though medium and large scale firms receive the largest amount of loans.

While the DIB has improved in marketing its services, other banks, especially the MIDB appear to be more innovative and more aggressive in marketing their services to potential investors. The MIDB, for example, has developed a marketing strategy whereby it first screens then approaches investors based on their potential interest in Egypt. It also maintains communications with institutions in other countries to identify investors who may be interested in locating their operations in Egypt.

- Technical Assistance. The DIB actively offers technical assistance to its clients, especially small scale enterprises. It maintains a small staff of engineers to review projects under loan consideration. It offers technical advice to clients in the appropriateness of equipment to existing or proposed operations. The DIB also assists clients in preparing and assembling documents for loan consideration. Most technical assistance is given after the loan application is submitted to the DIB. There is little effort, if any, made by the Bank to provide potential borrowers with assistance in obtaining the necessary approvals from either GOFI or the GAIFZ. As this process can be difficult for the first time borrower, it can dissuade borrowers unless some assistance is made available.

By comparison, the MIDB provides both technical and financial assistance to clients from the time the investment decision is made, including assistance in debt financing and equity participations. If MIDB cannot assume the entire investment project on its own, it will look to other financing sources and will syndicate the investment project. The MIDB also assists clients in obtaining project authorization from either the General Authority for Investment and Free Zones (GAIFZ) or the General Organization for Industrialization (GOFI). In addition, it assists investors throughout the entire process, including project implementation.

. Information Systems and Financial Management. The DIB's accounting and financial information systems are more developed than its statistical information system.

The information systems have been designed primarily to respond to the reporting requirements of the Central Bank of Egypt. Since the Central Bank is mainly interested in DIB's financial performance, the statistical information system which records economic impact data has received less emphasis. Moreover, statistical data is captured from the feasibility studies contained in loan applications. Since the DIB has only recently begun to collect actual performance data, it is presently unable to accurately assess whether the performance of the projects it has financed have achieved the targets proposed in the feasibility studies.

DIB management is limited in the amount of control it exercises in the financial management of the organization. Expenditure budgets must be reviewed and approved by the Central Bank before they can be implemented. In addition, profits of the Bank are distributed according to a predetermined allocation schedule.

. Staff Development and Training. The DIB recognizes the value of training and developing its staff. The Bank, with the financial assistance of the international lending institutions, has conducted training programs for its professional staff and foreign experts have provided technical assistance for strengthening its organization and personnel. Yet, the need for training is perceived only for middle management, professionals and staff, but not for top management. Training, to be most effective, should include all levels of management.

- <u>Recruitment and Staff Retention</u>. The Bank reportedly has experienced problems in recruiting and retaining qualified staff. This has been attributed in part to government constraints placed on salaries, performance incentives and career opportunities in the public sector compared to those in the private sector.

Although salaries and incentives offered by the DIB are in fact below those of the private sector, there is reason to believe that DIB's ability to recruit and retain staff has not been seriously affected. New hires have increased on average 15% per year since 1976 and staff turnover has declined from 7% in 1977 to 3% in 1980. The overall increase in DIB's clerical, professional and management staff is due largely to the increase in DIB operations. For example, since 1976 DIB has created 17 new positions in its top and middle management levels. These have included three general managers, ten deputy general managers, and four manager positions. These exclude additional positions created at the deputy and assistant manager levels.

While it may be argued that top graduates from Egyptian universities may be more attracted to private sector firms because of higher salaries and other incentives, this sector is not sufficiently large at present to absorb significant numbers of qualified applicants seeking employment. Furthermore, the DIB, as a public sector, profit oriented banking institution, offers more attractive salaries and incentives than other GOE administrative organizations or public sector companies. The DIB's position was recently enhanced as it was allowed to raise starting salaries for new graduates to almost the same level with private sector banks.

Salaries and incentives for experienced professionals and middle and top management are more of a problem because their salaries are significantly lower than in the private sector. For example, the LE 150 average monthly salary of a DIB loan officer with five years experience is about a third of that paid in a private sector bank. Interestingly, it does not appear to have caused a serious turnover problem. To what degree morale may eventually be affected as the private sector continues to grow and offers higher salaries is not known.

- Organizational Structure. The DIB is attempting to meet the needs of a wide range of client groups (from small scale industries to large firms) with an organizational structure not necessarily designed for either. For example, the bank cannot fully respond to the needs of a broad market such as small scale firms. With only two branches operating outside Cairo, there is some concern about the Bank's ability to effectively serve small enterprises in outlying areas.[9/]

The DIB is well aware of the need for more branches. However, in addition to the time required to go through the DIB's internal process of setting up a new branch, there are other external obstacles to be overcome. Suitable office space is limited in some of the provincial towns, especially in Upper Egypt. More serious perhaps is the problem of finding and training qualified staff willing to

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9/ The DIB is currently contemplating to open a branch in Upper Egypt in either Minya or Assiut.

locate outside the metropolitan areas. Until permanent branches are established, the DIB is considering putting into service mobile units to canvass nonmetropolitan areas in order to promote and carry out some of the initial steps required for issuing a loan.

The DIB has attempted to address the need of small scale firms by establishing a separate organizational unit devoted to SSI financing. However, the Small Scale Industries Department within the Bank consists of only 10 employees compared to 29 in the Long Term Lending Department. While it is recognized that long term loans are more complex and may involve more handling, the frequency of loans extended to SSI's and their market potential may warrant additional resources.

The DIB is not structured to be fully responsive to investors requiring large capital investment financing. In addition to the lending limits, the DIB has not developed expertise in syndicating large loans. By comparison, the MIDB has, since its creation in 1976, participated in 24 project syndications of which 13 exceeded $5 million; the largest required a total investment of $186 million.

It was noted that the organization of the bank is based on functional as well as program activities. Overlapping duties and responsibilities of a mixed organization such as this may at times contribute to confusion in decision making.

- Developmental Role of the DIB. According to DIB's Policy Statement, 10/ its principal objective is, "the promotion

10/ Approved by DIB's board on 31/3/80 and subsequently amended.

of industrial and related activities in Egypt through financial assistance for the establishment of essentially industrial new productive enterprises and for the modernization, expansion and improvement of existing ones. Financial assistance may be extended to professional services and activities which contribute to the growth of the national economy and social development of Egypt."

The DIB follows a policy of making finance available to projects which, "will contribute to the economic growth of the country." Economic growth of the country is determined according to the following criteria:

.. An increase in the rate of industrial capacity utilization, modernization of existing industry, processing of local resources and generation or saving of foreign exchange.

.. An adequate internal financial rate of return, soundness of the borrowing enterprise and its ability to service debt.

.. An adequate economic rate of return; in particular, projects contributing toward the creation of employment and income redistribution would be favored.

.. The spread of DIB resources among different regions and industrial sub-sectors with due regard to economic development objectives and priorities set by the government.

In practice, however, the DIB evaluates projects almost exclusively on the basis of the project's financial rate of return and its ability to repay the loan. Although data on the other criteria is collected, the decision to provide finance is based primarily on financial considerations. It may be argued that an initial screening of projects is done by either GOFI or GAIFZ since they must approve projects before the DIB considers them. To the extent that GOFI and GAIFZ approve only those projects consistent with Egypt's economic goals, in theory at least, projects considered by the DIB have already passed this test. Nevertheless, the DIB does not select projects according to all the criteria cited in its policy statement.

The DIB may be considered closer to a merchant bank than a traditional development bank in the sense that it does not seek to approve projects which may be desirable from a socio-economic or strategic point of view. This does not mean that the Bank's activity does not enhance economic development. Rather, it may be inferred that the capital available to the DIB is not used as effectively as it could be if economic development, rather than its profitability, were the Bank's primary objective.

Since the DIB operates as an integral part of the Egyptian economic environment its direction, policies and actions are influenced by that environment. Reportedly, the Central Bank of Egypt supervises and evaluates the DIB only on the basis of its profitability. In such a case the DIB management cannot be expected, on its own initiative, to assume a developmental role with the risks associated with such role if its performance is evaluated primarily on profitability. In order for the DIB to function as a traditional development bank its performance must be measured by different criteria than those followed at present.

B. AID/DIB PROGRAM HISTORY AND PURPOSE

1. Overview

The AID/DIB $32 million loan program was implemented in 1976 to assist Egypt in its economic development and, specifically, to expand the private sector of the country. At that time, the Open

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Door Policy showed signs of an improved investment climate, especially in the expansion of private sector enterprise.

AID projected that the demand for investment financing would increase more rapidly than the supply of foreign exchange. Anticipating this development, AID sought to increase the supply of development finance by supplementing the resources of the DIB.

The AID project paper to assist the DIB was developed in June 1976. It called for a $32 million loan to the GOE to be relent to the DIB for extending foreign exchange (FX) to its industrial sector clients. Clients would use the loan proceeds to import U.S. capital goods and related services. Of the total loan amount, $300,000 11/ would be used to finance training programs and to provide technical assistance for strengthening the DIB organization.

The terms to the GOE were 40 years maturity, including 10 years grace at 2% per annum during the grace period, and 3% per annum, thereafter. Repayment of principal by the GOE would be in U.S. dollars. The terms to the DIB were set at 20 years maturity, with 3 years grace, and at an 8% annual interest rate. The DIB would repay in Egyptian Pounds at the official rate prevailing at repayment time. Other major terms and conditions of the loan were:

- The DIB would sub-lend loan proceeds to sub-borrowers for up to 15 years maturity, up to 3 years grace and at an interest rate not less than 10% per annum. Sub-borrowers would repay in Egyptian Pounds with maintenance of value tied to the U.S. dollar.
- Investment projects for AID/DIB loan consideration would require at least a 15% projected internal rate of return.

11/ Subsequently increased to $500,000.

- The DIB would be allowed to independently approve loans of less than $250,000. Sub-loans over this amount would require AID review and approval.
- Procurement of capital goods would be consistent with AID regulations with respect to price tenders and would be restricted to U.S. source and origin, including ocean shipping and marine insurance.
- 65% of the loan proceeds would be used to finance private sector enterprises.

2. Objectives and Assumptions

The AID/DIB program had five principal objectives:

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

It was anticipated AID funds would be used to finance 75 to 100 enterprises mostly in the private sector although it allowed for up to 35% of the loan to be relent to public sector companies.

The program was based primarily on the assumption that private sector demand for foreign exchange investment and financing would be far greater than the projected supply. In addition, AID also assumed the proposed loan would be the only source of foreign exchange available to the DIB between 1977 and 1978.

3. Implementation Schedule

- Planned. Foreign exchange proceeds for sublending were expected to be fully utilized and disbursed during 1977 and 1978. However, to allow for unforeseen delays, the terminal date for final disbursement was set for the end

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of 1979. The implementation plan was scheduled as follows:

ACTIVITY	DATE
Authorization	June 1976
Agreement AID/GOE	June 1976
Agreement GOE/DIB	Sept.1976
Conditions Precedent (CPs) Fulfilled	Oct. 1976
Sub-lending begins (DIB/AID Project Approval)	Oct. 1976
Initial Disbursement	Dec. 1976
Final Disbursement	Dec. 1979

- Actual Performance. The program was authorized and contracts signed on schedule. However, delays occurred shortly after project start-up because the DIB encountered problems in satisfying the conditions precedent. Some of these problems can no doubt be attributed to the problems of organizational change and portfolio transfer associated with the change over from the SSPIS to the DIB. Also, some time was required for DIB management to become familiar with the program.

Even though the first project for $30,000 was approved during 1976, (63 days after the signing of the loan agreement), the DIB was under the impression (incorrectly, however) that it could not actively begin to use AID funds until the first project over $250,000 was approved by AID. Since this did not occur until October 1977, the program was delayed by one year before DIB sublending activities began.

During the first quarter of 1979, an informal evaluation conducted by the AID Mission in Cairo identified several problems regarding the utilization of AID/DIB funds, e.g., slow application processing, concentration in non-industrial projects, cumbersome organization. At that time 65 projects had been authorized totalling $27.8 million. However, AID subsequently rejected a $2.5 million project because it failed to meet eligibility requirements, 12/ and several other projects totalling $4.7 million were cancelled by borrowers primarily because the GOE decided to replace the official exchange rate of LE .40 per $1.00, with the parallel exchange rate of LE .70 per $1.00. These adjustments reduced the approved amount to 63% of the total available. A more telling fact regarding the speed with which the program was being implemented was that at the time of the evaluation only 10% of the funds had been disbursed.

As a means of accelerating the program's implementation, the evaluation report suggested several corrective actions that AID could take. Meanwhile, the Agency had already extended the termination date for final disbursement to December 1981 and was seeking a waiver to the loan agreement on the maintenance of value clause. The waiver would have allowed AID-funded sub-borrowers to continue to repay their loans at the official rate of LE .40 to $1.00. AID obtained the waiver only for those projects for which loan agreements had been signed and disbursement had been made prior to January 1, 1979, the effective date which the official exchange rate has been abolished. AID also raised the independent approval limit of the DIB to $500,000.

12/ AID disqualified a tourism project because it was ineligible under AID lending regulations.

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After four and a half years only 83% of the AID/DIB loan has been authorized and 49.9% disbursed.13/ It should be noted that of the $26.2 million currently authorized, two projects totaling $8 million are still awaiting AID approval. Approval will primarily depend on whether these projects will be granted a waiver from AID procurement regulations. 14/

C. EVALUATION FINDINGS

Our evaluation of the AID/DIB program was based on: (1) the extent to which the program satisfied its stated objectives; (2) an identification and analysis of factors which contributed to delays; and (3) an assessment of the program's economic impact.

1. Performance in Meeting Stated Objectives

- Increase Industrial Production. The program has contributed to increased industrial production in Egypt. As of the end of 1980, loans of $26.2 million, 15/ were authorized to 59 projects in various industrial and service sectors. Of the total amount authorized, an estimated 75% went to enterprises engaged in manufacturing activities. The remainder were loans to hotels and other tourism projects, cooling and storage facilities and professional services.

13/ Percentages are calculated on only the $31.5 million in funds allocated for sub-lending. The technical assistance component of the program has been fully disbursed.

14/ The two projects are Khalil Chemical Co. ($5 million) and Arab Contractors ($3 million).

15/ The decision was made by the consultants to include the two applications pending AID approval as we had no basis to fix a percentage probability on their possible rejection.

AID/DIB loans to industrial enterprises were part of a total investment 16/ of LE 66.9 million. This represents 63% of an LE 105.5 million total investment in which the entire AID/DIB portfolio in all sectors has participated. Data on both estimated and actual value added resulting from these capital projects was not available.

Analysis at the time of the Mid-Program Evaluation revealed that the AID/DIB portfolio was highly concentrated in service enterprises, primarily hotel and tourism projects. It was estimated that of the total $27.8 million authorized at that time, only 40% had gone to manufacturing activities. Since the AID evaluation, progress has been made towards redirecting AID funds to manufacturing, presently accounting for 63% of the total AID/DIB loans.

- Supplement DIB Resources. The program supplemented DIB's FX resources. This was particularly important during the period when the DIB had few other FX funds available. The DIB was selected to administer the AID program because it was the only financial institution that provided foreign exchange term financing to private sector enterprises. The amount of AID assistance was principally based on the projected demand for foreign exchange within the SSPIS's existing backlog of loan requests/application. This analysis, coupled with a review of the past funding activity of the SSPIS, formed the basis for estimating the

16/ Equity plus AID/DIB loans plus other loans or grants.

amount of AID funds to be programmed. Therefore, as stated in the project paper:

> "The foreign exchange component of unprocessed project proposals in the SSPIS pipeline in May 1976 totalled about $100 million. The proposed $32 million AID loan would be applied to a portion of the approximately $50 million unfunded 1977 and 1978 estimated foreign exchange requirements to finance approved sub-loans."

AID assumed that the DIB's other major source of foreign exchange until the end of 1978, would be the $25 million in FX loaned by the International Development Association (IDA). As of mid-1976, $15 million of this amount had not been utilized.

AID funds were made available at a time when DIB had limited foreign exchange available, and during the six months following program initiation, AID funds were the DIB's only major source of foreign exchange for sublending. However, during late 1977 and 1978 other FX resources were made available to the DIB from the following sources:

SOURCE	DATE OF AGREEMENT	AMOUNT (Million U.S.$)
African Development Bank	10/04/1977	6.00
OPEC Fund	12/16/1977	8.75
World Bank #1533	04/12/1978	40.00
Swiss Mixed Loan	09/12/1978	3.50
Total		$58.25

Despite the increase in FX resources, our analysis shows that the utilization of AID program funds was adversely affected by an increase in FX resources made available to the DIB which were similar to the AID program in purpose, loan structure and terms.

4.6

Exhibit I-8 shows the total FX resources made available to the DIB and the utilization of these resources. Even though the total supply of FX resources increased significantly, AID/DIB funds authorized during 1977 and 1980 totalled $26.7 million. Furthermore, during a 10-month period between late 1977 and mid-1978, AID funds were utilized at an average rate of $1.8 million per month. Once the official exchange rate was replaced by the parallel rate and additional funds were made available to the DIB from the World Bank, the utilization rate of AID funds slowed considerably. AID funds were being authorized quickly because, unlike other DIB FX resources, AID funds were still being offered at the official exchange rate of LE .40 to $1.00, while funds from the IBRD (#1533) and the Swiss Mixed Loan were offered at the parallel exchange rate.

- Respond to Private Sector Needs. The program was designed with the assumption that the availability of term credit, especially in foreign exchange, would appeal to private sector enterprises seeking to acquire imported machinery and equipment. The program addressed this need by requiring at least 65% of total program funds to be channeled to private sector enterprises. To date, the private sector's share of the total AID/DIB portfolio is 72.4%.

  In addition, the program addressed the anticipated difficulties of private sector borrowers to raise foreign exchange funds to repay loans by allowing FX funds to be repaid in local currency.

  Finally, program designers felt that the cost of borrowed funds should be attractive enough to encourage the private sector to undertake necessary investment projects. Therefore, funds were provided at a fixed interest rate set below the international market rate. AID had also found the lending policy of the SSPIS to be restrictive since it

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DEVELOPMENT INDUSTRIAL BANK
STATUS OF FOREIGN CURRENCY LOANS
as of 1/31/81 in $ (000)

Source/Title	Amount	Date of Agreement	1974	1975	1976	1977	1978	1979	1980	1981	Other	Resources Utilized	Total Percent Utilized
IDA I #412	$15,000	6/29/1973	$11,563	$744	$2,375	---	---	---	---	---	$16	$14,698	98.0% D
IDA II #576	25,000	7/30/1975	---	22	11,109	$13,706	$40	---	---	---	116	24,993	99.9 D
USAID (263-K-035)	32,000	7/29/1976	---	---	30	7,516	7,847	$2,126	$8,656	---	500	26,675	83.4 A
African Dev. Bank I	6,000	10/04/1977	---	---	---	---	5,901	---	---	---	---	5,901	98.4 A
OPEC Fund	8,750	12/16/1977	---	---	---	---	2,160	2,325	2,578	97	---	7,160	81.8 A
World Bank #1533	40,000	4/12/1978	---	---	---	830	9,422	23,177	6,053	---	473	39,955	99.9 A
Swiss Mixed Loan	3,500	9/12/1978	---	---	---	---	---	---	1,798	---	---	1,798	51.1 A
USAID (263-K-052)	5,000	10/23/1979	---	---	---	---	---	363	4,604	---	---	4,967	99.3 A
European Inv. Bank	20,000	12/13/1979	---	---	---	---	---	---	2,383	196	---	2,579	12.9 A
USAID (263-K-054)	5,000	12/19/1979	---	---	---	---	---	---	1,015	270	---	1,285	25.7 A
World Bank #1804	50,000	5/01/1980	---	---	---	---	---	---	33,257	2,981	---	36,238	72.5 A
Agro Industries	8,000	5/01/1980	---	---	---	---	---	---	727	---	---	727	9.1 A
African Dev. Bank II	14,000	6/20/1980	---	---	---	---	---	---	---	---	---	---	---
Total	$232,250		$11,563	$766	$13,514	$22,052	$25,370	$27,991	$61,071	$3,544	$1,105	$166,976	71.9%

D = Disbursement Basis

A = Approval Basis (net of cancellations)

Source: Development Industrial Bank of Egypt.

required borrowers to make Egyptian Pound deposits amounting to an equivalent of 20% of the FX loan. The original loan agreement would have eliminated this practice, but at DIB's request this part of the agreement was waived. Therefore, most AID/DIB loans made were required to meet this condition.

While the program did, for the most part, address some of the needs of private sector enterprises, the following factors limited full achievement of this objective.

- AID Procurement Restrictions. Interviews with Egyptian investors, bankers and US government officials revealed that shipping and insurance costs and problems encountered in obtaining tenders and receiving shipments were disincentives attributable to AID procurement regulations.

  An analysis was performed to compare the differences in cost increases from the FOB 17/ value attributable to cost of insurance and shipping because of AID procurement regulations. This analysis is summarized in Exhibit I-9. The AID/DIB financed procurement of equipment follows AID regulations that goods be of U.S. source and origin and shipped in U.S. flag vessels. In contrast, equipment purchased by IBRD financed projects with no restrictions on the shipper, usually originated from European sources. As shown, the average cost increase from the FOB value due to shipping and insurance on AID/DIB financed procurement averaged 12.6%. By comparison, the increase was 8.4% on IBRD financed procurement. While the difference in the incremental cost is only 4.2%, cost increases under the AID/DIB are more dispersed with 52% of the cases having cost increases of 10% or more. Only in one case reviewed

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17/ Freight on board of vessel at point of origin.

COMPARISON OF THE INCREASE IN COST DUE TO SHIPPING AND INSURANCE BETWEEN AID/DIB AND IBRD FINANCED PROCUREMENT a/

Cost Increase From FOB b/ Value Due to Shipping and Insurance	AID/DIB Financed Procurement (U.S. Source and Origin) Cases Reviewed No.	Percent	Percent of Value	IBRD Financed Procurement (European Origin) Cases Reviewed No.	Percent	Percent of Value
Less than 5%	1	3.2%	0.2%	7	31.8%	37.4%
from 6% to 10%	14	45.2	43.4	5	22.7	16.6
from 11% to 20%	10	32.3	48.4	9	40.9	45.9
from 21% to 30%	2	6.5	2.5	1	4.6	0.1
from 31% to 40%	3	9.7	4.5	-	-	-
over 40%	1	3.2	1.0	-	-	-
Total	31	100.0%	100.0%	22	100.0%	100.0%
Average Cost Increase			12.6%			8.4%

a/ Based on a sample of 53 cases reviewed totalling in $6.3 million procurement on cost plus insurance and freight (CIF) basis.

b/ Freight on board of vessel at point or origin.

Source: Developed by Coopers & Lybrand from information furnished by the DIB.

was the increase less than 5%. In contrast, under IBRD financed procurement, 31.8% of the cases increased less than 5% with the highest increase found to be 24%.

Based on this analysis, it may be inferred that shipping, insurance and freight related costs resulting from U.S. source and origin procurement are significantly higher than procurement from European origin. As a result, Egyptian investors may have been discouraged from seeking AID/DIB financing when other funds were available.

Reportedly another constraint to the use of AID/DIB funds is the time required to obtain price quotations. The DIB loan approval process is similar for both AID and IBRD financed loans except that in the case of AID the borrower must obtain price quotations from U.S. based suppliers. Our analysis shows that an average of 253 days was required for AID/DIB projects to receive DIB authorization from the date of application, whereas only 106 days were required of IBRD funded projects. 18/ Since IBRD/DIB borrowers were free to purchase equipment from any source, it is believed that part of the additional time for AID/DIB authorization may be due to problems encountered in obtaining price quotations from U.S. manufacturers. During our interviews with Egyptian investors they mentioned that, while they may be familiar with one U.S. manufacturer who could satisfy their equipment needs, they often encountered difficulty in identifying three U.S. suppliers offering comparable products as required by AID regulations.

- Effective Cost of AID/DIB Borrowed Funds. The high effective cost of AID/DIB borrowed funds is believed to be

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18/ Based on a random sample taken during our study.

another factor limiting AID's program responsiveness to private sector needs. Even though AID/DIB borrowers have for the most part been charged an 11% nominal interest rate (currently 12%), the average effective cost to AID/DIB borrowers was calculated to be 17%.19/

The additional cost is primarily the result of a 1% commitment fee charged by the DIB, and of the requirement that borrowers deposit funds equivalent to a percentage of the loan in a noninterest-bearing account. Most of these deposits have not been more than 20% of the loan, but in some cases the percentage was found to exceed 50%. AID/DIB financed public sector companies have not been required to make these deposits. Therefore, since the

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19/ The cost was computed on a present value basis on the total amount of loans actually granted, as if all had been granted on the same date. Disbursements on each loan were analyzed by quarterly periods over the first three years from the conventionally uniform contract date and present values were computed on the yearly totals. The quarterly amounts provided the basis for the calculation of interest at 11% per annum (i.e., 2.75% per quarter) on the disbursed amounts during the first 3 years and the one-year grace period, and of commitment fees at 1% per annum (i.e., 0.25% per quarter) on the undisbursed amounts. Present values of commitment fees and interest were calculated on the yearly totals. Payments of interest plus repayment of principal over 5 years, from the fifth through the ninth year, were taken into account as uniform yearly installments based on an amortization table for the amount loaned out at 11% per annum. Present values of the actual amounts provided by the borrowers on all the loans as "compensating balances" were taken into account as paid out at the beginning of the first year and recovered at the end of the ninth year.

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effective cost of funds was calculated on the total of the AID/DIB portfolio, the cost to the private sector is actually higher than indicated.

DIB practices which raise the effective cost of borrowing apply to all FX loan programs regardless of source. Therefore, AID/DIB funds were not found to be more costly than other FX loan programs within the DIB except in the case of the OPEC fund and the AID Commodity Import Program (CIP) which charge lower nominal rates of interest. The AID/DIB effective cost of 17% is still less than the 19% plus commitment fees currently charged by other banks in Egypt on FX loans. Nonetheless, the effective cost of the DIB loans can be lowered by eliminating the compensating balance requirement for private sector enterprises which is not required of public sector firms.

Because the DIB, unlike private sector banks, officially lends GOE FX funds, DIB clients are subject to a 2% surcharge from the Misr Import/Export Company on the total value of imported capital goods. Investors who borrow from the "own exchange" market are not subject to this cost. It has also been found that projects under the approval jurisdiction of the Ministry of Tourism are charged an additional 2% on the imported value of goods.

Finally, all DIB clients incur additional costs for obtaining mortgages on fixed assets to secure the loan. Fees for these services are based on the value of fixed assets and are significantly higher than notary fees in the U.S.

- Encourage Private Sector Development. The program encouraged private sector development by making FX funds available and by enabling borrowers to repay in local currency tied to the official rate of exchange. It also offered attractive features such as low nominal interest rates although, as mentioned above, these incentives were in part countered by the increase in the effective cost of borrowing.

  Projects under consideration are required to have a debt to equity ratio of 2 to 1 or less. The actual equity component of AID/DIB funded projects was 44% of the total projected investment. Thus, private entrepreneurs who use AID/DIB were required to mobilize a significant level of equity funds before they could seek DIB project financing. Therefore, it may be stated that while the program did encourage private sector development, it did so by financing those investors who had sufficient equity to meet DIB requirements to begin with.

  Our review of the DIB/AID portfolio also showed that few small scale firms were financed with AID funds. Small scale industries are able to obtain FX financing from the DIB's OPEC fund resource at lower interest rates. Therefore, it can be further stated that the program appealed to medium, and to some extent, large scale enterprises rather than small scale industries.

- Strengthen the DIB as an Institution. The program strengthened the institutional capabilities of the bank, especially in the areas of project appraisal and the processing of loan applications. The loan agreement included a $500,000 grant for technical assistance, primarily for staff training and purchasing equipment.

The technical assistance grant was extended in August 1977 and the DIB soon began to utilize allocated funds to purchase a telephone system and for travel. 20/

The training program conducted by Arthur D. Little began on March 1979 and focused on improving DIB's staff capabilities in project appraisal. In total, two eight-week cycles were conducted in which 41 employees participated.

The technical assistance appears in part to have contributed to the DIB's improved overall performance in evaluating loan applications. Between 1978 and 1980, the amount of projects authorized by the DIB increased 95%. Foreign exchange loans authorized have shown a more impressive increase. From 1978 to 1980 authorized FX loans increased 157% from LE 18 million to LE 46.6 million.

However, because the application and appraisal process is not yet fully standardized processing time is still relatively slow and the process cumbersome. While it is recognized that many factors contribute to the time required to obtain authorization, many of which are not within DIB's control, some action such as standard procedures could assist in expediting the process.

20/ The total technical assistance (TA) budget of $500,000 was subdivided into three components: Participant travel $50,000; equipment $100,000; and $350,000 for training programs. It should be noted that an additional $2 million has been granted for TA under a separate AID program with the DIB.

2. Analysis of Implementation Delays

Delays in program inplementation may be attributed to:

- Delays at the outset of the program while the SSPIS portfolio was transferred to the DIB and while the DIB was becoming familiar with program inplementation procedures.
- The occurrence of a large number of cancellations partly caused by the currency reevaluation.
- Various factors adversely affecting the utilization rate of AID funds by the DIB, e.g., procurement policies.

It it possible that had the initial delays not occurred, the AID funds would have been fully utilized by now. Perhaps in future programs AID should provide assistance aimed at familiarizing recipient institutions with AID regulations.

Of the conditions cited above, the latter two are more important at present. Since the program is not yet fully utilized if the causes of the delay problems are not identified and corrected, adverse effects will probably continue.

- Cancellation Problem. For the years 1978 through 1980, 27 projects totalling $20.2 million were cancelled. DIB actually authorized a total of $46 million but only $26.2 million resulted in net approvals as shown in Exhibit I-10. As previously indicated, included in the net amount approved are two large projects which are still awaiting AID approval. Cancellations in 1980 rose to the point where they exceeded the total amount of gross approvals.

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FUNDS BY SECTOR

Amounts in ($000)

	1976 No.	1976 Amount	1977 No.	1977 Amount	1978 No.	1978 Amount	1979 No.	1979 Amount	1980 No.	1980 Amount	Total No.	Total Amount
1. Minerals & Engineering												
. Gross Approvals	--	--	--	--	3	$ 393	--	--	--	--	3	$ 393
. (Cancellations)/Additions	--	--	--	--	--	--	--	--	--	--	--	--
. Net Approvals	--	--	--	--	3	393	--	--	--	--	3	393
2. Printing & Paper												
. Gross Approvals	--	--	1	$ 133	2	465	--	--	--	--	3	598
. (Cancellation)/Additions	--	--	--	--	--	--	(2)	$(465)	--	--	(2)	(465)
. Net Approvals	--	--	1	133	2	465	(2)	(465)	--	--	1	133
3. Chemicals												
. Gross Approvals	--	--	3	520	4	1,383	1	82	1	$ 5,000	9	6,986
. (Cancellations)/Additions	--	--	--	--	(1)	(236)	--	--	(2)	(660)	(3)	(896)
. Net Approvals	--	--	3	520	3	1,147	1	82	(1)	4,340	6	6,089
4. Building & Construction												
. Gross Approvals	--	--	1	1,995	--	--	1	5,000	1	3,000	3	9.995
. (Cancellations)/Additions	--	--	--	--	--	--	--	--	(1)	(5,000)	(1)	5,000
. Net Approvals	--	--	1	1,995	--	--	1	5,000	--	(2,000)	2	4,995
5. Food												
. Gross Approvals	--	--	3	788	14	6,271	6	2,971	1	324	24	10,354
. (Cancellations)/Additions	--	--	--	--	--	--	(1)	(454)	(2)	(2,374)	(3)	(2,828)
. Net Approvals	--	--	3	788	14	6,271	5	2,517	(1)	(2,050)	21	7,526
6. Spinning & Weaving												
. Gross Approvals	--	--	6	931	3	948	1	155	--	--	10	2,034
. (Cancellations)/Additions	--	--	--	--	(2)	(958)	--	--	--	--	(2)	(958)
. Net Approvals	--	--	6	931	1	(10)	1	155	--	--	8	1,076
7. Wood	--	--	--	--	--	--	--	--	--	--	--	--
8. Leather												
. Gross Approvals	--	--	1	600	1	93	--	--	--	--	2	693
. (Cancellations)/Additions	--	--	--	--	--	--	--	--	--	--	--	--
. Net Approvals	--	--	1	600	1	93	--	--	--	--	2	693
9. Tourism & Hotels												
. Gross Approvals	1	$ 30	12	10,317	7	2,685	5	950	2	85	27	4,067
. (Cancellations)/Additions	--	--	--	--	(2)	(3,543)	(7)	(4,432)	(5)	(1,299)	14	(9,274)
. Net Approvals	1	30	12	10,317	5	(858)	(2)	(3,482)	(3)	(1,214)	13	4,793
10. Other												
. Gross Approvals	--	--	1	30	1	17	2	1,000	1	247	5	1,294
. (Cancellations)/Additions	--	--	--	--	--	--	(2)	(817)	--	--	2	(817)
. Net Approvals	--	--	1	30	1	17	--	183	1	247	3	477
11. All Sectors												
. Gross Approvals	1	30	28	15,314	35	12,255	16	10,158	6	8,656	86	46,413
. (Cancellations)/Additions	--	--	--	--	(5)	(4,737)	(12)	(6,168)	(10)	(9,333)	(27)	(20,238)
. Net Approvals	1	$ 30	28	$15,314	30	$7,518	4	$3,990	(4)	$(677)	59	$26,175

Source: Development Industrial Bank

All cancellations were initiated by either AID or the investors, not the Bank. AID rejected three projects totalling $8.2 million because they failed to qualify under AID regulations.[21] Cancellations initiated by investors were due to several reasons. However, many stem from the change in the exchange rate which increased the borrower's effective debt liability by 75%.

Of the 27 potential borrowers, 14 did not seek financing from other sources; 6 were reauthorized and financed with IBRD resources of the DIB; 6 were financed with the investors' own funds and; one secured financing from a private sector bank. The fact that about half of the investors were discouraged from seeking additional financing lends credence to the important role DIB plays in financing private sector projects.

- Utilization Problem. Four and a half years after program initiation, AID funds have not been fully authorized. AID funds were utilized as rapidly as $1.8 million per month when the DIB had few other FX resources available and they were offered at the exchange rate of LE .40 to $1.00 . The utilization rate slowed considerably when the DIB's supply of FX resources increased. At the same time utilization of IBRD funds accelerated. A comparison of the DIB's utilization of the AID, IDA and IBRD loans is shown in Exhibit I-11.

21/ The Nile Hilton Hotel, Suez Cement Co. and the Cairo Clothing and Hosiery Co. For more information on AID/DIB projects cancelled see Appendix A.

DIB PERFORMANCE IN UTILIZING AID/DIB LOAN COMPARED TO OTHER SIMILAR DIB LOANS

	IDA II LOAN (No. 576)	AID/DIB LOAN (No. 263-K-035)	WORLD BANK LOAN (No. 1533)
Amount of Loan Proceeds	$ 25 million	$ 31.5 million	$ 40 million
Date of Loan Agreement	July 30, 1975	July 29, 1976	June 4, 1978
No. of Days to First Approval	160	63	53
No. of Days to First Disbursement	352	615	250
No. of Days Between First and Last Approval	814	---a/	803
Percentage Utilized as of 12/31/81	100%	83.1%	100%
Percentage Disbursed as of 1/31/81	98.8%	49.1%	55%
Average Rate of Utilization per Month	$921,376	$506,613b/	$1,494,396
Number of Loans	80	59	84
Average Size of Loan	$ 312,500	$ 443,600	$ 476,190

a/ The AID loan has not yet been fully utilized.

b/ Based on the amount of AID/DIB funds authorized as of 12/31/80.

Source: Developed by Coopers & Lybrand from data provided by the DIB

The IDA loan agreement became effective in July, 1975 while the AID and IBRD loan agreements were made in July 1976 and June 1978 respectively. Both the IDA loan of $25 million and the IBRD loan of $40 million were completely authorized by December 31, 1980, but only 83% of the AID loan was authorized by that date. The utilization rate of the AID loan was about $500,000/month as compared to $921,000/month and 1.5 million/month for the IDA and IBRD loans.

In January 1980, the DIB received an additional $50 million loan from the IBRD under terms and conditions similar to those of the AID loan except for the restrictions to purchase goods, shipping and insurance from U.S. based suppliers. Although the 4% DIB spread on the AID/DIB loan is higher than that of the recent IBRD loan, $36.2 million of the latter was utilized within a seven month period.

A review of the DIB organization, the banking system in Egypt and other factors suggests that AID program funds have not been utilized as quickly as anticipated because of the following reasons:

- Within the DIB, AID funds are less attractive to borrowers because of AID procurement regulations.
- The competitive disadvantage of US products in the Egyptian market.
- The DIB does not promote its services as actively as it should.
- The full benefit of the AID/DIB program funds is not being extended to borrowers. Therefore, they may compete with the CIP funds provided to the Bank by AID.

- AID Procurement Regulations. AID procurement regulations are restrictive and do not appeal to investors primarily because of the costs associated with freight and insurance and because of the inconvenience experienced by investors in obtaining price quotations from U.S. manufacturers.

- Competitiveness of U.S. Products. U.S. products are at a competitive disadvantage when compared to European goods because of the following:

  .. U.S. manufacturers are not as well represented in Egypt as the Europeans

  .. Scarcity of spare parts and maintenance services

  .. Longer delivery times

  .. Problems in conforming to existing production processes prevalent in Egypt, and

  .. Low adaptability to weight, measure and voltage standards in Egypt.

Because of these reasons Egyptian investors tend to prefer their traditional European trading partners unless U.S. products have a clearly perceived competitive advantage. Currently, few U.S. products are perceived in this manner.

- Promotion and Marketing of DIB Services. A limited number of interviews with investors and bankers, revealed that some were unaware of the DIB's activities and services. Once these were described, they found the repayment of FX loans in Egyptian pounds to be the most appealing feature of the DIB loans. They further stated that had they been aware of DIB's services, they would have considered it as a potential source for FX financing.

It appears, in view of the above, that the DIB is not very aggressive in promoting its services and competitive advantages. Yet it holds a large share of all term financing to industrial private sector companies in Egypt. This may be attributed to a relative lack of competition as the DIB is only one of two institutions which have been active in providing investment financing to the industrial sector.

. Lending Policies of the DIB. As previously stated, the Bank is not extending the full benefits of the AID/DIB loan. While it is stipulated in the loan agreement that the DIB may extend maturities up to 15 years and grace periods of 3 years, most loans made with AID funds ranged from 5 to 7 years with grace periods of no more than 2 years. Because of these practices, the AID/DIB funds may be competing with 2 other AID CIP programs within the DIB.

During 1979, AID initiated two Commodity Import Programs (CIP) of $5 million each with the Bank. The purpose of these programs is similar to the AID/DIB loan in that they offer foreign exchange financing for importing U.S. equipment. One difference, however, is that under the CIP, a borrower, in addition to importing goods for end use, may also import goods for resale. Nominal interest rates vary according to the purpose of the transaction. They are currently 6% per year on end use financing and 10% on resale financing. CIP loan maturity ranges from 2 to 3 years. Transactions financed under the CIP are limited to no more than $500,000 for one commodity or $1,000,000 for the same importer in any 12 month period. A 25% down payment is normally required to qualify for financing. Like the AID/DIB program, CIP financing is subject to the same AID procurement regulations and also allows borrowers to repay in local currency.

Each program offers advantages and disadvantages to potential investors, so it is difficult to determine which of the two is more appealing. For example, an investor seeking longer terms and grace periods may prefer AID/DIB financing. However, he may decide against this loan because DIB's requirements for compensating balances increase the effective cost of borrowing in direct proportion to the duration of the loan.

If a potential investor is unwilling to assume a debt liability for a long-term period, he may prefer the CIP program which allows him more choice over the use of financing. In addition, the effective cost of borrowing would be lower because of lower nominal interest rates and shorter maturity.

It is difficult to compare DIB's performance in utilizing CIP versus AID/DIB funds because it was only during 1980 that both programs were administered by the DIB. Even for that period, the comparison may be inaccurate because two large AID/DIB loans totalling $8 million were authorized by the DIB but have not yet been approved by AID.

Of the two $5 million CIP programs made available to the DIB at the end of 1979, one was fully authorized within approximately 12 months and the other is presently 25.7% authorized. During 1980, a total of $5.6 million in CIP funds were authorized by the DIB and more approvals have been made during January 1981.

3. Economic Impacts

This section analyzes the impact of the AID/DIB program on investment, employment, value added, regional development and the distribution of funds among economic sectors.

. Investment. Most AID/DIB loans have been lent to medium and large scale enterprises. AID/DIB authorized loans to sub-borrowers amounted to $26.2 million or about 15% of a total investment of about LE 105 million during the 1976 to 1980 period. The distribution of the AID/DIB loans by project size is shown below:

Approved Loan Project Size (LE)	Number of Projects	Percent of Total Projects	Amount (Thousand LE)	Percent of Total Amount
0 < 150,000	10	17.2%	326.4	2.4%
150,000 ≤ 250,000	10	17.2	597.8	4.3
250,000 ≤ 500,000	4	6.9	383.2	2.8
500,000 ≤ 750,000	7	12.1	830.8	6.0
750,000 ≤ 1,000,000	4	6.9	276.4	2.0
1,000,000 ≤ 3,000,000	10	17.2	1994.0	14.4
3,000,000 ≤ 5,000,000	6	10.3	1,641.8	11.8
5,000,000 ≤ 7,000,000	2	3.5	2,315.0	16.7
7,000,000 ≤ 9,000,000	4	6.9	5,050.7	36.4
≥ 9,000,000	1	1.8	445.0	3.2
TOTAL	58[a]	100.0%	13,861.1	100.0%

a/ An additional loan was approved recently but total investment information about the project was not available.

Most AID funds (about 82% of the total) were lent to projects of more than LE 1 million in total investment. About 36% of the total AID funds (LE 5.0 million) were loaned to four projects ranging from LE 7 to LE 9 million in total investment. Whereas 34% of all loans were made to projects with less than LE 250,000 total investment the total amount of AID funds lent to projects of this size is less than LE 1 million, or about 6% of the total amount. Since loans to SSI's are small, it is evident that only a small portion of AID/DIB funds were loaned to SSI's.

In 17 projects, the AID loan covered all financing needs other than equity. Total investment in these cases amounted to LE 11.6 million made up of LE 6.7 million in AID loans, (58% of total investment) and LE 4.9 million in equity (42% of total investment). It may be concluded that in these cases AID funds acted as a catalyst in stimulating project investment. But if the total AID loan portfolio is considered, where AID funds represented only 15% of total investment, there is a question as to whether all AID funds can be definitely linked to generation of investment. If, in fact, these AID funds could not have been provided from other sources, then these funds were indispensable to project realization. However, in many cases AID funds made up a relatively small percentage of the total investment which implies that the borrower could have found an alternative source of funding. In such cases AID funds probably did not act as a catalyst for investment.

- Employment. Investment in which AID funds participated generated an estimated 3,971 jobs in the 1976 to 1979 period. 22/ The corresponding Capital/Labor (K/L) ratio for the period was about LE 19,000 per job, and for 1979

22/ The number of jobs is estimated by the borrowers at the time their application and reviewed by the DIB during its evaluation procedure. Although the actual number of jobs is not closely scrutinized, once the project is in operation the projected data is considered to be fairly accurate.

alone it was about LE 25,000 per job. By comparison, the K/L ratio for all projects funded by the DIB in 1980 was LE 33,000 per job. The fact that AID funds were used in more labor intensive projects is probably a reflection of the large percentage of AID funds initially going to hotel and tourism projects which tend to be relatively labor intensive.

- Value Added. 23/ Data was not available exclusively for AID funded projects. Data for all DIB loans in 1980 shows a value added of LE 27 million for local currency investment of LE 61 million and value added of about LE 57 million for FX investment of about LE 113 million.

- Regional Development. Most DIB projects, including those funded by AID are concentrated in the Cairo and Alexandria areas. In 1980, the DIB approved 921 loans, 467 of which were recorded in Upper and Lower Egypt. However, the vast majority of these were located in Giza or Kalyoubyia Governorates, both part of the greater metropolitan Cairo area. It is estimated that almost 90% of all approved loans were for projects located in the Cairo and Alexandria regions. Thus, it may be concluded that, so far, DIB activities are not contributing significantly to the promotion of regional development.

The geographical concentration of DIB loans in metropolitan areas may be attributed to several factors. Most of the economic activity of the country is centered in Cairo and Alexandria. It was natural for the DIB, especially in the early years of its operations, to deal

23/ DIB calculates value added as the total of salaries, profit before taxes, interest, depreciation, actual or estimated rent, and pensions or other such benefits.

with investors in these areas. Another reason is that until recently when a branch office was opened in Tanta, DIB had branches in Cairo and Alexandria only. Since the communication system in Egypt is still beset with problems and distances are often long, it was difficult for these two branches to service outlying areas.

- Loan Distribution Among Economic Sectors. As shown in Exhibit I-12, of the 3,834 loans approved by the DIB, 1,190 or 31% were made to the metals and engineering sector, whereas the amount of loans funded to this sector totalled about LE 27 million or about 13% of the total. In terms of the volume of funds loaned, they were rather equally dispersed among most sectors, with the food and beverages sector having the largest share with LE 43 million or about 21% of the total.

  Most of AID/DIB funds went to food and beverages (25%), chemicals and leather (31%) building and construction materials (21%), and tourism and hotels (16%). Most of the IBRD funded loans followed a similar distribution with the addition of spinning and weaving, which received about 14% of the IBRD loans.

  Whereas the average size of all DIB loans was LE 54 thousand, the average size of IBRD/DIB loans was LE 218 thousand and of AID/DIB loans was LE 232 thousand. The low average size of DIB loans is explained by the fact that most of them have been working capital loans and by the large share of loans extended to small scale industries.

D. CONCLUSIONS

The program has, for the most part, utilized AID funds in a manner consistent with stated objectives, i.e., to increase industrial production; supplement DIB financial resources;

COMPARISON OF DIB, AID/DIB AND IBRD LOANS APPROVED BY ECONOMIC SECTOR, 1976-1980

	DIB			AID/DIB			I B R D		
Economic Sectors	Number of Loans	Amount Loaned (Million LE)	Average Loan Amount (Thousand LE)	Number of Loans	Amount Loaned (Million LE)	Average Loan Amount (Thousand LE)	Number of Loans	Amount Loaned (Million LE)	Average Loan Amount (Thousand LE)
Total	3834	203.2	54	59	13.9	236	192	41.8	218
% of Total	100.0	100.0	--	100.0	100.0	--	100.0	100.0	--
Food and Beverages	355	43.3	122	21	3.5	169	31	12.1	391
% of Total	9.3	21.3	--	35.6	25.2	--	16.1	29.0	--
Chemicals and Leather	543	31.6	58	8a/	4.3	537	28	4.9	176
% of Total	14.2	15.6	--	13.6	30.9	--	14.6	11.8	--
Spinning and Weaving	666	30	45	8	0.4	50	40	5.7	143
% of Total	17.4	14.8	--	13.6	2.9	--	20.8	13.7	--
Building and Construction Materials	445	28.7	65	2a/	2.9	1450	28	7.1	253
% of Total	11.6	14.1	--	3.4	20.9	--	14.6	17.0	--
Metals and Engineering	1190	27.1	23	3	0.2	68	26	3.9	150
% of Total	31.0	13.3	--	5.1	1.4	--	13.5	9.2	--
Tourism and Hotels	144	26.6	185	13	2.2	169	21	6.5	309
% of Total	3.8	13.1	--	22.0	15.8	--	10.9	15.5	--
Printing and Paper	156	6.8	44	1	0.1	100	15	1.4	91
% of Total	4.1	3.3	--	1.6	0.7	--	7.9	3.3	--
Doctors and Other Professionals	58	1.6	27	3	0.3	100	--	--	--
% of Total	1.5	0.8	--	5.1	2.2	--	--	--	--
Other	277	7.5	27	--	--	--	3	0.2	66
% of Total	7.1	3.7	--	--	--	--	1.6	0.5	--

a/ Includes one loan approved by the DIB but not by AID.

Source: Development Industrial Bank.

respond to private sector needs; encourage private sector development; and strengthen the DIB as an institution. The majority of the funds have been authorized for loans to the industrial sector, with over two-thirds of the funds lent to private firms and the remainder to public firms.

Whereas the program has been consistent with its related objectives, the slow pace in which the funds have been utilized by the DIB raises concern over the ability of the program to best meet the need to expand the private industrial capacity of Egypt. Further, it is anticipated that the DIB will not be able to utilize AID funds at a significantly faster rate during the next twelve months if the IBRD extends an additional FX loan to the DIB of a reportedly greater amount than its previous loans.24/

24/ An agreement has not been announced as of this date. The amount of the loan may range from $70 million to over $100 million.

AID/DIB CANCELLED LOANS

Investor	Amount of Loan	Date of Loan Application	Date Approved by DIB	Date Cancelled	Reason for Cancellation	Further Action Taken
Red Sea Hotel	$200,000	07/02/77	12/31/77	01/16/79	Cost increase due to change in exchange rate.	Did not seek other financing
Port Said Factory for Plastics	235,967	02/03/76	10/20/77	12/25/78	" "	Initially reduced the amount of loan then cancelled altogether.
Semiramis Travel	62,842	12/01/75	02/04/78	06/04/79	" "	Refinanced within DIB with IBRD funds.
Cairo Envelopes and Printing Factory	238,796	09/29/77	02/23/78	01/18/79	" "	Financed project with own funds.
Lotus and Maryland Hotel	200,000	07/04/77	04/26/78	01/16/79	" "	Financed project with own funds.
Intrabus Tours Co.	372,000	——	09/14/78	10/21/79	" "	Did not seek other financing.
Alexandria Hotel	181,000	——	07/24/79	12/23/79	Discouraged by price of U.S. goods.	Decided to purchase goods locally. Other FX requirements were financed with IBRD funds.
Ahmed Ashour Printing	226,325	06/03/75	01/11/78	01/16/79	After using a portion of the loan the price increased.	Refinanced unused portion of AID/DIB loan within DIB with IBRD funds.
Dr. Fathi Lousa	800,000	——	03/05/79	06/13/79	Cancelled because of personal reasons.	Did not seek other financing.
Dr. Mohammed Rafat and Company	$16,804	——	06/08/78	06/14/79	Cost increase due to change in exchange rate.	Did not seek other financing.

(Continues)

Investor	Amount of Loan	Date of Loan Application	Date Approved by DIB	Date Cancelled	Reason for Cancellation	Further Action Taken
Beau Soleil Hotel Luxor	$50,000	02/01/77	04/24/78	09/20/80	Cost increase due to change in rate exchange rate.	Financed project with own funds.
Isis Hotel	250,000	----	10/19/78	05/03/80	" "	Did not seek other financing.
Mohattam Dyeing Company	390,300	04/16/78	05/29/78	01/12/80	Equipment required not available in U.S.	Financed project with own funds.
Lounis Dyeing Company	81,693	----	03/28/79	03/09/80	" "	" "
Aton Tourist Hotel Company	1,494,000	10/19/78	05/30/77	07/12/78	Cancelled because of personal reasons.	Did not seek other financing.
El Maadi Pearl Hotel	100,000	----	05/02/79	09/10/80	Discouraged by price of U.S. equipment.	Decided to purchase some equipment locally and finance other within the DIB with IBRD funds.
Narsh Express	224,400	----	08/06/79	01/02/81	Cancelled the loan to purchase machinery locally.	Did not seek other financing.
Misr Co. for Soft Drinks	453,510	----	07/24/79	10/01/79	Used portion of loan and cancelled the balance. Was satisfied with production output achieved with equipment purchased.	Did not seek other financing.
Ekhnatoun Tourist Company	2,049,257	12/01/76	09/11/77	11/15/78	Decided to purchase equipment from Europe.	Financed project within DIB using IBRD funds.
Hyatt Prince Hotel	950,000	----	09/14/78	03/05/80	Cancelled because of high collateral requirements.	Sought financing from another bank in Egypt.
Nile Company for Clothing	$290,000	----	12/07/78	04/24/78	----	Financed project with own funds.

(Continues)

AID/DIB CANCELLED LOANS (continued)

Investor	Amount of Loan	Date of Loan Application	Date Approved by DIB	Date Cancelled	Reason for Cancellation	Further Action Taken
El Salam Cold Storage Co.	$1,191,000	----	01/23/79	04/02/80	Cancelled because too many cold storage facilities were established in the area.	Did not seek other financing.
Suez Cement Co.	5,000,000	----	12/17/79	10/01/80	Not approved by AID because public sector company with assets greater than LE 100 million.	Did not seek other financing.
Cairo Clothing and Hosiery Company (Tricona)	668,000	08/31/77	03/06/78	10/19/78	Not approved by AID.	Financed project with DIB using IBRD funds.
Misr Hotels Co. (Nile Hilton Hotel)	2,500,000	----	10/31/77	04/28/79	Not approved by AID.	Did not seek other financing.
Eng. Mohamed Magd El Din, Keshk	1,182,500	12/03/77	03/06/78	07/07/80	Cancelled because of personal reasons.	Did not seek other financing.
Delta Tourist Hotel	915,750	---	08/01/77	07/09/79	Decided to sell property instead of starting business.	Did not seek other financing.
Total Cancellations	$20,324,144					

Source: Development Industrial Bank

PN-AAL-169

UNITED STATES AGENCY
FOR INTERNATIONAL DEVELOPMENT

DEVELOPMENT INDUSTRIAL BANK OF EGYPT

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

FINAL REPORT

VOLUME II

AUGUST 1981

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

FINAL REPORT

BY

COOPERS & LYBRAND

AUGUST 1981

VOLUME II

ASSESSMENT OF FUTURE USAID ASSISTANCE
FOR
PRIVATE SECTOR DEVELOPMENT

FOREWORD

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.

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VOLUME II

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LIST OF EXHIBITS

ASSESSMENT OF FUTURE USAID ASSISTANCE FOR PRIVATE SECTOR DEVELOPMENT IN EGYPT

This volume consists of a brief overview of the Egyptian economy; sources and availability of capital; a review of the banking system including a brief discussion of development banking; an assessment of private sector development needs and the role DIB may possibly play in future industrial development. Finally, several ideas are presented on how USAID might respond to the investment needs of the private sector.

A. OVERVIEW OF THE EGYPTIAN ECONOMY

The recent economic history of Egypt has been marked by the 1952 revolution and its aftermath and the 1973 "Open Door Policy." Prior to 1952, the private sector was a dominant force in an economy characterized by rapid population growth, a large agricultural sector employing traditional production methods, declining agricultural output and an emerging industrial sector insulated from foreign competition with high protective tariffs and other barriers to imports.

Following the 1952 revolution, the Government of Egypt (GOE) took an increasingly active role in the country's economy. By 1965, the GOE had nationalized all banks and large enterprises and begun to control the production activities of small businesses. Throughout this period, the private sector remained an important part of the nation's economy. In 1966-1967, it accounted for more than 80 percent of the total gross value-added in leather, furniture, wood, painting and weaving and apparel manufacturing. The government's support of the industrial sector contributed to an increase of industry's share of GNP from 10 percent in 1952 to about 22 percent in 1969. However, by the end of the 1960's and in the aftermath of the 1967 war, Egyptian industry was facing problems of obsolete equipment, shortages of raw materials, a lack of sophisticated marketing techniques and capital and foreign exchange shortages. These and other difficulties prompted the GOE in 1973 to proclaim the Open Door Policy to stimulate both domestic and foreign investment and gradually lift private sector control and regulation.

Since 1973 the economy has in some areas achieved considerable progress as may be seen in the following indices:

Economic Indicators

	% of Share of Gross Domestic Product	
	1972/73	1979/80
Exports (Goods and Services)	14.6	43.8
Imports (Goods and Services)	21.0	53.0
Gross Annual Foreign Capital Flow[a/]	10.4	17.6
Total Stock of Medium and Long Term Debt (Outstanding and Disbursed)	38.0	58.0
Investment	22.3	30.4
Private Investment (Domestic and Foreign)	5.2	9.4

a/ Includes direct foreign investment.

Source: World Bank, Arab Republic of Egypt: Domestic Resource Mobilization and Growth Prospects for the 1980's, Report No. 3123 EGT, December 10, 1980, p. 3.

During the same period, the Gross Domestic Product has grown in real terms annually by an average of 8 percent. Most of this growth resulted from the rise in petroleum output which was accompanied by an increase in prices, the re-opening of the Suez Canal, growing remittances from Egyptian workers abroad, an increase in tourism and the continued exports of goods in which Egypt traditionally has had a comparative advantage such as cotton. The infusion of funds by foreign governments and international organizations has provided additional financial support.

There is a consensus that the Egyptian economy needs to diversify and alter its structure in order to continue to meet the needs of its citizens. The industrial capacity of the country needs to expand to be appropriately responsive to a growing demand for capital and consumer goods. Similarly, the agricultural sector needs to increase the supply of arable land, not only in terms of land reclamation, but also by adopting more modern techniques of production, storage and distribution, and by increasing vertical integration in food processing and agro-industries. In addition, the civil service is faced with a need to reorganize and modernize in order to better support the development process.

While the GOE has introduced measures to increase output in all sectors, the scarcity of agricultural land, the relatively greater availability of mineral and other natural resources, the large labor force and the size of the domestic market suggest that the country's comparative advantage exists in the development of its industrial sector. In order for the Gross Domestic Product to grow at a rate between 6 percent and 7 percent per annum during the eighties, it will be necessary to make substantial and efficient investments such that the incremental capital to output ratio (ICOR) be 4:1 or higher.1/

1/ Estimated by IBRD which also considers an ICOR of 4:1 to be high for Egypt's current state of development.

In order for this growth rate to be realized, the World Bank has estimated that necessary sources of investment and financial support will be:

Projected Savings and Investment as Percent of Gross Domestic Product

	FY 81/82	FY 83/84	FY 85/86	FY87/88
Investment	28.1	29.8	31.0	32.3
Expected Foreign Savings	9.9	9.7	9.7	9.4
Public Savings	7.1	8.4	10.1	11.6
Domestic Bank Financing	5.2	4.8	4.3	3.5
Required Voluntary Private Savings	5.9	6.9	6.9	7.8
Expected Voluntary Private Savings	7.9	8.0	8.2	8.6

Source: World Bank, Arab Republic of Egypt: Domestic Resource Mobilization and Growth Prospects for the 1980s, Report No. 3123 EGT, December 10, 1980.

The level of savings and investment envisioned by the World Bank is considerably higher than the level in Egypt today. In order to transform a high proportion of savings into investment, it is necessary to change the nature of savings from short to long term deposits, activate capital markets, create new financial instruments, and perhaps, create new institutions to encourage savings and investment.

Since the adoption of the Open Door Policy, investment in Egypt has steadily increased. Through July 31, 1980, the GOE, under Law 43, has approved 824 projects. The table below describes the status of these projects.

Law 43 Projects
Equity Investment Authorized Through 7/31/80
by Status of Project

Status of Project	Number of Projects	Percent of Total (%)	Equity Investment (Million LE)	Percent of Total Equity %
Approval	203	24.6	712	28.6
Implementation	295	35.8	946	38.1
Production	326	39.6	827	33.3
Total	824	100.0	2485	100.0

Source: International Finance Corporation, Report and Recommendations for Development of Capital Markets in Egypt, Draft Report, January 1981. (Original data from General Authority for Investment and Free Zones.)

Although the number of projects authorized under Law 43 is substantial, by 1979 only one-third had gone beyond the implementation stage into production.2/ Further, the Open Door Policy has not attracted the number or type of foreign investments that originally had been anticipated. Large manufacturing companies which were expected to set up sizeable production facilities have been few. The majority of foreign investment has been in the service fields such as banking, tourism and management services, not in manufacturing.

2/ The "in production" classification is somewhat vague in that it may be applied to factories in their last stages of construction as well as to fully operational factories.

Private Industrial Sector. The GOE has stated its commitment to gradual transformation from government control to market orientation. While this new philosophy has been ascribed to in varying degrees within the government structure, private sector investment is being encouraged and the government has taken measures to foster its growth. For example, foreign exchange restrictions have been liberalized and Law 43 has been amended to extend not only to foreign and joint venture companies but also Egyptian private companies.

A measure of the growth of the private sector can be seen in Exhibit II-1. Of all equity investment authorized through July 31, 1980, under Law 43, 72 percent have been in the private sector. Of the total industrial equity investment authorized, 69 percent have been in the private sector. However, the private sector's share of the gross value of industrial output increased modestly from 27 percent of the total in 1973 to slightly over 28 percent in 1977. Although only about one-third of authorized investments have reached the production stage, it is anticipated that as more private investment projects reach full production during the next few years, the share of the private sector's industrial output will increase.

Sources and Availability of Investment Funds. Bankers and investors interviewed reported that foreign exchange funds are more available today than in recent years, although the opposite may be true for local currency. The major sources of foreign exchange are receipts from petroleum exports, the Suez Canal, workers' remittances, tourism, grants and loans obtained from banks, bilateral organizations and foreign governments. The relative shortage of local funds, on the other hand, is principally the result of tight credit policies adopted by the Central Bank of Egypt as part of its effort to check inflation.

The primary source of investment funds for public sector companies has been GOE budget allocations and company-generated

LAW 43 PROJECTS

EQUITY INVESTMENT AUTHORIZED THROUGH 7/31/1980

Type of Project	Number of Projects	Total Investment	Public Amount	Public Percent of Total Investment	Private Amount	Private Percent of Total Investment	Egyptian	Foreign
Industrial	338	700	216	30.9	484	69.1	235	249
% of Total	41.0	28.2	31.5	----	26.9	----	29.6	24.8
Nonindustrial	486	1,785	469	26.3	1,316	73.7	559	757
% of Total	59.0	71.8	68.5	----	73.1	----	7034	75.2
	824	2,485	685	27.6	1,800	72.4%	794	1,006

Source: General Authority for Free Zones and Investment.

profits used for reinvestment. Public sector companies may also secure short term loans, usually up to one year, from commercial banks. Longer term loans are occasionally granted but only on a case by case basis. GOE budget allocations were, until recently, administered through the Investment Fund of the Ministry of Finance. The fund's activities were transferred to the National Investment Bank which was established in October 1980 for the purpose of financing all projects included in the state's General Plan for Economic and Social Development, "by participating in the capital of these projects or by supplying them with loans or other methods."3/

Loans and advances to public sector companies from 1975 to 1980 are shown in Exhibit II-2. As of mid-1980, banks registered with the Central Bank of Egypt had total loans outstanding to public sector companies of L.E. 1,251.9 million. About 70 percent of these loans were to industrial firms and almost all were in the form of short-term credit.

Private sector firms obtain funds generated from their own operations or from banks and other lending institutions. Until recently, private firms were at a distinct disadvantage relative to public firms since their only FX came from "own generated" funds. However, since the liberalization of FX regulations, they may now borrow from financial institutions or convert local currency to FX in the "own exchange" market.4/

Outstanding loans and advances to the private industrial sector, shown in Exhibit II-3, increased substantially from L.E.

3/ Legislation No. 119, for the Year 1980, establishing the National Investment Bank.

4/ The own exchange market is a system created by a government decree in 1974 that permits Egyptian nationals to maintain foreign currency holdings.

OUTSTANDING LOANS AND ADVANCES TO INDUSTRIAL

PUBLIC SECTOR ENTERPRISES
(Million LE)

BANKS	Dec. 1975	Dec. 1976	Dec. 1977	Dec. 1978		Dec. 1979		June 1980	
				LC	FX	LC	FX	LC	FX
Commercial Banks									
Loans & advances	409.3	499.5	650.2	698.3	16.7	770.9	0.6	822.6	8.5
≤ 1 year	402.5	495.8	642.8	696.0	11.6	751.7	0.4	808.3	8.4
≥ 1 year	6.8	3.7	7.4	2.3	5.1	19.2	0.2	14.3	0.1
Investment Banks									
Loans & advances	---	---	---	---	---	---	---	---	---
≤ 1 year	---	---	---	---	---	---	---	---	----
≥ 1 year	---	---	---	---	---	---	---	---	----
Specialized Banks									
Loans & advances	---	2.8	7.6	6.1	2.3	7.5	4.7	7.9	5.4
≤ 1 year	---	---	---	0.3	---	0.3	---	0.3	---
≥ 1 year	---	2.8	7.6	5.8	2.3	7.2	4.7	7.6	5.4
Offshore Banks	---	---	---	---	---	---	---	---	---
Total Loans and Advances to Industrial Sector	409.3	502.3	657.8	704.4	19.0	778.4	5.3	830.5	13.9
Percent of all Sectors	63.8	57.2	60.2	59.4	87.6	57.0	2.9	67.8	50.2
Total Loans and Advances to all Sectors	641.3	878.1	1,095.1	1,186.4	21.7	1.365.4	254.2	1.224.2	27.7

Source: Central Bank of Egypt

Exhibit II-3

OUTSTANDING LOANS AND ADVANCES TO INDUSTRIAL

PUBLIC ENTERPRISES

(Million LE)

BANKS	Dec. 1975	Dec. 1976	Dec. 1977	Dec. 1978		Dec. 1979		June 1980	
				LC	FX	LC	FX	LC	FX
Commercial Banks									
Loans & advances	52.9	36.5	193.3	195.3	24.9	295.7	34.2	346.7	82.5
≤ 1 year	47.7	36.4	191.9	184.9	15.7	267.7	29.1	319.7	76.4
≥ 1 year	5.2	0.1	1.4	10.4	9.2	28.0	5.1	27.0	6.1
Investment Banks									
Loans & advances	--	--	--	--	21.7	1.4	36.0	4.7	40.9
≤ 1 year	--	--	--	--	12.3	0.4	24.5	2.1	28.1
≥ 1 year	--	--	--	--	9.4	1.0	11.5	2.6	12.8
Specialized Banks									
Loans & advances	--	10.8	21.4	22.5	5.5	27.4	11.7	43.9	18.0
≤ 1 year	--	6.6	5.3	7.1	--	7.7	--	12.2	--
≥ 1 year	--	4.2	16.1	15.4	5.5	19.7	11.7	31.7	18.0
Offshore Banks									
Total Loans and Advances to Industrial Sector	52.9	47.3	214.7	217.8	52.1	324.5	81.9	395.3	141.4
Percent of Total	22.7	11.4	35.1	33.0	21.9	33.2	39.7	30.3	24.5
Total Loans and Advances to all Sectors	233.4	415.6	612.3	659.2	237.7	978.6	206.1	1,306.3	576.9

Source: Central Bank of Egypt

53 million in 1975 to L.E. 537 million in mid-1980; an annual rate of increase of 52 percent. Outstanding loans and advances to all sectors during the same period increased from L.E. 233 million to L.E. 1.88 billion, an average annual rate of 46 percent. In 1980, firms in the private industrial sector obtained L.E. 395 million in local currency and L.E. 141 million in FX, representing 30.3 percent of total local currency outstanding loans and 24.5 percent of total outstanding foreign exchange loans made to the private sector. About 80 percent of local currency funds and FX funds were loans to private industrial firms for one year or less. Although some of these loans are made with the understanding that they will be renewed or rolled over at the end of the year, the majority of financing was made available for shorter periods of time.

This preponderance of short-term lending is indicative of the nature of the deposits in commercial banks and perhaps of the reluctance of bankers and entrepreneurs to make long-term commitments.

Types of Deposits in Commercial Banks
(Million L.E.)

Type of Deposit	1978	% of Total	1979	% of Total	1980	% of Total
Demand	1,693	44.6	2,188	42.7	2,812	44.4
Time & Savings	1,334	35.2	2,079	40.6	2,680	42.3
Earmarked	766	20.2	854	16.7	846	13.3
Total	3,793	100	5,121	100	6,337	100

Source: International Finance Corporation, Report and Recommendations for Development of Capital Markets in Egypt, Draft Report, January 1981.

Most commercial bank accounts are in the form of demand or short-term deposits. This places a constraint on the banks' capacity to provide medium or long-term loans. This condition, along with the low level of gross domestic savings, the small amount of activity in the securities markets and the virtual absence of long-term financial instruments, results in a shortage of funds for long-term investment.

In an attempt to overcome this problem the GOE has taken steps to increase the availability of investment funds. For example, Law 120 was passed to stimulate banking activity and Law 43 to allow foreign banks to operate in commercial and investment activities. In addition, the Development Industrial Bank was established to provide long-term financing in both local and foreign currencies. The Misr Iran Development Bank also provides long-term financing to the private sector. Although these have been steps in the proper direction, it is perhaps too soon to assess their impact.

Interviews with members of the banking community concerning the availability of investment funds suggest that banks in Egypt are highly liquid, averaging 75 percent for private banks and 85 percent for public banks.[5/] However, the reported liquid position of the banks consists primarily of funds available for short term loans and not for long term financing. Estimated FX available from the banking system to private sector firms for medium and long-term credits in 1980 and 1981 is shown below:

5/ Liabilities (deposits and borrowings) exceed assets (loans and other commitments) by 75 percent and 85 percent respectively.

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Estimated FX Available from Egypt's Banking System

	3 to 5 Year Credits	Over 5 year Credits (Million U.S. $)	Equity Participation
Commercial Banks	66	8	6.5
DIB	66	40	---
Misr Iran Development Bank	22	10	11.0
Merchant Banks	22	5	4.5
Multinational Banks	55	11	11.0
Foreign Branch Banks	33	5	4.5
Investment Firms	--	--	11.0
Total	264	79	48.5

Source: R.R. Nathan Associates, A Study of the Feasibility of a Private Investment Encouragement Fund for the Egyptian Private Sector, September 1979.

It is estimated in the study by R.R. Nathan Associates that during 1980 and 1981 about $80 million will be available for long-term credit and about $48 million for equity participation. About half of the long-term credit is expected to be made available through the DIB.

There is near unanimity among bankers, investors and government officials interviewed that the demand for investment will increase substantially during the next few years. This expectation was based on the need for stability in the region, continuous improvements in the administrative apparatus of the country, availability of skilled labor and a favorable perception by potential investors of the general business climate. There are several indicators which support expectations for increased investment in the near future. According to the General Authority for Investment and Free Zones (GAIFZ), 498 projects were classified as being approved or under implementation at mid-1980. The corresponding investment value of these projects amounted to L.E. 1,658 million. It is not certain how many of these projects will reach the final production stage. However, even though the projected investment costs will be spread over a

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period of years, it does indicate substantial demand for investment.

Another indicator of increasing demand for investment financing is the number of projects under consideration by the DIB and other banks which extend long-term credit financing. The DIB reports pending applications for loans totalling L.E. 96 million or $137 million. The MIDB reports projects pending as the equivalent of $83 million in total investment.

The 1979-83 five year plan of the GOE projects that total investment requirements of the private sector will reach L.E. 4.5 billion, of which L.E. 1.7 billion will be in foreign exchange. These numbers represent an average annual demand for foreign exchange investment of over L.E. 300 million per year. Even if overestimated by 20 percent or 25 percent, annual requirements will exceed L.E. 200 million annually.

B. THE BANKING SYSTEM IN EGYPT

Since the enactment of Law 43 in 1974 and Law 120 in 1975 the banking sector in Egypt has rapidly grown. In fact, it has matured to the point where a broad array of domestic, foreign and domestic/foreign joint venture banks viably compete in the market.

Banks and Financial Institutions. In addition to banks many other types of financial institutions have also been established in Egypt. The table below sets out the number of banks and other financial institutions by type currently operating in Egypt.

Banks and Financial Institutions Operating in Egypt as of December 31, 1980

Type of Organization	Number
. Central Bank of Egypt	1
. Commercial Banks	
- Public Sector	4
- Private Sector, Egyptian Owned	4
- Private Sector, Joint Ventures	8
. Development Banks	
- Development Industrial Bank of Egypt	1
- Principal Bank for Development and Agricultural Credit a/	1
. Investment or Merchant Banks	
- Joint Ventures	4
- Foreign Branch Banks	16
. Free Zone Banks	1
. Other Institutions	
- Investment Companies	4
- Insurance Companies	4
- Nasser Social Bank	1
- Pension Funds	2
- Stock Exchanges	2
- Multinational Banks	3
- Representative Offices of Foreign Banks	28

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a/ Engages in both commercial and developmental banking activities.

Source: RRNA, Ibid.

Financial indicators for a sample of the above listed institutions is presented in Exhibit II-4. Exhibit II-5 presents a comparison of four-year growth in assets for the same institutions. Of these institutions, only the Development Industrial Bank and the Misr Iran Development Bank extend long-term credit to

Exhibit II-4

FINANCIAL INDICATORS OF SELECTED BANKS OPERATING IN EGYPT
12/31/1979

Banks	Total Assets	Loans Outstanding	Deposits	Net Profits	Return on Equity (%)	Return on Assets (%)
	(THOUSAND $)					
Arab African Development Bank	1,362.5	669.8	361.6	13.1	10.8	1.0
Arab International Bank	1,159.0	343.4	912.0	25.2	14.2	2.2
Bank of Alexandria	1,599.0	798.0	1,381.0	-	-	-
Banque du Caire et Paris	27.4	6.7	14.7	1.2	12.3	4.3
Banque Misr	2,700.0	1,426.0	1,920.0	72.4	134.0	3.4
Cairo Barclays International Bank	81.0	36.4	61.8	2.7	20.1	3.3
Chase National Bank	228.6	74.2	194.2	7.1	62.5	3.1
Delta International Bank	106.4	75.1	55.4	3.2	64.0	3.0
Development Industrial Bank	110.5	103.1	8.7	3.6	3.7	3.3
Egyptian American Bank	167.4	71.3	121.3	5.0	33.6	3.0
Misr America International Bank	68.2	40.5	38.3	.8	19.3	1.2
Misr International Bank	285.7	155.7	257.7	5.8	70.7	2.0
Misr Iran Development Bank	176.8	20.0	60.0	3.9	13.9	2.2
National Bank of Egypt	4,030.0	2,575.0	1,928.0	62.8	72.1	1.6
Nile Bank	51.2	9.9	33.3	1.2	19.5	2.4
Suez Canal Bank	293.9	145.6	201.5	7.6	53.0	3.7

Source: Cairo Barclays International Bank, Report on Competitive Activity, (unpublished).

Exhibit II-5

GROWTH IN ASSETS OF SELECTED BANKS OPERATING IN EGYPT
(% change from prior year)

Banks	1976	1977	1978	1979
Arab African Development Bank	2.8	11.1	89.0	17.5
Arab International Bank	9.5	38.0	17.0	8.8
Bank of Alexandria	8.9	n.a.	n.a.	n.a.
Banque du Caire	38.5	36.4	49.4	n.a.
Banque du Caire et de Paris	n.a.	n.a.	n.a.	25.0
Bank Misr	38.0	30.9	25.8	27.6
Cairo Barclays International Bank	year 1	11.8	45.4	62.8
Chase National Bank	year 1	47.8	12.6	21.8
Development Industrial Bank	year 1	55.7	64.9	59.0
Egyptian American Bank	-	year 1	33.0	46.2
Misr America International Bank	n.a.	n.a	n.a.	110.1
Misr International Bank	year 1	701.0	51.0	66.0
Misr Iran Development Bank	year 1	83.0	33.6	39.2
National Bank of Egypt	n.a.	.97	n.a.	n.a.
Nile Bank	-	-	-	year 1
Suez Canal Bank	-	-	-	year 1

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n.a.: not available

Source: Cairo Barclays International Bank, Report on Competitive Activity (unpublished) industrial firms. All other banks concentrate on short-term credit although in a limited number of low risk cases medium term credit is also extended. Investment companies are not as active today as they were a few years ago, mainly because their primary sources of funding are the oil producing Arab states which, for political reasons, do not presently maintain close ties with Egypt.

Interest rates for both deposits and loans in local currency are regulated by the Central Bank of Egypt. Interest rates on local currency loans are currently established at a rate of 13 percent to 15 percent. In some special cases, local currency loans by the DIB and the Principal Bank for Development and Agricultural Credit may qualify for government subsidies of approximately 50 percent. FX loan interest rates are, for the most part, established on the basis of the prevailing London Inter Bank Offering Rate (LIBOR) plus 2 percent. Exceptions are the development banks - DIB and MIDB - which determine their rates based on the source from which the subloan is made. Currently, this rate is 12 percent. There are also limited FX funds available for small scale industries at reduced interest rates as a result of a restricted use loan made to the DIB by the OPEC Fund.

Capital markets in Egypt are not very active. The Cairo and Alexandria stock exchanges, which have been in existence for a number of years, have only 56 corporations listed with total capitalization of approximately L.E. 159 million. Twenty-eight of the companies listed are in the public sector. Twenty-one are private companies under Law 26 and five are private under Law 43. The status of two of the corporations was not ascertained.[6/] An analysis of the distribution of capital shows

6/ IFC Report and Recommendations on Development of Capital Markets in Egypt, p. D-1, January 1981.

that public sector corporations account for L.E. 102 million (64 percent of the total), Law 43 L.E. 49 million (31 percent of the total) and Law 26, L.E. 5 million (5 percent of the total).

As would be expected, stock markets do not in any significant way contribute to the supply of investment financing presently available. A recent study conducted by the International Finance Corporation recommended several actions designed to increase the supply of securities. However, for the present, capital markets may be expected to continue to have little impact on the supply of funds available for project investment.

In addition to the above, the "own exchange" market is an important source of finance for foreign exchange. The own exchange market came into existence in 1974 when the GOE allowed Egyptians to hold foreign currency. Egyptians with such holdings were authorized to use them to import goods specified by the government for parallel market transactions. The parallel market exchange rate had originally been set 50 percent higher than the official rate in order to encourage Egyptians holding foreign currencies to convert them to Egyptian pounds. These foreign currencies were then made available to the private sector to import specified goods. A primary source of own exchange funds are remittances by Egyptians working abroad. The IFC reports that in 1979, remittances and own exchange imports amounted to L.E. 610 million and L.E. 839 million respectively, a total of L.E. 1.4 billion. Our interviews with bankers suggested that L.E. 1.4 billion may be a conservative figure, with L.E. 2 billion possibly being more accurate. Even if L.E. 1.4 billion is correct, it represents a rather significant amount which should be channeled toward productive investment.

Development Banking. Broadly defined, a development bank is an institution established, usually by government authority, to promote economic development by providing funds and other forms of assistance to the economy. Currently, there are over 85 development banks operating in 50 countries -- both developed and developing. Not many of these banks operate under the same set of objectives and policies, nor do many have similar organizational structures. Some are publicly owned, others are private and some have mixed ownership. Whereas some banks have very specific objectives within a development plan formulated by other government organizations or departments, other banks have broader functions which may include participation in national development planning. Some deal exclusively with the private sector, others with the public sector and some with both. Although particular circumstances determine the functions, objectives and policies of a development bank, most have a common goal of stimulating investment by promoting and financing capital loan projects and by providing various kinds of technical assistance to start-up or high-risk companies who would not normally qualify under prevailing conditions set down by the more typical commercial banking enterprises.

A fundamental difference between a development bank and a commercial or merchant bank is that the development bank must strike a balance between making a profit and achieving developmental objectives. Should the development bank pay attention only to profitability, then its contribution to economic development may come about only as a by-product of its operations. Should it, on the other hand, be overly concerned with development, it may not fulfill its financial responsibility to its shareholders.

Another distinguishing characteristic of the traditional development bank is its promotional function. Promotional activities by a development bank may include involvement in all phases of project development (i.e., conceiving an idea; studying its economic, financial and technical feasibility; arranging financing; organizing the company; and participating in the management of the project). At the other end of the promotional spectrum, involvement of the bank might be limited to making itself accessible to potential investors. It must be noted that promotional activities are not cost free. They require funds, staff time, the possible use of consultants, overhead and other outlays as well as opportunity costs. Promotion, therefore, must be consistent with an overall philosophy of profitability while at the same time fulfilling development objectives.

Whereas a few development banks deal with all sectors of the economy, most specialize in specific sectors or only with certain types of investors (e.g., mining and the processing of minerals, large scale manufacturing, tourism or small scale enterprises). An advantage of specialized development banks is that they become intimately familiar with all aspects of investment and associated risks in a particular sector and can, based on their experience and specialized knowledge, be of greater service to clients. A disadvantage of specialization may result in a bank being relatively limited in its ability to diversify its portfolio and spread risk.

Development banks generally operate within the constraints of their particular country's political, social and economic framework. Theoretically, government agencies establish operational policies and objectives and then evaluate performance to ensure that the bank's activities are consistent with the country's overall development objectives. In reality, however, financial profitability is often given greater emphasis than socioeconomic contributions.

There are a number of ways in which to structure a development bank and an equally large number of ways to assess its developmental contribution. Based on our assessment, and on a limited investigation of other development banks, the DIB compares favorably to other development banks in terms of economic contribution and financial performance. If, however the DIB is to be characterized, it is our opinion that the bank is oriented more towards institutional profitability than economic development issues.

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C. ASSESSMENT OF INDUSTRIAL PRIVATE SECTOR DEVELOPMENT NEEDS

Our review indicates that many individuals and companies seeking investment financing in Egypt have only a limited knowledge of resources that may be available to them. They do not know where funding can be obtained and perhaps more importantly, they have no concept of debt financing. This is particularly true for small scale industries (SSI's). SSI's encounter difficulties in obtaining proper documents, preparing acceptable feasibility studies and applying for the necessary GOFI and GAIFZ approvals. Difficulties further extend to securing price quotations from suppliers, obtaining import licenses, submitting loan applications and obtaining mortgages for security. For many small investors this is a prohibitive process because they are not prepared to do it themselves and cannot afford to have it done by others. Despite DIB's and the efforts of other financial agencies to assist clients in the loan application process, a large number of investors become discouraged and never reach this stage.

Banks in Egypt place strict requirements on potential investors before they will finance a project. For example, compensating balances and a debt to equity ratio of 2 to 1 or less are common prerequisites. In effect the banks provide financing only to those investors who have sufficient equity to adequately meet bank requirements. These requirements also suggest that the size of the loan extended to a prospective borrower is often proportionate to the size of the borrower's enterprise. In the absence of other sources of capital, the development of the private sector is almost totally dependent on finance generated by existing businesses or the availability of external (i.e., from outside the country) resources. It appears that an entire market for investment capital exists in Egypt which is currently not being served.

Relationships among investors and bankers are based on both business and personal considerations. A banker becomes intimately familiar with his client's operations and financing needs for working capital, investment financing and other services. The banker thus assumes an important advisory role and becomes the main source of information concerning available financing. Investors planning a new investment project deal almost exclusively with bankers with whom they have developed personal relationships. This is due partly to the length of time required in seeking financing from bankers who are unfamiliar with a businessman's operations or personal integrity and partly because investors are reluctant to disclose financial information to persons with whom they have not established a relationship of trust.

Our interviews with bankers also suggest that, from their perspective, there is an adequate supply of funds for investment finance; yet few projects have materialized. "Any viable project can obtain financing," we were told by several bankers. The bankers we spoke with offered many reasons why there was not more activity in the development area. These included:

- "Excessive governmental bureaucracy."
- "The extremely lengthly and complex process required to obtain licenses and approvals."
- "The extensive and everchanging government rules and regulations."
- "The scarcity of entrepreneurial talent which manifests itself in the inability or unwillingness of Egyptian business to structure and manage large projects even though there is a demand for such projects."
- "A reluctance to undertake any but very safe investments."
- "While changing, there appears to be a societal reluctance to undertake debt financing."

During our interviews and discussions in Egypt we perceived that "need" and "demand" for investment are often used interchangeably. However, whereas the "need" to improve the standard of living is evidently abundant, "demand" is a function of market conditions, technical feasibility, government regulations and many other real and perceived factors affecting return on investment and the associated risks. Whereas a sizeable need for investment exists, it is not the same as demand, nor should it be assumed that need can automatically be transformed to effective demand.

With respect to the apparent supply of finance, it should be remembered that most bank deposits are of a demand and short term nature. These may constitute a money market of adequate size to finance working capital and short-term loans, but not enough to supply funds to adequately satisfy demand for long-term investment.

Entrepreneurs, Egyptian or foreign, who consider investing funds, especially long-term funds, perceive several factors which will, to a greater or lesser extent, affect the return on their investment. In addition to those factors which influence product demand, technical feasibility, taxation, etc., the following must also be taken into consideration: the history of nationalization of private firms; bureaucratic obstacles; skilled labor shortages; inaccessibility of raw materials; inadequacies in the communications and transportation systems; and the military and political stability of the region. These and other problems, which either exist or are perceived to exist by potential investors, are not unique to Egypt. Private investment will occur only if there is reasonable expectation for adequate return relative to the level of risk undertaken. Since measures undertaken by the GOE to improve the business environment will require time to produce results, the GOE should, as other governments have done, be willing to undertake part of the risks.

In summary, we found that there is a need:

- 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 competitive in actively seeking out the first time investor.
- For the GOE to improve the business climate in Egypt and to assume part of the risk of long-term investment.

D. THE FUTURE ROLE OF DIB IN EGYPT'S FINANCIAL COMMUNITY

Since its creation in 1976, the DIB has played a major role in providing investment financing to private sector industrial enterprises. However, this cannot be attributed solely to factors internal to the organization. The DIB is the only GOE sponsored public sector bank mandated to provide term financing for private sector development. In order to accomplish its objectives the DIB has been granted certain operational privileges not available to other private or public banks. Partly because of these advantages the DIB has achieved a good record for financing private sector enterprises, particularly medium and small scale. Further, these privileges and protected environments have also helped the DIB improve its financial performance and build expertise in processing applications and in managing its portfolio without the normal competitive pressures normally faced by a financial institution in a start-up situation. On the other hand, these privileges have, to some degree, restricted the bank's institutional development by allowing it to operate in a protected environment.

The DIB's institutional and competitive weaknesses (discussed in Volume I) have limited its expansion into the entire investment financing market. MIDB and NBD on the other hand have aggressively entered this market, especially in the area of large capital investment financing. These weaknesses have forced the DIB to adopt a conservative lending policy, thus raising the effective cost of funds to its borrowers and reducing its initial advantage in offering interest rates below prevailing international market rates. Finally, these weaknesses have limited the DIB's ability to operate as a development bank in the traditional sense.

The increasing interest and activities of private sector banks in the investment financing market will place added pressure on the DIB. Therefore, to maintain its current position as a leader in financing medium and small scale investment projects, the bank must work to overcome certain organizational weaknesses. It may be assumed that the DIB will continue to receive financial support from international institutions. However, these institutions have begun to provide assistance to organizations other than the DIB. Thus, there is increasing pressure on the DIB to improve operations and to become more aggressive in establishing its presence in these markets if it wants to maintain or improve its competitive position relative to other lending institutions with similar activities.

DIB is expected to play an increasingly important role in financing investment projects of SSI's while at the same time strengthening its relations with medium and large companies. DIB can also be expected to continue to offer competitive interest rates on four to seven year loans for amounts less than $5 million.

Before leaving the subject of the future role of DIB we believe that a comment is warranted on the subject of the bank's "profit" orientation. We believe this is to be a favorable position for several reasons. First, if the DIB takes the type of risks typically associated with development financing it is bound to sustain losses on a percentage of its portfolio.

Profits are needed to establish reserves to cover these losses. Second, through its profitability DIB can show others in the financial community that risk-oriented, long-term lending can be both sound and profitable. Third, as it is a public bank, a certain level of profitability minimizes government involvement and public criticism -- both of which can be extremely detrimental in fostering future development. Finally, the bank may want or have to borrow money from the capital market. This will only be accomplished through a history of profitability. In conclusion, it can be anticipated that DIB will play a growing role in the Egyptian capital market and that no attempts should be made to stem the momentum it has established. In fact, every effort should be made to support the Bank and its future plans.

E. AID AND INDUSTRIAL DEVELOPMENT IN EGYPT

General Objectives for A.R.E. Economic Development. AID's general objectives place primary emphasis on assistance programs at the infrastructure level, directed to the lower income levels of the community in developing nations. In Egypt, along with its general objective of directly assisting the poorest-of-the-poor, the agency is actively promoting industrial development. When the mission initially re-established a presence in the A.R.E., most of its industry-building endeavors were public sector. This was in keeping with the national priorities of the time based on the government's near total control of production facilities dating back to the mid-1950's and nationalization. However, in keeping with the changing economic philosophy of Egypt, AID has recently focused on the private sector with such projects as, for example, Suez Cement Company. With increased emphasis, the Cairo mission is exploring ways in which private sector industrial development can be stimulated through grant or loan project activities.

AID's Experience in the Egyptian Banking Community. AID's involvement in the Egyptian banking community is linked directly to its desire to stimulate private sector industrial development. Its primary industrial project experience to date has been with the Development Industrial Bank. Its association with the bank dates to the early seventies when the DIB was still a branch of the Bank of Alexandria, fairly early in the re-establishment of AID-country activities. At that time the mission, as well as its staff, was new and the DIB project was designed with specific but recognized limited objectives. Our analyses, as described in Volume I of this report, show that these limited objectives were essentially met, but maybe not as quickly or as efficiently as might have been hoped.

Since that time the objectives of the mission, and the collective knowledge of its staff, has increased in proportion to Egypt's position within AID's overall global mission and priorities. Keeping this growth in proportion, the mission, in the areas of banking and private industrial development, has increasingly perceived a need to move away from a micro or project perspective to a more macro or program concept.

Future AID projects may well seek to achieve or increase the following program attributes: influence; visibility; and creativity. AID/Cairo, given an increased awareness of the Egyptian environment and an increase in the resources it commands, may desire to move toward a greater role of influence for banking policy and operations to maximize the contribution to private sector industrial development. AID has the potential financial capacity to be the country's principal financier of external foreign exchange. Such capacity should implicitly command a level of impact on policy and decision making. AID, by virtue of its programs in the banking community, should have a high degree of visibility. This, most probably, will necessitate active involvement on AID's part with a number of banks in addition to the DIB and future program planning for the mission will need to be adjusted accordingly. Finally, with an established program in place, AID has the opportunity to exercise creativity in its design of banking projects and programs.

With these three principles in mind, it is possible to explore a number of new options, for project consideration in the future, some proven, others more experimental. Several recommendations for mission consideration follow, based on our evaluation of the DIB and other project experience in Egypt.

F. RECOMMENDATIONS

In this section we briefly discuss several recommendations for AID's consideration. The objective of these recommendations is to suggest methods for increasing the flow of AID funds through the Egyptian financial institutions to the private sector for industrial investment.

Some of these recommendations, namely the Loan Guarantee Fund, the Loan Reimbursement Program, the Loan Blending Program, a New Development Bank and a program to encourage U.S. investment in Egypt would require major commitments by AID to study in depth the validity and viability of each recommendation. Furthermore, implementation would also require major effort and would call for at least some restructuring of the present financial system. Other recommendations are of a narrower scope and would be implemented with relatively minor modifications of existing institutions.

1. Loan Guarantee Fund. Two of the major constraints to long-term investment activity in Egypt are the shortage of funds available for long-term financing and the perception by bankers and potential investors that there are unacceptable risks associated with long-term investment.

In order to address these problems AID, in cooperation with GOE, could establish a fund which would be used to guarantee a portion of each loan extended to projects consistent with GOE development objectives. The Loan Guarantee Fund program would involve a GOE institution, probably the Central Bank, public and private sector banks, investors and AID. The role of each participant is briefly described below.

The Central Bank would set up a fund for the purpose of promoting industrial investment, consistent with Egypt's development objectives. This fund would be available to cover guaranteed loans in case of default. In addition, the Central Bank in cooperation with AID would establish the criteria under which banks would be eligible for participating in the program. These criteria (such as internal and social rates of return, employment generation, foreign exhcange earnings) would be established by the Central Bank in cooperation with AID. The Central Bank and AID would also have the right of final project approval to ensure that loan guarantees are extended only to eligible projects.

Any type of bank (commercial, development, investment) may participate in the program as long as it has the necessary personnel and facilities to promote, analyze, evaluate and finance projects on the basis of both financial and economic criteria. In addition, it should be capable of providing technical assistance, if needed. Banks which are interested in the program but do not initially possess the requisite qualifications may, with the help of AID, hire new personnel or train existing staff to service projects under this program.

Investors would be responsible, with the help of participant banks, for structuring projects meeting program criteria. Perhaps AID could design and implement programs to acquaint potential investors with the Loan Guarantee Fund and with other AID programs such as the Private Investment Encouragement Fund and the MMEP program.

AID's function would be to make available to the GOE, perhaps through the CIP program, an amount equal to that of the Loan Guarantee Fund in order to increase the amount of funds available for long-term investment. AID would also be instrumental in designing the program, establishing criteria for bank and project eligibility, providing technical assistance to banks and investors, coordinating this program with other existing or future AID programs, monitoring the performance of the program and introducing modifications whenever needed.

2. Loan Reimbursement Program. There is precedent for AID grant monies being used to encourage local financial institutions to take risks to stimulate selected sectors of a national economy.

In Bangladesh, such a program works in the following way:[7/] The local AID mission implemented, through the existing banking system, a program designed to encourage lending to the rural poor. This sector has traditionally been excluded in developing countries from the institutional types of credit more readily available to the affluent or urban entrepreneur. Lending to the rural poor has traditionally involved higher administrative costs, higher lender risks and lower awareness of institutional credit.

AID Bangladesh received the support of nine financial institutions in an experimental program designed to provide institutional credit to the rural poor, with the Bangladesh Bank (nee: the central bank) acting as the local facilitating agency. Each institution was given, on a grant reimbursable basis, one-third of all loans recovered from that population. These reimbursements then became a part of the participating bank's wholly owned assets. Defaults and the higher administrative costs associated with the program were paid for by AID.

7/ RFP #388-0025/USAID Bangladesh.

The program had a 73 percent recovery rate (as of December 31, 1980). Also as a result, saving accounts in rural areas increased significantly.

Several characteristics of this program may be considered when evaluating its potential for transferability to the A.R.E. One, it is designed for a borrower population historically excluded from the traditional forms of institutionalized credit. Two, it serves to indemnify participants and encourages the banking system to provide financing to a class of borrowers usually overlooked or purposely avoided. Three, it has direct applicability to the rural poor. Four, it adds to the existing assets of the banking community by purposely providing a multiplier effect over time.

AID/Cairo may find it desirable to use a similar grant reimbursement program in Egypt to stimulate rural farmer productivity, as was done in Bangladesh, or to encourage other sectors of the economy such as artisans, handicrafts and small scale enterprises.

3. Loan Blending Program. While there is an adequate FX and local money supply in Egypt to support short-term programs, there is a reluctance on the part of commercial banks to participate in medium and long-term lending and to take the risks generally associated with such investment financing. This reluctance in a developing country is difficult to reverse due to government policies, inadequate level of savings, a money supply concentrated in short-term demand deposits, prevailing interest rates and investment levels, etc.

These are purely economic issues and as such are, for the most part, beyond the control of the commercial banks. However, the risks associated with them and with development lending on the other hand is within the banks' control through practices that minimize such risk. One such mean is participation; two or more banks joining together to spread risk over a broader base thus diluting the impact of any one loan or its implications for a single institution. One form of participation is "blending," a procedure where two banks participate in a loan with one taking the short-term position and the other the medium or long. The mechanics of this process vary. Usually, a bank advances funds for feasiblity studies, design and construction and startup. Once these stages in the development process have been accomplished, the other bank takes the first out of its term position (usually a fee is paid at this point) while maintaining normal commerical banking relationships with the business. The second bank operates as a discount window -- something that does not yet exist in Egypt.

To our knowledge blending is not practiced in Egypt. However, it seems to be an ideal way of getting commercial banks more involved in development financing. Therefore, we recommend that AID/Cairo undertake a study to determine its feasibility. We would also recommend that the DIB be the bank to take the medium to long-term position, thus taking advantage of an existing organization already in place. Utilizing the existing commercial banks also makes sense in that: one, they have already established working relations with business prospects; and two, they are operational, aggressive marketing units, -- an area where the DIB is considered weak.

4. Establishment of a New Development Bank. Egypt currently has three banks active in long-term industrial investment. However, none of these three operates as a true development bank. Each is primarily profit motivated and thus, averse to taking risk typically associated with development financing. Also, in an apparent attempt to avoid risk, each bank markets to an array of types and sizes of companies. The natural outcome is that, while certain development needs are satisfied, a greater portion go unmet. A new development bank could play an important role in Egypt's development. The activity of this bank could be limited to one or perhaps two markets based on either industry, size or type of client activity.

Further, we believe the bank should not be a public sector bank but rather a joint public-private enterprise free from existing government policies regarding employee salaries, profitability, etc. The private sector involvement would be from one of the existing private sector commercial banks and the initial capital and control would also come from the private sector. Expansion would come from planned private sector capital infusions made over a period not exceeding ten years, to a point where private interests eventually may hold 50 percent of the capital invested.

We believe the advantages of such a structure to be four-fold. First, government's involvement through the establishment and control of the various aspects of the bank's charter assures that the new bank will adhere to truly development policies. Second, free from government/public sector employee requirements, the newly formed organization would be able to attract and retain the highest caliber employee. Third, private sector ownership will serve to attract those entrepreneurs that have been reluctant to deal with a public bank. Fourth, it would provide a vehicle for the commercial banks to avoid some of the difficulty and risks of investing directly in development projects.

A disadvantage of this proposal may be the reluctance of commercial banks to invest in such a joint venture as it might interfere or even take away from their ordinary business. This could be overcome by the argument that a successful development bank which raises the general level of economic activity will also benefit the commercial banks by increasing the total number of businesses and the expansion of existing ones.

AID's role in this process could take the form of first providing grant monies and technical assistance to the GOE to study the issue. This study should determine the charter of the bank; e.g., in what area the new bank should specialize, what the organizational structure is to be, what level of capitalization is required, where is the bank to be located, etc. Second, provide the bank's capitalization through a direct loan to the GOE.

In our opinion, all of these alternatives have merit. However, they are complex and will require time to implement. They will require GOE approval and possibly changes to laws and regulations. Therefore, in order not to lose momentum already established we propose three additional alternatives for consideration. All of these alternatives can be implemented within existing structures and would require a minimum of regulatory change, if any.

5. Encouragement of U.S. Investment in Egypt. A certain number of private enterprises in Egypt might offer attractive opportunities for U.S. investment. What is needed is a mechansim to bring such opportunities to the attention of potential investors.

The first step must be to select suitable opportunities. A projected high rate of return is not sufficient to motivate a U.S. industrialist or capitalist to make an investment abroad. Besides an attractive rate of return and a propitious investment climate (which may now be taken to exist) there must also be a good "business reason". For example, a U.S. manufacturer of ready-to-wear shirts with a large production volume might well be interested to take an equity participation in an Egyptian textile factory in order to gain an assured source of supply of high quality all-cotton poplin (for his "luxury" line) at an advantageous price (due to abundant production of top quality long-strand cotton in Egypt and relatively cheap labor). A joint venture of this sort should be mutually beneficial.

Opportunities such as these could be identified by consultants already familiar with the sort of applications for financing that are submitted to the D.I.B. The consultants should then prepare project profiles in English, to be circulated to potential partners in appropriate lines of activity in the U.S. through the Department of Commerce or an agency such as O.P.I.C.

6. <u>Form a Subsidiary Within DIB for Equity Participation Financing</u>. Various forms of this alternative have been briefly discussed with members of the AID Mission and with members of DIB management. A suggestion was made to make the subsidiary a private sector firm as a means of attracting higher caliber entry-level employees and providing an incentive vehicle for moving more competent employees out from under public sector controls. Controls that, in the viewpoint of the bank's management, were restricting the growth and profitability of the bank and hindering the ability of the bank to retain qualified employees.

As was previously pointed out in our report, this, in fact, has not been a serious problem. The supply of potential employees is sufficient for the bank to be able to attract and retain competent employees.

We believe that the concept may have merit for further consideration, but for reasons other than those held by either Bank management or Mission personnel.

- It would provide a means for the Bank to isolate control and then expand this type of lending activity. An activity that has high risk associated with it and without proper control could measurably damage the bank's financial position.
- It would put the bank in a more competitive position with other major banks in Egypt -- namely Misr-Iran -- who are aggressively marketing this type of lending.
- It would allow more involvement in "at risk" situations by providing a means for offsetting higher effective interest costs.

- It would serve to supplement investor equity positions -- particularly, with small scale industries.

The above list is by no means complete and can be added to with additional study of the opportunities associated with establishing such a subsidiary.

7. Provide Technical Assistance Grants to DIB. On the whole, the DIB has gotten off to an excellent start in its first five years of operation. There are, however, as in almost all starting situations, certain operational weaknesses that could be strengthened. Included among these are:

- A lack of an aggressive promotional or marketing effort.
- Inadequate loan follow-up.
- Limited capability to provide technical assistance to borrowers.

A series of grants can be given to study these issues and formulate strategies for overcoming them. Specific points that could be examined include:

- A fleet of mobile office (lending units) mounted on trailers that could go to outlying areas to directly contact individuals at their places of business.
- A series of public seminars concentrating on development financing -- what it is, who offers it, and how to get it.
- A department within the bank to provide business management assistance to borrowers -- an internal group of management consultants.
- More intensive and broader training of staff related to issues such as: financial evaluation, marketing, portfolio management, supervisory skills (people management).

PROJECT NUMBER:

PROCESS | ACTION | DATES | INITIALS:

CATALOGUE — for shelf list - 1656

ABSTRACT

FICHE ✓ RANDD

COMMENTS:

Coopers
&Lybrand

C&L

PROJECT NUMBER:

PROGRAM ACTION DATE

CATALOGUE ✓ for shelf list-1656

ABSTRACT

FICHE ✓ RANDD

COMMENTS:

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