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# THE PRODUCTION CREDIT PROJECT

(263-0147)

## A STATISTICAL PROFILE

## OF

## PARTICIPATING FIRMS

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Resources
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Support

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# EXECUTIVE SUMMARY

1. Title: The Production Credit Project: A Statistical Profile of Participating Firms

   Directorate of Industry and Support initiated this study of PCP (263-0147) in late August 1986.

2. PCP

   Constraints it Addresses

   First Order: Unequal access to credit and FX by private and public sector firms

   Second Order: Adverse policy on interest and exchange rates

   Adverse banking and credit policies and procedures

   Project goals

   A means: To develop Egyptian financial capability to service the full range of private sector financing needs

   To an end: To increase the private sector's contribution to Egyptian productive output

   Delivered

   $87 million in short-term credit for the procurement of American commodities. Lent dollars to 304 firms through 589 transactions. Repaid in local currency. Implemented by participating banks.

   Relationship to Mission Strategy

   -- Policy reform
   -- Encourage private sector
   -- Remove constraints to term-credit
   -- Facilitate institutional (bank) development

3. Statistical Profile

Purpose

-- Not an evaluation, and not to provide recommendations
-- To provide a statistical profile of participating firms
-- To explore previously identified issues, including use of PCP resources primarily as a cheap FX window, effects cheap FX have on investment decisions, additionality, and contributions beneficiary firms make to realizing project goals and purposes.
-- To contribute to design of evaluation plan for follow-on Private Sector CIP component of the new Private Enterprise Credit Project.

Methodology

Structured personal interviews with a probability sample of firms representing the population of 244 (non-trader) beneficiary firms

Major Findings

-- Beneficiaries are new and modern: 76% created since 1974; 71% place high importance on finding new products; 93% describe selves as quite modern and progressive.
-- They are growing firms in growing markets: 62% increased output by 100% or more over past 5 years; 71% increased sales and revenues by 100% or more; fewer (37%) increased employment by at least 100%.
-- Average per firm assets are LE 2,650,000; 17% have assets of less than LE 1 million.
-- 55% produce consumer goods or services; 45% supply intermediate products.
-- 31% of those producing consumer goods provide them for middle and upper-income consumers.
-- 24% export.
-- 84% of firms had 30% of all PCP transactions.
-- Only 26% of industrial firms procured equipment under PCP; 61% of agricultural firms and 100% of "all others" (primarily health) procured equipment.

Conclusions

-- There are significant inter-firm and inter-sectorial similarities and differences. Earlier studies (an AID evaluation and an IG audit) failed to capture this statistical diversity. They also failed to recognize differences among sectors and firms in responding to the several components of the assistance provided them.
-- Beneficiaries are the kinds of private sector firms AID might wish to encourage.
-- Beneficaries have developed the resources and orientation to help sustain their continued growth.

4. Significant Issues

(a) Only a Cheap FX Window?

Findings

-- Firms are import-dependent: The population of 244 firms has annual FX needs of about $500 million
-- They are price-sensitive: 87% obtain product and price information from as many suppliers as possible.
-- 43% rely on their banks to provide needed FX.
-- PCP met the entire FX needs of 12%; it met the entire credit needs of 28%. (Refers to year of transaction.)
-- 43% say that PCP met important credit needs.
-- However, credit is least important to firms in the largest sector: only 26% of industrial firms say PCP credit is equally or more important than FX.

Conclusions

-- Sectors and firms within them differ in the role that PCP credit rather than FX played for them.
-- Cheap FX is important, but providing it does not obviate the importance that credit plays for up to 43% of all firms. PCP is not "just" a cheap FX window. The project's short-term credit component is important to many firms, but least so to industry.

(b) Distorted Investment Decisions

Findings

-- It appears that industrial firms bought equipment at the free-market rate of exchange. But, again, they are least likely to procure equipment under PCP.

Conclusion

-- PCP did not distort decisions on industrial investments nor lead to unjustified investments in this sector. If any distortion occured, it was most likely in the "all other" (primarily health) and agricultural sectors.

(c) Additionality

Findings

-- 17% of the firms would most likely have dropped their proposed projects if they had not received PCP assistance. Another 29% would probably have met their needs, but it would have taken them longer to do so.

-- Investment and expenditure plans and behavior would not have been affected for the other 54%. They would have immediately met their needs in some other way.

Conclusion

-- Additionality was realized for a large minority of beneficiaries. The project's purpose ("to expand investment for productive private sector enterprises") was partially achieved, but the project has much room for improvement.

(d) The Project's Goal of Increasing the Private Sector's Contribution to Egyptian Productive Output

Findings

-- Sales and revenues increased, as noted earlier.
-- Investment also increased: 5 years ago, the median new investment was LE 120,000; this year it is LE 500,000.
-- 91% say they are likely to expand quite a bit over the next three years.

Conclusions

-- Although the credit "means" to achieve project "ends" never got off the ground, the ends themselves were partially realized.
-- These "achievements" are found among those meeting and not meeting the additionality criterion, as well as among firms differing in the relative roles they assign the credit and FX components of the project.
-- PCP is helping the kinds of firms AID might wish to encourage, but the help provided may have minimal effect on progress toward achieving project goals, especially within the raw-materials-oriented industrial sector.

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CHAPTER 1

INTRODUCTION

A. Why another study?
B. What is PCP?
    1. Goals and purposes
    2. Evolution and present status
    3. Conclusions and limitations of earlier studies
C. What will the present study accomplish?
D. Research procedures
E. Summary

## A. WHY ANOTHER STUDY?

In December 1984 a four-person team of banking, economics, and commodity-procurement experts evaluated the Production Credit Project (AID project 263-0147). In addition to reviewing documentary materials, the team talked with 75 Egyptians and Americans familiar with the project. This evaluation was followed nearly one year later by an Inspector General's audit of the project. Three auditors conducted field work from September 1985 through January 1986. They too reviewed project files and interviewed knowledgeable individuals. A third review of many of the same issues covered in the first two reports was undertaken during the fall and winter of 1985 in the course of preparing the new Private Enterprise Credit Project Paper (263-0201).

All three series of studies provided detailed information on key project issues. The reports were insightful and useful to the Mission.

Given these three studies, what is the rationale for still a fourth albeit different type of investigation of the same project?

There are several answers to this question. Most importantly, the earlier studies focussed heavily on credit, banking, and foreign exchange issues. This focus covers the credit component of the project's goal. It does not adequately address the ability of the credit and foreign exchange (FX) provided by the project to realize its objective of increasing the private sector's contribution to national development. Information on the uses of project funds by beneficiaries requires that data be collected from the actual users. Other issues identified in the earlier reports also require an analysis of information collected systematically from participating firms.

Very little is known about these firms, a void that the present study helps fill.

Therefore, the present study differs from earlier ones in its objectives, sources of information, and research methodology.

This chapter has three objectives:

1. To briefly describe PCP's objectives and present status.

2. To introduce the purposes of the present survey; and

3. To present the research methodology that provided the information for this report.

B. WHAT IS PCP?

1. Goals and Purposes

PCP goals include an implied means to achieve an end:

End: To increase the private sector's contribution to Egyptian productive output.

Means: To develop Egyptian financial system capability to service (the) full range of private sector financing needs.

The project purpose is:

To expand investment for productive private sector enterprises.

The project achieves these goals and purposes by providing short and medium-term credit to Egyptian private sector firms to finance the dollar costs of importing commodities and equipment from the United States.

Other meanings have been added to the above. For example, the project-evaluators imply that imported commodities should be of "high developmental value." They also rephrase the project goal as helping to "increase private sector output through the provision of short-term credit for the import of needed industrial raw materials, spares and capital equipment." (Emphasis added.) GOE-issued circulars approved by AID have given further specificity to these added concerns by defining eligible industries and commodities.

2. Evolution and Present Status

A private sector set-aside from the Commodity Import Program preceded PCP. Consecutive CIPs from FY 1977 to FY 1981 disbursed $137 million to private firms.

PCP was authorized in August 1982 and amended in March 1985. By the middle of August, 1986, ten participating banks processed 589 transactions worth nearly $87 million for approximately 304 firms. (The number of banks increased from nine for most of the project's life up to 12 today.)

In addition to decisions banks make about extending PCP funds to applicants, USAID also approves individual transactions. PCP funds are tied to the procurement of U.S. commodities.

3. Conclusions and Limitations of Earlier Studies

AID's own evaluation of PCP found deficiencies but also accomplishments and opportunities for improvement. The Inspector General's audit was more pessimistic. Both reports focus primarily on the credit means to achieve the project's goals of increasing the private sector's contributions to Egyptian productive output. (Summaries of both reports are included in Annex D.)

> From the AID evaluation: Although the project's "goals were overly ambitious," it "was very successful in providing foreign exchange inputs to private sector industries that used these imports efficiently...The credit market and institutional development side of the project never got off the ground."
>
> With the changes recommended by the evaluators, the team conjectured that "a more effective and targeted project could be developed to build on the accomplishments of this project."

> From the Inspector General's audit: "The audit showed that the project goals could not be achieved, indicators for measuring project success were invalid, and the project was being implemented in a manner that was unlikely to bring about the desired outcomes."

These conclusions were based on extensive interviews and reviews of project materials. However, the research procedures adopted by the evaluation and audit teams do not allow them to assess progress in meeting either (1) the project's goal to increase the private sector's contributions to Egyptian productive output or (2) the purpose of expanding investment for productive private sector enterprise. Conclusions relating to the project's goals and purposes require that inferences be based on evidence collected in a systematic way from a representative sample of the firms participating in PCP.

Both of these earlier reports rely on on two types of arguments in making inferences. First, inferences are based on a fortiori reasoning: Distortions in exchange and interest rates impeded the development of the credit system and practices intended for the project. If these systems and practices were not achieved, then there is even stronger reason to believe that the productive and investment objectives of the project could not be achieved either. There is only one means to the project ends, and if the means are defective, it is obviously not possible for the ends to be realized.

Second, the evaluation and audit teams heavily rely on subjective if not circumstantial evidence provided primarily by those not directly participating as project beneficiaries. Findings and inferences based on this information come from the perceptions of the project held by bankers, businessmen, government officials and AID staff, but only a small number of representatives of beneficiary firms. The IG audit talked with what was claimed to be "a representative cross section of PCP customers engaged in different types of business activities..." This sample consisted of two traders and six non-traders only. No information is given on the questions asked or how they were asked. The written project materials and other reports on which the team drew did not provide systematic information on the performance of participating firms, nor did the perceptions of those interviewed provide such evidence.

Experienced auditors and evaluators often are able to make sound inferences based on the kinds of second-best data collected to date for PCP. We simply point out the qualifications that should be placed on these presumed findings and conclusions.

Having done so, we now move to a research project designed and executed in ways that allow us to directly test some of the inferences that the earlier evaluation and audit made regarding progress in achieving project goals and purposes.

## C. WHAT WILL THE PRESENT STUDY ACCOMPLISH?

This study is intended to help fill the evidence and inference gaps that the earlier evaluation and audit have with regard to project goals and purposes relating to the performance of individual private sector firms. The scope of work (which is more of a research proposal, included as Annex E) describes the study as a "proposed statistical profile" of participating firms.

Information is not available on the universe (population) of all private sector entities in Egypt, so it is not possible to ascertain whether or not project funds could have been put to better use by other firms. And since it was not feasible to review the underlying financial records of firms, it was not possible to directly measure enterprise profitability, sustainability, or value-added. These limitations in the research design were consciously and deliberately intended.

The study has three general purposes, each covered in a separate chapter:

<u>Chapter 2</u>: <u>A statistical overview of participating firms</u>: Information is presented on what kinds of firms from which sectors obtained FX from the project, what these firms produce, what commodities they procured under the project, and the dollar costs of these procurements. The emphasis is on firms, not transactions (which was the more common primary "information unit" for the evaluation and audit).

This is baseline information that will allow project management to chart and measure changes in the future, as well as predict some of the likely consequences following from proposed changes in project policies and procedures.

Chapter 3: Is PCP used primarily as a cheap FX window? The project was intended to effect changes in credit and banking practices and policies. The evaluation and audit report that FX moved quickly through the credit system but without changing it in anyway.

This chapter looks at the importance that participating firms place on the (cheap) FX and credit components of the project. What proportion of these firms' FX , credit, and import needs are met by the project? What are the respective percentages of firms reporting that the project's major importance to them was its FX or credit?

Chapter 4: Contributions of PCP to Realizing the Project's productive and investment objectives: This chapter addresses the significance that PCP has for participating firms more generally. Firms that benefit from cheap FX can still contribute significantly to increased private sector production and investment. However, if the beneficiary firms would have met their FX and credit needs in other ways (if PCP were not available), then no "additionality" results from the project. This and other policy issues are considered in this chapter.

Chapter 5 briefly summarizes the results of the earlier chapters. The emphasis is on statistical findings and conclusions that can be cautiously based on them. This study is not intended to be a standard AID evaluation. Recommendations are not ventured.

## D. RESEARCH PROCEDURES

Four kinds of evidence are used in this report:

1. Information from the PCP management information system. (This was not very useful for present purposes.)

2. The findings and materials reported in the AID evaluation and IG audit.

3. Quantifiable information collected from structured interviews conducted with representatives of a probability sample of PCP firms.

4. Qualitative comments obtained from these same firms in the course of the interviewing.

Annex A contains thumbnail sketches of 21 of the firms participating in the sample survey. Annex B describes the research procedures adopted. Annex C contains the interview schedule.

The sample was drawn from a universe of 244 firms. They are the end-users of the project. "Traders" were excluded from the universe because they no longer qualify for participation in the project.

These 244 firms were divided (stratified) into six cells according to sector (industry, agriculture, and all others) and number of transactions (one only and two-or-more). Replacements were drawn at the same time the original intended sample of 51 firms was selected.

Because of a lack of staff time and resources, as well as the absence of a reliable roster of potential beneficiary firms, no matched (control) population of non-participants was interviewed. Nor does this study build on earlier data-collection activities that would allow before-and-after comparisons to assess some of the consequences of the project's interventions (i.e., the provision of credit and FX). Firms did, however, provide numerical estimates of firm performance levels for both the current year and five years earlier. In both instances, as well as throughout the interview schedule and present report, "estimates" are recorded.

These qualifications are more than caveats. They are intended to emphasize the limitations of the survey as an evaluation device and as a compilation of very precise statistical information.

Fieldwork was conducted between October 8 and November 5, 1986. Interviews were done in the field, but most were completed in the USAID offices. Egyptian FSN staff conducted slightly less than half the interviews in Arabic. The study director (Robert E. Mitchell) conducted most of the remaining interviews and all those completed in the field. He also designed and drew the sample, prepared the interview schedule, and wrote the present report.

Forty of the intended 51 interviews were completed. It appears that many if not most non-respondents resulted from inadequate addresses. The firms could not be located. This was most pronounced for rural-based agricultural sector firms.

Because there are no apparent differences between respondents and non-respondents, the numerically deficient cells in the stratified sample were weighted so that the completed sample would make it possible to refer to the universe of all 244 participating firms. There is one small exception to this: The three percent of the universe that is from the "all other" sector having two or more transactions.

Table 1.1 presents the sample used for the present report. Readers are referred to Annex B for a more detailed discussion of the sampling and fieldwork procedures adopted for this study.

Table 1.1
Sample Used For
Present Report

| Sector | Number of Transactions 1 only | 2 or more | Total |
|---|---|---|---|
| Industry | 15 | 13 | 28 |
| Agriculture | 10 | 3 | 13 |
| All others | 8 | 0 | 8 |
| Total | 33 | 16 | 49 |

E. SUMMARY

A recent AID evaluation and IG audit of the Production Credit Project found that the credit and banking changes intended for the project were not achieved. These changes are means to realize two ends: (1) increase the private sector's contribution to productive output and (2) expand investment for productive private sector development.

Measures of progress toward achieving these ends require that evidence be systematically collected from a representative sample of firms participating in the project. Neither the evaluation nor the audit had this evidence, although they collected considerable amounts of subjective and circumsantial information. The present study attempts to fill this evidence gap and in so doing test some of the inferences appearing in the evaluation and audit reports.

Since its inception in 1982, PCP disbursed $87 million to 304 firms for 589 transactions. Project funds are administered by ten participating banks that provide FX repayable in local currency for the procurement of U.S. commodities.

Chapter 2 of this report provides a statistical overview of the 244 (non-trading) end-user firms participating in the project. Chapter 3 assesses the relative importance these firms place on the FX and credit components of the project. And Chapter 4 assesses the contributions these FX transactions made to realizing the project's productive and investment objectives.

To achieve these research objectives, a stratified probability sample of 51 firms was selected. Forty structured interviews were completed with representatives of these firms. Because there are no apparently significant biasing differences between non-respondents and respondents, the sample has been weighted in a way to permit us to generalize about the population of 244 participating firms.

# CHAPTER 2

## A STATISTICAL OVERVIEW OF PARTICIPATING FIRMS

A. Beneficiaries tend to be new, modern, and expanding
   1. They are Infitah firms
   2. Over half are outside the larger cities
   3. Traditional legal structures still predominate
   4. But they are modern in other respects

B. PCP firms are rapidly expanding in competitive growing markets
   1. Their markets are growing and competitive
   2. They are growing along with if not creating their markets

C. The resources and strength of beneficiary firms
   1. Fiscal assets
   2. Employees
   3. Sales and revenues

D. Industry provides more than half of all firms

E. Firms provide both intermediate goods and consumer products for all income groups.

F. PCP transactions

G. Summary

USAID's management controls for PCP emphasize transactions, not firms. Information is recorded and tracked on the size of the transaction, commodity, participating bank, letters of credit, supplier, and other pertinent facts that allow AID to fulfill its fiscal responsibilities. This fiscal focus is incorporated in the project's MIS, which in turn carried over to the evaluation and audit. They drew on the most readily available information, supplemented by only a limited data-collection effort for the firms behind the transactions.

The present chapter provides simple basic descriptive information on these firms: Who they are, where they are located, their sector of activity, what they produce, who buys their output, the resources available to the companies, how much money they obtained under PCP, and what they procured with these funds.

This information identifies firms that have benefitted from the project. It does not address "how" they benefitted nor the importance of the benefits. These two concerns are covered in Chapters 3 and 4.

In addition to filling an information gap, the chapter helps provide a baseline for measuring future changes in the project.

## A. BENEFICIARIES TEND TO BE NEW, MODERN, AND EXPANDING

### 1. They are Infitah Firms

Law 43 of 1974 laid the legal basis for the accelerated development of new private sector investments. This law has been amended several times, and additional legislation--e.g., Law 159 of 1981--further encouraged private sector development.

PCP has been supportive of Egypt's private sector responses to new economic opportunities: 76 percent of all beneficiary firms were created since (and including) 1974; 35 percent were created after 1980.

### 2. Over Half Are Outside Larger Cities

New firms may have their business offices in the Cairo or Alexandria metropolitan areas, but many of their manufacturing or service centers are located outside the older built-up cities: 14 percent are in new communities; 30 percent are in smaller towns or villages; 48 percent are in a "larger city."

Agricultural operations are not city-based, nor are they limited to the metropolitan areas

Thirty-seven percent of all beneficiaries are in Cairo or Giza; only eight percent are in Alexandria, whereas 37 percent are in one of the non-metropolitan governorates.

### 3. Traditional Legal Structures Still Predominate

Most firms are organized as family or individual operations. Only 18 percent are clearly "independent corporations."

Others seem to have the same corporate legal status, but these firms are so dominated by one person or one family, they are self-described as sole proprietorships (22 percent) or family firms (45 percent). Seventy-one percent have one of these more traditional equity, legal, and ownership forms.

### 4. But They Are Modern In Other Respects

PCP firms are market-oriented and innovative. Of those providing information, 71 percent place "high importance on finding new markets," 78 percent "look for new products," 91 percent "place high importance on reducing costs," and 93 percent describe themselves "as quite modern and progressive."

These new, modern (they are often built on established names and families) express other important modern chacteristics central to PCP: They work with banks, and most rely on bank-extended credit. Within a short period of time, these PCP firms have been able to establish their credit worthiness. No doubt there are many other excellent new and older private sector firms that could benefit from the PCP. However, it may take another kind of program to assist these firms, especially those without a credit rating, a family name, or a willingness to work through banks.

## B. PCP FIRMS ARE RAPIDLY EXPANDING IN COMPETITIVE, GROWING MARKETS

### 1. Their Markets Are Growing and Competitive

Egypt offers a good market for most PCP firms. Only one company reported "the market for your product is declining." For those who provided information, 68 percent say they are in a growing market. Demand is pulling expansion and investment, as will be seen later.

PCP firms are sensitive to their markets, and they respond in various ways to this competition, including looking for new markets and products, as well as reducing costs. (See A.4 above.) Forty-five percent say they face a "very competitive market"; another 24 percent of report that their market is "not very competitive."

### 2. They Are Growing Along With If Not Creating Their Markets

By both subjective and objective measures, PCP firms are growing (Table 2.1).

TABLE 2.1

PCP FIRMS HAVE RAPIDLY EXPANDED OVER THE PAST FIVE YEARS

| Type of Change Over Past 5 Years | Subjective Appraisal of Change* | Objective Performance* |
|---|---|---|
| Total Output | 86 percent report an increase | 89 percent expanded; 62 percent increased output by 100 percent or more; 27 percent increased by 200 percent or more.** |
| Gross Sales and Revenue | 85 percent report an increase | 97 percent experienced an increase; 71 per cent increased by 100 percent or more; 32 percent increased by 200 percent or more. |
| Employment | Fewer firms, 69 percent, report an increase | 76 percent had some increase; 37 percent increased by at least 100 percent |

* Percentages based only on those providing information.

** The unit of output varies by type of firm and product.

## C. THE RESOURCES AND STRENGTHS OF BENEFICIARY FIRMS

PCP beneficiaries are not all made out of the same mold. They differ in their gross value, work force, and sales. Blanket statements about the project's participants, their contributions to national development, and the benefits they receive from the project must be tempered by these variations.

### 1. Fixed Assets

Although relatively new to the market, PCP firms report a sizable investment. The 42 firms providing information on the value of their buildings, land, equipment, inventory, and other assets report a total of LE 210,563,000. Projecting to the universe of 244 PCP firms yields an investment of about LE 1.2 billion

The average PCP firm has assets valued at LE 2,650,000. But smaller firms are not excluded from the project: 17 percent have assets of less than LE 1 million; the same proportion have assets in excess of LE 10 million.

### 2. Employees

Larger firms bias the mean number of employees: 205. The median is 60 workers.

### 3. Sales and Revenues

The average size 1986 firm of 205 employees working with an average of LE 2,650,000 in assets will produce average annual sales and revenues of LE 2,590,000 (for the 37 firms providing information). Twenty-four percent of the firms have annual revenues exceeding LE 10 million; 24 percent have less than LE 1 million in sales.

## D. INDUSTRY PROVIDES MORE THAN HALF OF ALL FIRMS

Based on an analysis of the project's MIS, industry accounts for 46 percent of all 581 transactions. (Traders are included in these figures.) Agriculture claims 19 percent, with health eight percent and the other sectors (construction, services, tourism and education) accounting for seven percent only.

When end-users are considered(traders are excluded),industry's share increases: 56 percent of participating firms are from this sector, followed by 26 percent for agriculture and 19 percent from the other sectors.

## E. FIRMS PROVIDE BOTH INTERMEDIATE GOODS AND CONSUMER PRODUCTS FOR ALL INCOME GROUPS

Sector-level information hides considerable heterogeneity in actual products. The agricultural sector has the least variety: eggs and broilers predominate, but firms in this sector also produce feed, manure, and breeding stock (see Annex A). End-users in the health sector provide different specialized services--e.g., services for premature babies, adults with kidney diseases, particular kinds of dental work, etc. And industry has even greater diversity--from soup to plastic containers.

AID's evaluation of PCP attempted to relate transactions to sectors that earlier studies suggested provide Egypt with a comparative advantage. Again, the categories used are too general. The best the evaluators could claim is that "at least they (the presumed subsectors receiving transactions) do not appear to be categories where investment is definitely not warranted."

For the present survey, products and services were classified as "intermediate" or "consumer." The former includes cardboard boxes, plastic bottles, window glass, etc.; the latter includes eggs, sweets, medical services,etc.

This crude distinction yields a fairly close split between the two types of products: 55 percent are consumer products; 45 percent are intermediate.(Some firms producing intermediate goods consider them to be consumer products. Our classification is obviously crude.)

The GOE counterpart for PCP has expressed concern over providing project funds to firms producing primarily for middle and upper-income consumers. Of the 32 firms providing information on their consumer products or services, 31 percent report their market is for this segment. Sixty-nine percent serve the entire market, while 25 percent focus almost entirely on "the popular classes."

Twenty-four percent of the firms export some portion of their output. About two-fifths of the exporters also produce for the Egyptian middle and upper-income market. There appears to be somewhat of a conflict between domestic markets favored by the GOE and Egyptian export potentials.

It is not clear that the non-exporting firms can be classified as "import-substitution" investments. Some PCP firms are providing commodities and services new to the Egyptian economy. Eggs and poultry operators provide a new source of protein for new population segments that obtained their protein from non-poultry sources in the past.

Other firms are manufacturing replacements for existing products, many of which may have had a higher local content in the past. This observation might apply to plastic containers.

At least in the Egyptian context, classifying products for investment and PCP purposes does not lend itself to facile decisions by either AID or the GOE.

F. PCP TRANSACTIONS

A relatively small number of firms account for a high proportion of all transactions. Most firms only participate once. In the universe of all end-users and traders, 62 percent have had only one transaction (they may have had a transaction under the predecessor Private Sector CIP). This 62 percent had 32 percent of all transactions.

Approached from the heavy-user side, eight percent of the firms had 30 percent of all transactions. One-fifth of the firms had 52 percent of the total number of transactions. (These figures, again, refer to the universe of all firms, including traders.)

The present sample of 49 firms had 83 transactions worth $14,640,000. The average transaction size was $176,116.

Individual firms differ widely in the amount of PCP FX they received. The average was $298,776, but 20 percent of the firms had $500,000 or more from the project. At the other extreme, 26 percent received less than $50,000.

Project funds were used for a wide range of commodities. Some firms procured both equipment and raw materials. Most (61 percent) got raw materials; 43 percent obtained equipment.

As will be emphasized again in chapter 4, industrial firms are least likely to use their PCP FX for equipment. This usage is most common in the "all other" sector (primarily health): 100 percent of their transactions are for equipment; agriculture follows with 61 percent, whereas only 26 percent of the industrial firms are acquiring American equipment under PCP.

American raw materials are in highest demand. This is especially so for plastics. Polyethylene comprises 14 percent of the universe of transactions (for traders and non-traders). In industry alone, 22 percent of the transactions are for this commodity.

## G. SUMMARY

This chapter fills an information-gap. The emphasis is on description; there is no "dependent" variable and, therefore, no need for the use of statistics helpful in explaining variations in a dependent variable. The descriptive information provides the Mission with a baseline for measuring future changes in PCP. This information also lays the basis for a consideration of the policy and program issues discussed in the following two chapters.

PCP beneficiary firms differ in their background, industry, size, growth rates, uses of PCP, and other features. One must be cautious in making blanket assertions about either the firms or the effects PCP has on them. These variations will be shown in the next two chapters to raise questions about conclusions and recommendations earlier studies made concerning this project.

Information on the universe of Egyptian private sector firms in the different sectors is lacking. As a consequence, it is not possible to ascertain the similarities and differences between PCP beneficiaries and the universe of potential beneficiaries. However, it appears that the participating firms are:

1. New, modern, and growing. PCP has been helping the new private sector in its early development stages.

   Many firms operate under traditional family and individual ownership, but the firms are market and modern-oriented in most other respects. These firms should be able to make good, efficient use of PCP resources.

2. In a strong, growing market. The firms are responding to market demand by increasing output, sales, and employment.

3. Developing the resource base (assets, employment, and revenues) for continued growth and contributions to the national economy.

4. Heavily represented by manufacturing companies in the industrial sector.

5. Manufacturing and providing both intermediate goods and consumer products. Many firms serving the middle and upper-income consumers are also exporters.

6. Different in the number of their PCP transactions and dollar values. A relatively small number of firms have a high proportion of all transactions. However, small as well as large firms participate. The size of the benefits varies greatly.

7. Different in the kinds of commodities they procure under the project. Industrial firms buy U.S. raw materials; firms in the health and "all other" sector procure equipment. The agricultural sector falls between these two extreme patterns.

# CHAPTER 3

## IS PCP USED PRIMARILY AS A CHEAP FX WINDOW?

A. Beneficiaries are import-dependent
B. Obtaining FX has high priority
C. Firms differ in their reliance on PCP FX and credit
D. Agricultural and health firms say that PCP credit is important
E. Why not try again?
F. Summary

In January 1986, FX provided under PCP was sold at 43 percent less than its market value. This translated into a 77-percent subsidy. It is little wonder, then, that the project has been criticized as simply a cheap FX window.

Some critics have even charged that beneficiary firms have no problem in obtaining credit. Since PCP was "to develop Egyptian financial system capability to service (the) full range of private sector financing needs," the absence of any such needs (i.e., the "no problem") undercut the project's very purpose.

This chapter explores these assertions by examining the demand for imports, FX and credit, the degree to which PCP helped meet these needs, the personal judgements of company representatives concerning the importance they assign to the FX and credit components of the project, and reasons why those who demand FX do not seek additional support from PCP.

### A. BENEFICIARIES ARE IMPORT-DEPENDENT

PCP beneficiaries are a self-selected group. Most are dependent on imported equipment and raw materials. They need FX, for without it there would be no raw materials to process and, therefore, firms would cease operating. Some firms, of course, are less dependent than others on imports and FX.

All the firms providing relevant information report they have imported raw materials and/or equipment over the past five years. Seventy-six percent imported both equipment and raw materials; 15 percent limited themselves to equipment only; nine percent were limited to raw materials. Even these figures are deceptive, for they refer to commodities that firms themselves imported from all sources. Firms also procure foreign commodities available in the local market.

Thirty-eight of the firms reporting information on imports estimated they imported $386,461,000 in raw materials and equipment over the past five years. This is about $77 million a year. All 244 participating firms have annual needs of perhaps nearly $500 million a year.

## B. OBTAINING FX HAS HIGH PRIORITY

FX is seen to be a scarce and extremely valuable resource. Acquiring it is a top priority for these import-dependent firms.

PCP firms seem to be quite price-sensitive in their import behavior, and they are likely to respond quickly to changes in the exchange rate, the value of the U.S. dollar, and the cost of U.S. commodities. Eighty-seven percent of the firms providing information say they "obtain product and price information from as many suppliers as possible" for their imports.

Their need for FX puts PCP firms in contact with banks. Sixty-two percent say they "take out a loan from a local bank" to pay for their FX, but fewer--only 43 percent--"rely on your banks" to actually provide the FX. A majority of PCP firms, one way or the other, obtain their FX from the free market at free market rates. Still, banks do play a significant credit and FX role for private sector beneficiaries of PCP FX.

## C. FIRMS DIFFER IN THEIR RELIANCE ON PCP FX AND CREDIT

Private sector demand for FX far exceeds PCP resources, a fact confirmed in the present study.

According to the AID evaluation, as of 1983, AID's contribution of the then-$67 million in PCP toward the Egyptian private sector's import financing requirement was only 1.52 percent of U.S. exports to Egypt, 2.38 percent of exports funded by U.S. assistance, and 0.53 percent of Egypt's total imports for that year.

The 49 firms surveyed for this study received $14,640,000 in PCP funds, whereas they are importing at the rate of at least $77 million of commodities a year. PCP's life-of-project funds may have met between three and five percent of these firms' needs over the five-year period.

But for any one year, the contribution is much higher (and firms differ in their yearly demands). Twelve percent report that PCP met their entire FX needs; 39 percent had half or more of their needs met.

Again, firms differ widely among themselves for the year(s) of their transactions: 38 percent report they received one-fifth or less of their FX through PCP. It seems likely that PCP FX made a potentially significant contribution to at least 60 percent of all firms.

Similar comparisons are found for "year-of-transaction" credit needs met by PCP: 18 percent met all their needs through PCP, 28 percent met at least half of their needs, but 18 percent did not meet any of their needs through the project. These firms used banks as money-changers. They bought their dollars outright.

## D. AGRICULTURAL AND HEALTH FIRMS SAY THAT PCP CREDIT IS IMPORTANT

Given the high demand for FX to pay for large amounts of imports, it is not surprising that modern firms know of and gain access to PCP resources. The demand these firms have is certainly one measure of "need," although probably not the same need the audit and evaluation had in mind.

Fifty-seven percent of the respondents reported that FX was the "most important need that PCP helped" them meet. Only 11 percent said that credit needs were more important, but another 32 percent said both FX and credit needs were equally important.

PCP may be a cheap FX window, but 43 percent of all beneficiaries recognize the importance of the credit mode of providing FX. This is one indicator of the project's partial success.

But the success is weakest in the industrial sector, the area that the project evaluation saw as the key to PCP's goal. Only 26 percent of industrial firms say that PCP credit is equally or more important in meeting their credit rather than FX needs; agricultural firms had double that rate, 61 percent, whereas 72 percent of the all other (mostly health) firms recognize the importance of PCP credit.

The cheap FX-window argument may have merit for the largest segment of project beneficiaries. (Industrial firms represent 56 percent of all beneficiaries.) PCP as a credit mechanism has more merit for non-industrial firms.

A firm's perspective on PCP depends in part on the firm's sector and the different credit and other meanings associated with the sector.

More will be said on this matter in Chapter 4.

E. WHY NOT TRY AGAIN?

If PCP's cheap FX is so attractive, why don't more firms seek additional transactions?

Twenty percent of the answering firms report they did not seek more transactions because they had met all their FX needs; another 20 percent claimed they had the maximum amount allowed under the program. But the largest single category of answers -- 42 percent-- referred to "other reasons." These reasons pertain largely to delays in funding PCP.

Several firms were highly critical of their own government's and AID's handling of the project. AID's role was highly visible; the Mission is involved in the transaction-approval process, and the tied-procurement feature of the transactions highlights the American connection. To at least one respondent, the banks were a bothersome ineffective screen between the Agency and the private sector.

Some firms hold-out hope for additional funds. In anticipation of new FX, they reduce the size of their local procurement below the level at which suppliers offer quantity discounts. But at least one dissatisfied participant reported that wise firms realize they can not depend on AID, PCP, or their own government. PCP, to some firms, has added to the lack of predictability in the private sector environment. Unfulfilled expectations have created some resentment and dissatisfaction at the same time these particular firms are grateful for the assistance they received.

AID faces a challenge of weaning some firms away from PCP. The Mission's approval of a second transaction sends a message to these firms that AID has given them its approval. They feel the Agency has a commitment to keep on supporting them.

## F. SUMMARY

Cheap PCP FX is important to import-dependent cost-conscious modern firms. But that does not mean that the mechanism for providing FX--which is credit--is not equally important to many firms.

This chapter has described wide variations among firms in their dependence on imports, FX, and credit to obtain the FX. PCP differs as well in the degree to which it meets beneficiary firms' FX and credit needs.

FX and credit needs are not mutually exclusive of one another. Many firms recognize this and report that PCP was equally as important in meeting their credit as in meeting their FX needs.

But sectors differ in what they feel they get from PCP. The largest sector--industry--emphasizes the FX component of PCP. Firms in other sectors, primarily agriculture and health, give about equal importance to credit as to FX. These intersectorial differences may reflect variations in credit standing and in banks' attitudes toward the sectors.

PCP could no doubt move much more money. Many firms are frustrated in obtaining additional transactions because they feel the dollar flow of funds into the project is erratic and unpredictable. On the basis of success rates to date in obtaining funds, it seems probable that a relatively few firms would capture a major share of transactions, if the project ran at a higher and more even rate of disbursements, as seen earlier in Chapter 2, Section F.

# CHAPTER 4

## CONTRIBUTIONS OF PCP TO REALIZING THE PROJECT'S PRODUCTIVE AND INVESTMENT OBJECTIVES

A. Additionality: A mixed picture
   1. The issue
   2. Additionality applies to fully/only half the firms

B. Distortion is distorted
   1. The issue
   2. Cheap PCP FX probably has little effect on the investment decisions of industrial firms

C. Windfall profits to Egyptian firms and fortuitous assistance to American exporters

D. PCP firms are contributing to Egyptian productive output (the Project's goal)
   1. The issue
   2. PCP firms are increasing their output and investment

E. Summary

To what degree does PCP (1) "increase the private sector's contribution to Egyptian productive output" and (2) "expand investment for productive private sector enterprises"? The first objective is the project's goal; the second is its purpose.

These questions pertain to macro-sectorial contributions, but the contributions are necessarily realized by individual firms.

The private sector may appear to be realizing the project's objectives, but this achievement may have nothing to do with PCP or other AID projects. Furthermore, macro-economic developments may hide inappropriate patterns--e.g., industries with no comparative advantage (and even negative value-added) may be growing because of subsidies and protections offered them.

Assessing progress toward project goals is difficult. Both the AID evaluation and the IG audit have critical comments on goal and purpose-achievements to date. While we are not able to provide definitive measures of progress, it is possible to address several key issues that such measures would entail.

Three issues are considered in this chapter. First, does PCP provide assistance over and above what beneficiary firms would have provided in any case? This is the "additionality" issue. Second, to what degree does cheap FX adversely distort investment decisions? Third, regardless of reservations raised regarding additionality and distortions, are beneficiary firms growing and thereby providing a private sector contribution to increased productive output?

## A. ADDITIONALITY: A MIXED PICTURE

### 1. The Issue

The 1982 "Report of (the) Private Sector Reconnaissance Team Visit to Egypt" reaffirmed Agency policy that AID financing must assure additionality, not the substitution of AID funds for other sources. The IG audit found that "most, if not all, of the commodities obtained (by end-users and two traders) would have been purchased even if project credits were not available, although probably not from U.S. suppliers."

USAID agreed with this assertion, at least for traders. They were excluded from the project, in part because they already had access to credit and FX. (They were also said to receive windfall profits.)

### 2. Additionality Applies to Fully/Only Half the Firms

About half (54 percent) of the firms report they would have "immediately met your (their) needs in some other way" if they had not gotten PCP assistance. The additionality criticism seems to apply primarily to these firms, a slight majority of all beneficiaries.

Nearly one-fifth (17 percent) of the beneficiaries say they would "most likely (have) dropped the project made possible by the transaction"; another 29 percent would have "probably met these needs,but it would have taken somewhat longer."

The productive output of nearly half the firms would have been at least partially lost were it not for PCP. As production involves more than the resources provided by the project, there would also have been less private sector investment were it not for the project.

Still, it appears that many finance-smart firms, nearly all of whom are dependent on imports, look to PCP as a FX window. Their investment and development plans were not based on the availability of PCP credit or FX. These firms are no different from the traders who were excluded earlier from participating in the project.

## B. DISTORTION IS DISTORTED

### 1. The Issue

Conventional wisdom argues that limited productive resources will be best employed if they are priced at their true market value. The IG audit argues that, instead of basing decisions "on the true cost of capital," the project's cheap FX provides subsidies that can "distort the real cost of investment decisions." "Subsidized foreign exchange also can lead to unwise investment decisions and eventually to business failures." Furthermore, the project's "transactions did not cause investment decisions to be made that would not have been made in the absence of the project and their impact, therefore, could not be expected to be developmental." Project funds were allowed "to flow to firms least in need of the financial assistance provided," a danger that the IG claims could be partially avoided by greater sectorial targetting.

Distortion, therefore, refers to sectors as well as to factor investments within individual firms. Cheap PCP FX encourages distorted investment decisions that have broader developmental implications.

### 2. Cheap PCP FX Probably Has Little Effect on the Investment Decisions of Industrial Firms

Arguments about distortion seem to imply an industrial model: The major investment of firms is in plant and equipment, the large upfront pre-production costs of manufacturing. These are the costs that can be easily distorted.

Although most PCP firms are newly created, few of them would have been in a position to realistically base their go-no-go investment decisions on the availability of limited USAID resources for the private sector.

Transactions involving equipment do seem to allow for new or expanded activities, whereas raw materials play primarily a current maintenance-of-production role. Ninety-five percent of those who obtained equipment report that the equipment allowed them "to do new things not possible earlier"; 64 percent of those obtaining raw materials report that the materials were used primarily to "maintain you(r) current production levels"; ten percent say the materials went into a new product, and another 20 percent say the materials allowed them to "produce beyond your then-current productive levels."

AID's new Private Enterprise Credit Program proposes restricting the use of the follow-on PCP activity in meeting the raw materials requirements of established firms, a proposal supported in the IG audit. This decision may significantly reduce industrial demand on the project, shifting a larger share of transactions to other sectors.

Industrial firms typically procure their equipment from non-American sources. The FX is probably bought in the free market at the free market rate of exchange. Cheap PCP FX does not affect this initial production decision. AID enters later in the development process by providing cheap FX that is used to procure raw materials that are processed by equipment that companies acquired earlier with non-U.S. resources.

Which firms, then, are procuring U.S. equipment? By the definitions used by the firms interviewed in the present study, only 26 percent of the industrial firms procured equipment with PCP funds. But 61 percent of the agricultural firms and all 100 percent of the firms in other sectors (primarily health) obtained equipment.

The largest share of beneficiaries, therefore, have development trajectories that seem to have involved initial investment decisions based on the true cost of capital. These firms are heavily dependent on imported raw materials, but the availability of cheap PCP FX for the procurement of these raw materials is unlikely to have distorted investor decisions on entering a sector or selecting the factor-mixes within individual production processes.

Annex A includes brief thumbnail sketches of the non-industrial and non-agricultural firms whose decisions on equipment were presumably most likely to have been distorted by the availability of cheap dollars.

## C. WINDFALL PROFITS TO EGYPTIAN IMPORTERS AND FORTUITOUS ASSISTANCE TO AMERICAN EXPORTERS

Cost and profit-minded businesses will be sensitive to the obvious benefits of cheap FX. It helps reduce the cost of at least one factor of production (e.g., raw materials), and this in turn should increase profitability over and above what would otherwise be possible. Seventy-five percent of the firms report that their PCP transactions helped them to reduce their "normal operating costs."

Firms differ in how they benefitted from their cheap FX. One firm was able to hold its prices constant for 2.5 years, an important advantange in this firm's competition with another modern expansion-oriented company in the same business. The other company also participated in PCP but did not use its transaction for a product directly in competition with the other firm's.

Still another company (Underground Plumbing) reported that cheap PCP FX turned an operating loss into a profit. And still another firm claimed that its whole operation was based on the prospect of cheap FX. The investment would not have been feasible without PCP.

Does this mean that PCP is subsidizing the unprofitable? This may happen, although the participating banks should be sensitive to this possibility. In the two instances above, there is reason to question the assertions made. A major American firm in one of the sectors is currently investigating entering the Egyptian market because it seems so profitable. (This firm has obtained support from AID's Private Sector Feasibility Studies Project.) Other firms are looking into the other sector, a promising one in the Egyptian context.

The large majority of PCP beneficiaries are able to set their own prices in a competitive market. Any losses are not directly attributable to government price controls: 17 percent of the firms report they are subject to government price controls. These include two egg-producers. However, other firms in the same sector claim the controls are meaningless. (The price per egg rose from 4 p. to 9 p. this year.) Certain health services were also said to be price-controlled, and still another firm reported Government sets low (15 percent) profit margins that act indirectly as price controls. It is not apparent that these different regulations in fact affect the pricing policies of firms.

Still, without a close scrutiny of underlying financial data, it is not possible to determine how many if any unprofitable firms are being subsidized by PCP. One would think that the banks participating in PCP would be very reluctant to lend to losers. These firms would not be creditworthy.

Cheap FX benefits American exporters as well as Egyptian importers. Given the cost-consciousness of Egyptian businessemen, it seems unlikely that many of them would continue their American connections if the GOE adopted a unified free market exchange rate, as has been urged upon them. The cheap FX and its tie-in to American commodities have created fortuitous opportunities for American exporters.

However, the limited size of individual transactions, as well as the fairly wide diversity of commodities involved, are unlikely to yield significant increases of sales for many of the U.S. exporters benefitting from this project.

## D. PCP FIRMS ARE CONTRIBUTING TO EGYPTIAN PRODUCTIVE OUTPUT (THE PROJECT'S GOAL)

### 1. The Issue

According to the IG audit, "The project was successful in moving funds into the private sector, but not necessarily in ways supporting the project's goals of expanded private sector output and employment." The AID evaluation reported that the project is too small to have a significant effect on the private sector, although the evaluators recognized that PCP has a larger impact on the industrial sector.

One report questions the effects on individual firms; the other questions the impact on the larger economy.

Our present study does not have information on the exact effects that PCP had on recipient firms. Even retrospective information that allows surrogate before-after comparisons will not serve this purpose. We lack a control population, and measured changes can be attributed to a number of causes other than the PCP intervention. (We resist falling into the *post hoc ergo propter hoc* fallacy.)

Despite these qualifications about data and method, it is possible to provide information suggesting that the beneficiary firms are the kind that the project might wish to encourage.

### 2. PCP Firms Are Increasing Their Output and Investment

Table 2.1 indicated that PCP firms have significantly increased their output and sales over the past five years. Investment also increased, despite the caveats regarding additionality. Five years ago, the average new investment per firm for the year was LE 892,000; this year it is LE 1,905,000. (The medians are much lower, 120,000 and 500,000 respectively.) Thirty percent of the firms are investing at least LE 1 million this year.

These investment figures suggest that the firms are becoming more capital-intensive. Table 2.1 shows that, while the firms have added employees over the five years, the rate at which employment is increasing falls behind the rates of financial growth.

PCP firms expect to continue their growth. Ninety-one percent say they are "likely to expand quite a bit over the next three years."

These firms were not selected by a lottery. They had to seek project assistance. The assistance may have nothing to do with their recent or anticipated future growth rates. But is seems that these firms display many of the characteristics desired by the project.

E. SUMMARY

PCP has considerable room for improvement. But the project also has some successes.

Beneficiaries are split about half and half on additionality. One half would have had to delay or drop their production plans. While they received subsidies in moving ahead with their plans, the very movement very likely required some investment on the part of these companies.

Some firms may have made distorted unwise investment decisions based on the subsidized FX they obtained, but these distortions were relatively uncommon in industry. Industrial firms seem to procure their equipment outside PCP and probably at the free market exchange rate. The large majority of industrial firms obtain raw materials, not equipment, under their transactions.

American equipment-manufacturers do not seem to have much of the Egyptian private sector equipment market. To the degree AID wishes to encourage equipment-based development calculated on the real cost of capital, it seems that the Agency may have to look for some mechanism other than PCP.

Most firms do benefit from cheap FX (which probably helps offset the higher cost of many American commodities), but it is unlikely that the project is helping unprofitable companies.

Finally, although PCP itself may not be playing an appreciable role in the growth of beneficiary firms, these firms themselves are increasing their contributions to Egyptian productive output, and many are also expanding their investment. It is always possible, of course, that other firms would contribute even more toward the achievement of project goals and purposes. USAID has the challenge of designing means to extend assistance to these firms in ways that will at the same time help realize the project's hitherto unrealized banking and credit objectives.

# CHAPTER 5

## SUMMARY



### A. BACKGROUND, PURPOSE, AND METHODOLOGY

Two earlier investigations of PCP -- one a 1984 AID evaluation, the other a 1986 IG audit -- made statements about the types of firms participating in the project, their need for assistance, how they used project funds, and the contributions the firms made toward realizing the project's goals and purposes.

Neither of these earlier studies systematically interviewed representative samples of what are now 244 (non-trader) beneficiary firms. Instead, the studies focussed primarily on more readily accessible information sources: project files on transactions, banks, and informed observers of the American aid program for the private sector.

Much of what these studies report concerning the project and its beneficiaries is true in general. But the nature of the evidence the studies collected prevent them from giving "orders of magnitude" -- that is, the proportion of firms deviating by different degrees from the ideal situation proposed for the project. Findings and conclusions tend to be sweeping if not vague.

The present study partially fills the evidence gap found in the earlier investigations. With improved evidence, improved inferences should be possible. Conclusions must be based on accurate information.

Improved evidence comes from structured interviews conducted with a probability sample selected from a universe of 244 non-trader beneficiary firms. The sample was pre-stratified and post-weighted so that we can refer to the entire population of participating firms (with the one caveat specified regarding three percent of the universe of firms). Forty completed interviews, when weighted, give a sample size of 49. This is the base on which percentages are reported. Because not all firms answer all questions, the base is sometimes smaller. ("No information" answer categories are excluded, when noted.)

Evidence collected in this manner is used for two purposes:

1. To draw a descriptive statistical profile of participating firms.

2. To explore issues that AID, the evaluators, audit team, and others had earlier identified. They include the use of project resources as a cheap FX window rather than as a source of credit, additionality, the effects that cheap FX has on investment decisions, and the contributions the beneficiary firms make toward realizing the project's goals and purposes.

The evidence presented represents "rounded" estimates provided either by the owners or key managers of firms interviewed for the survey. These estimates are not intended nor should they be interpreted as being precise. We did not examine underlying financial and production records. Furthermore, the statistics reported here are open to the usual sampling, interviewing, and measurement errors.

Despite these qualifications, we feel that biases are not significant for the purposes covered in this report.

Chapters 2, 3, and 4 provide detailed findings and conclusions. This summary chapter addresses several hightlights only.

## B. HIGHLIGHTS

### 1. Significant Inter-Firm and Inter-Sectorial Similiarities and Differences

Beneficiary firms share a number of general characteristics -- e.g., they tend to be new, growing, modern, import-dependent, and demand FX.

They also differ greatly among themselves -- e.g., in size, product or service provided, specific raw materials used, specific commodities imported under the PCP project, and contributions of the project toward meeting their import, FX and credit needs.

Firms are homogeneous on some dimensions,but heterogeneous on others.

Any evaluation or audit of the project must recognize this statistical profile. Systematically collected evidence from a representative sample of beneficiaries is needed to support inferences. This kind of evidence is also needed before concluding that the project is either a "success" or a "disappointment." Few projects lend themselves to these simple dichotomies. Instead, assessments must refer to "degrees" of achievement by certain percentages of different types of beneficiaries.

This kind of statistical profile -- and the subsequent analysis of issues based on adequate evidence--is needed to support overall go-no-go recommendations on this kind of project, as well as to assess the likely consequences of proposed changes in it.

2. Although the "Means" Failed, the "Ends" Were Partially Realized

PCP was to effect changes in credit and banking policies and procedures as a means to achieve private sector output and investment objectives. This component of the project never developed. As a consequence of failed means, the ends would presumably not be realized either.

But an anomalous situation appears: Despite failures in developing the credit means to output and investment ends, these ends nevertheless seem to have been partially realized.

Banks are reported to be executing PCP by rationing cheap FX, primarily by means of short-term credit, probably to many of their existing most-favored clients. However these beneficiary firms were selected -- by lottery, favoritism, or economic analysis -- they seem to be the kind of enterprises PCP would like to see develop in Egypt.

Nevertheless, PCP may have no cause-effect relationship to the contributions these beneficiaries make to the project's goals and purposes. Progress towards achieving project goals are found among firms meeting and not meeting the additionality criterion, as well as among firms differing in the relative roles they assign the credit and FX components of the project.

If project means are unrelated to project ends, is the project needed?

Just what is the project? Is it intended to be:

-- A private-sector CIP to accelerate the development primarily of industrial firms? If so, can project resources be better targetted?

-- Primarily a project that uses cheap FX as a means to change current credit and banking procedures and policies? If so, the means are not working on the intended institutions, although private sector non-banking firms benefit. Their benefits, however, are incidental to one of the project's two major goals.

-- Assure sustained provision of credit and FX to firms that contribute to increased production and investment? If so, "sustainability" has already been partially achieved. Many if not most of the beneficiaries are already clients of the banks extending them PCP FX, and a large proportion of beneficiaries (especially those in the industrial sector) are continually buying FX in the free market.

-- Extend term credit and bank-provided FX to a wider range of "deserving" firms, especially to firms for the procurement of equipment that would process Egyptian-supplied raw materials? Instead of rationing PCP funds among their more favored clients (we have no direct evidence that this in fact is a common practice), the banks would seek-out other newer clients that would meet project objectives. While this can no doubt be done to some extent (especially for the non-industrial sector), it is quite possible that PCP is not the most appropriate mechanism for this purpose.

The present survey is not intended to be an evaluation nor provide recommendations. However, the final option above would seem to offer the greatest opportunity for contributing to project goals and objectives within the existing project structure. PCP could improve its contributions to private sector development by closely linking itself to the new credit guarantee program for small-scale industry; formulate new more targetted criteria to guide and motivate banks so they would extend PCP benefits to certain kinds of firms; and continue Mission policy-dialogue efforts to effect exchange and interest-rate reforms.

### 3. Cheap FX Does Not Obviate the Benefits of PCP Credit

Many firms no doubt used PCP as a cheap FX window. But this does not mean that other beneficiaries do not need and benefit from PCP credit. Forty-three percent of the participating firms report that PCP contributed equally or more significantly to meeting their credit rather than FX needs.

Many firms also no doubt received some windfall profit from their cheap FX. Cost-conscious import-dependent Egyptian private sector firms are sensitive to the price of FX.

Insufficient information exists on the size of the windfall and the number of firms benefitting from it. In addition to the cost of the dollar relative to other currencies, the cost and quality of U.S. commodities must be compared with the cost and quality of commodities from other countries. These comparisons -- and the cost-quality trade-offs--are the determinants of "windfall" from the perspective of individual importers. Information on subsidized dollars by itself says very little about windfalls.

### 4. Cheap FX Probably Does Not Distort Investment Decisions Made in the Industrial Sector

The lack of distortion may actually be a weakness of the project. For industrial firms are not procuring PCP-funded equipment to add new capacity or improve industrial productivity. Instead, they seem to buy their equipment from other sources and countries, probably at the free market rate. PCP is used to procure raw materials that this foreign equipment processes.

Most of the firms participating in PCP made their important investment decisions prior to the project, and it does not seem that industrial firms based their investment plans on the continuing large infusions of cheap U.S. dollars.

A relatively high proportion of firms in all other sectors (primarily health, but construction also) procure equipment with their PCP transactions. These sectors deal in non-tradables; except for tourism, they do not earn FX, and they do not create much employment either.

Industry seems to be the problem sector for PCP. Beneficiary firms in the sector are least likely to say that PCP credit is important to them; they primarily import raw materials, but for most firms, the imports are a one-time only occurrence. Firms in this sector would obtain their FX (and credit) in other ways if PCP did not exist.

If PCP wishes to be industry-focussed, and if industrial firms use the project as they have been doing to date, does the sector really need the project?

Cutting-back or closing the project would most affect other sectors, not industry. But since these other sectors represent a relatively small proportion of all participating firms and project funds, it seems unlikely that the sectors themselves would be much affected by reduced PCP funding.

5. A Mixed Picture on Additionality

A slight majority (54 percent) of the beneficiary firms would not have delayed their procurement of imports if PCP had not provided them FX. These firms seem to have the ability (and credit) to obtain the FX they need.

But many firms would have been adversely affected; 17 percent would have dropped the project based on PCP resources.

At a minimum, therefore, it seems that only this 17 percent made investments specifically attributable to PCP. Another 29 percent spent their resources in an uninterrupted manner because they received project assistance.

Additionality was realized, but the project has much room to improve on this criterion.

6. Potential Conflict Between Criteria of Firm-Eligibility and Export Opportunities

Few firms probably make one product for the Egyptian market and another for export. Their exports are based on capabilities and experiences gained from production for the domestic market.

Some firms that cater to the Egyptian non-popular classes are offering a quality product that could meet price and quality standards of export markets, especially those elsewhere in the region. However, the GOE reportedly disallows PCP funds to go to such firms, primarily because they serve the upper part of the Egyptian market.

This conflict between export potential and meeting essential basic needs in-country seems to be most apparent in the food sector. The conflict may not, however, be resolvable; nor will it necessarily be a major problem for the firms involved. They use PCP primarily for raw materials, and the demand for these materials far surpasses the resources available through PCP. These firms are and have been able to obtain FX in other ways on a continuing basis. They do not need AID-sponsored credit or FX.

## C. FINAL COMMENT

Is PCP a success or a failure?

The present report has cautioned against questions with an implied dichotomy. Instead, we have seen that the project has had some success with a certain proportion of particular kinds of firms.

This assessment can be phrased negatively as well: About half of all firms receiving AID funds did not do anything differently because of their individual success in extracting from AID (through implementing banks)a cheap, scarce but needed resource: FX.

Whether this is fully or only 50 percent, it is obvious that PCP is not a perfect instrument to achieve the objectives set for it. Despite its real successes, the project has considerable room for improvement. The present survey provides a baseline against which these improvements can be measured.

## ANNEX A

## DESCRIPTIONS OF INDIVIDUAL FIRMS

### Industrial Sector

1. Brothers Plastic Container
2. Oklahoma Coloring
3. Surface Chemical
4. Ideal Whitegoods
5. International Vehicle Glass
6. Underground Plumbing
7. Sell-More Food
8. Food Concentrate, S.A.E.
9. Helwa Candy
10. World Office Supply
11. New Valley Paper Products
12. Karim's Speciality Garments
13. Industrial Fabrics

### Agricultural Sector

14. East Delta Egg & Poultry
15. Abdel Fakka Poultry
16. New Poultry
17. West Side Eggs
18. North Delta Egg

### All Other Sectors

19. The Garden Mosque Health and Cultural Society
20. Dr. Asnaan's Clinic
21. Central Egypt Pediatrics Hospital

NOT TO BE QUOTED

## BROTHERS PLASTIC CONTAINER CO.

After working eight years for his father, the lead-brother in this two-brother partnership entered an import-export firm. He felt that the future of Egypt depended on production, not trade,so he began exploring differences between the world of plastic containers in Europe and the use of metal containers in Egypt. After determining that Egyptian firms would switch to plastic, if the quality was right,he and his brother entered the blow-moulded plastic container business.

The lead brother took responsibility for business,marketing,and finance. The other brother was to know everything about the machines and technology after two-years time.

They began with two small machines, added another two the same year, and subsequently acquired three large sophisticated machines from Europe. Brothers Plastic is now one of Egypt's largest and fastest growing firms in this sector. From 700,000 weight units of output in 1982, the firm has grown to 3.5 million units today. Employment increased from 21 to 65. Total assets are LE 4.4 million.

PCP provided two loans,one for $394,000 in 1983,the other for $249,000 in 1985. Both were used for polyethlene H.D.

AID FX was especially important in the initial expansion of the firm. 40 percent of the raw material tonnage requirements were met by PCP in 1983; this fell to 25 percent in 1985. 45 percent of the FX needs were met by PCP the first year, falling to 20 percent in 1985. Credit proportions follow the same pattern.

Cheap FX was the reason the firm turned to PCP. But now it seems that Brothers feels that PCP is the key to its present level of operations and especially to any expansion. The firm seems to think AID owes it continuing support; the Agency can not turn its back on companies it helped create with cheap dollars.

The firm has alternatives,although the brothers do not want to consider them. European and Saudi polyethylene is cheaper, but the quality is not as high as American materials. American polyethlene allows the firm to operate its machines 30 percent faster and also to produce a higher quality container. Brothers is quality-conscious; "quality" affects the firm's and owners' personal images.

All of the machinery is European (primarily English and Italian). When something goes wrong, the firm pays the equipment-supplier to immediately send an expert for one day or so. This TA mode is cheaper than allowing the machines to lay idle.

Brothers is anxious over the delays in the release of new PCP funds. The firm would like AID staff to visit its factory,but if the two brothers are refused new PCP funds, the visit may not be a pleasant one.

R. E. Mitchell
19 Oct. 86
Firm 205

NOT TO BE QUOTED

OKLAHOMA COLORING CO

This is one of several separate but related firms in the textile sector. Created in 1979, the firm provides custom dying and printing for its own and other private sector companies. Oklahoma Coloring has developed a sufficient reputation for its services to be sought out. Little or no marketing is needed.

Although its production(services) and employment levels remained fairly stable over the past five years, the firm has acquired a number of new European machines, and it plans to provide new printing services.

Cost-control is a major concern. The firm employs 350 workers,but the foreign-trained Egyptian manager says he could achieve current production levels with only 50 employees (if they had been appropriately equipped and organized from the start). Company salaries are said to be ten times higher than prevailing wages, and the firm's employees are driven hard at their work.

The firm is dependent on imported equipment, dyes, and chemicals. PCP's FX was hoped to help reduce production costs. Higher American prices--especially with the strength of the dollar at the time--raised questions about the FX value PCP offers.

Oklahoma Coloring would like another PCP loan to procure equipment. But the firm perceives several problems: (1) it may not have the 20 percent downpayment required by its bank, and (2) U.S. textile industry equipment has a high foreign componentry. This equipment may not qualify under PCP regulations.

For certain dyes, the firm would not be able to obtain three U.S. bids. Dye colors are fairly idiosyncratic. Matching exact colors with quality standards often limits the source to one manufacturer only. America does not seem to have any competitive edge in this field. Oklahoma Coloring would have quickly obtained its dyes from other sources if PCP FX had not been available at the time.

R. E. Mitchell
23 Oct. 86
Firm 110

NOT TO BE QUOTED

## SURFACE CHEMICAL CO

This is a second-generation company operated by two sons working in urban Egypt; a the third son lives and works in the U.S. The firm imports raw chemicals that are then converted into the raw materials that are sold both to distributors and to other firms directly for use in their production processes.

Surface Chemical operates in a very competitive market, with most of the competition from traders. It is a growing market, and the firm is expanding its output, as well as offering new technical services for its clients. The brothers describe their company as modern by Egyptian standards but conservative by American.

Egyptian producers are only able to supply about ten percent of this firm's raw materials needs. The rest is imported, which means a steady demand for FX. They meet their FX needs through the free market. In fact, they operate off their cash-flow. The brothers claim they are conservative regarding credit and do not seek loans from banks.

The $11,000 PCP FX was not in loan form. Surface Chemical bought the dollars outright to procure 65 tons of a special chemical only available from one U.S. supplier. Since the chemical is needed on an on-going basis, the firm would have gone ahead with the transaction, even without AID FX.

R.E. Mitchell
22 Oct. 86
Firm 103

## IDEAL WHITEGOODS CO.

The owner of this firm ignored our cabled request for an interview, in part because he was dissatisfied with the behavior of the U.S. supplier of electric motors provided under the PCP project. We dropped-in unannounced for the interview and were cordially received.

Established in 1977 by a graduate of a secondary technical school, the firm operates out of two crowded sites in a popular urban area. The owner lists two relatives as partners (for tax purposes),but this is a sole-proprietorship.

Ideal Whitegoods manufactures two lines of a single,inexpensive household appliance. There are several private sector competitors. Because this firm's products are cheap, simple, and easy to maintain, the owner believes his market among the popular class will hold for another 50 years. His traditional workshop with semi-modern equipment has found a market niche that absorbs as many units as he can manufacture.

His manufacturing license from Government limits the number of units he is able to produce per year. This amount is below existing capacity. Production over and above the licensed level must be done without government notice. The owner believes that Government is attempting to protect the public sector company's market share,even though his own factory is not in direct competition with the public firm's output, one that is said to be expensive because of governmental inefficiencies and over-staffing.

PCP was not entirely a happy experience for two reasons. (1) The American supplier made a price quotation that was deceptively low but, when converted at the official exchange rate, raised the price of the electric motors to the same level as equally good imported units available for purchase in Egyptian pounds on the local market (without the hassel of the PCP credit program). Evidently this complaint has been registered by other PCP participants in the same geographical area. The only advantage of PCP is in its installment payments, but the cheap FX was the reason for using PCP. (2) About 20 percent of the shipment was damaged. The supplier failed to honor his promise to provide replacements.

Ideal Whitegoods in now meeting its needs by paying local currency for imported Chinese and Taiwanese motors.

Although the firm's owner bought land for a new factory, he seems to have dropped plans for this new venture. He is doing well with his existing technology and management. He visits European manufacturers for tips on manufacturing processes, which he then builds himself for local use (e.g., a half-open paint shed for enameling operations). The firm also procured new equipment several years ago. This allowed him to halve his workforce, although it has expanded to earlier peakload levels as the firm increased its output.

R.E. Mitchell
20 Oct. 86
Firm 106

NOT TO BE QUOTED

## INTERNATIONAL VEHICLE GLASS CO.

International Glass has been in business for 16 years making replacement glass for all nameplates in Egypt,as well as original components for locally-assembled trucks and buses. Located in a large basic building,the owner,assisted by his son,has acquired furnaces and other equipment from Finland, Switzerland, Italy , and the U.S., supplemented by equipment the company itself has developed and built.

In 1984, a PCP transaction for $282,000 was used to import polyvenil. It is the inner cloth-like sheet sandwiched within lamented glass.

The firm's three larger furnaces produce about 700 pieces a day over a 2-shift period. The AID FX was said to provide enough supplies for 6-months operation. However, the firm still was using these commodities during our tour of the factory.

International Glass is not in a very competitive market. One other firm produces the same product at a higher cost but with an English-language trademark. International Glass uses an Arabic-language trademark,a practice followed for some time. The owner seems to have had a nationalistic purpose in starting the factory and in emphasizing its Egyptian character.

Although there is not much competition in the market for replacement glass, the firm has imported new equipment to keep prices down. The new furnaces allowed the company to cut its workforce by half. It has also developed distributorship arrangements with over 40 small shops that handle glass work in metropolitian areas.

The real competition is for FX and credit. International Glass does not rely only on its bank for FX. It must also go into the free market. The firm relies on imported materials, and access to these materials seems to be the company's primary concern. Credit also is a problem,one that is complicated by the long delays in receiving payment from public sector clients.

Government recently imposed customs duties on imported materials. The firm's owner successfully lobbied to reduce these rates from 50% down to 5%.

PCP FX is cheap,but the size of the loans imposes cost penalities. International Glass applied for $1 million; it got $282,000. This only allows small procurements. Supplier discounts require larger size orders.

International Glass does not see too much opportunity for expansion or for implementing its plans for new projects. Shortages of FX and the resulting limitations on needed imported supplies has given the firm a bare-survival mentality.

R. E. Mitchell
20 Oct. 86
Firm 111

NOT TO BE QUOTED

## UNDERGROUND PLUMBING

This three-way Gulf-Egyptian-Far Eastern Law 43 joint venture began producing plastic hardware-type products in 1982. Since then, output increased 40 percent, employment 20 percent, and investment 50 percent.

The market is growing, but so is the competition.

Underground Plumbing is almost entirely dependent on imported raw materials and equipment. PCP FX worth $500,000 was purchased outright (rather than through a loan). These dollars were used to import about one-fourth the firm"s tonnage needs for the year.

The FX was much appreciated, as it permitted the company to offer greater variety in its products. Most importantly, it allowed the firm to reduce its costs. Without the PCP FX, the firm would have had a financial loss for the year.

Attempts by the firm to secure additional transactions have been frustrated by a reported lack of funds in the project.

5 Nov. 86
R.E. Mitchell
Firm 124

## SELL-MORE FOOD CO

After being nationalized under Nasser, the owner of this firm opened several operations in the Gulf Area. He returned to Egypt to open a new, modern factory that now produces nearly 50 food product lines.

Sell-More has been operating since 1981. Each year has seen significant expansion: 50,000 cartons of one product were made in 1982; the number today is 250,000. Gross sales rose from LE 1.6 million in 1982 to nearly LE 20 million today. Employment increased from 50 to 450 during the same time. These workers are located in one factory and in five major distribution centers, four of which have been established within the past several years.

$15 million in FX have been used over the past five years. PCP met about 15 percent of both the FX and credit needs at the time. Given the size of the FX and credit needs, every bit helps, but Sell-More would have met its needs in other ways if PCP assistance had not been available. In fact, the firm feels it sacrificed quality for cheap foreign exchange. (The particular European ingredients were said to be superior to what America can offer.)

Sell-More has developed a growth momentum. This was helped by Government's decision to restrict and sometimes prohibit imports. This decision eliminated competition in some lines. But there is some domestic competition, and the market does not hold steady for all products, even those with no competition. The firm introduces about ten new products a year; it is working hard to expand exports (that now account for about ten percent of output). It is looking for other food-processing firms that it can buy-out, and it is also receptive to foreign joint ventures. One major U.S. firm is currently talking with the firm, and another U.S. licensing agreement began recently. An American fast-foods expert is currently on-site consulting with this company.

To keep-up with an increasingly complex and changing market and organization, Sell-More's owner sends his staff for management-training, and the firm was one of the last clients of the Management Development for Productivity project. The older leadership seems more aggressively modern and risk-taking than are the younger hiers.

PCP funds would be used again if available,but they are not crucial. The firm cites reasons for not obtaining subsequent transactions:(1) recent scandals in the banking community made the firm's bankers especially cautious; (2) the bank sought borrowers with more FX earnings than Sell-More had at the time; (3) there is only one supplier of some ingredients,but PCP requires three offers; (4) PCP start-and-stop stuttering builds-up false acticipations that wise firms learn to discount. PCP is not a dependable, reliable FX or credit source.

19 Oct. 86
R. E.Mitchell
Firm 204

NOT TO BE QUOTED

# FOOD CONCENTRATE, S.A.E.

The mother firm for this new company was the agent for a number of American and other foreign food and household goods during the Nasser years. In 1981, Food Concentrates moved into the production of these formerly imported items.

The firm has two factories, the oldest of which began operations in 1983. Since that time, sales increased from LE 944,000 to LE2,300,000 this year.

Four PCP transactions covered equipment, containers, and basic ingredients. These were procured through the local firm's home licensing source in the U.S. Since then, the Egyptian company procured equipment and supplies from other countries able to offer cheaper prices.

PCP FX allowed Food Concentrates to hold its prices steady for 2.5 years. The cheap FX was the major attraction of PCP.

It is unlikely the firm will obtain additional support under PCP. GOE officials are said to be opposed to using AID funds for food products catering to middle and upper-income families.

This attitude is not stopping the company from its expansion plans. New equipment is on order, new products are planned, and new packing has been adopted to make existing products more competitive.

4 Nov. 86
R.E. Mitchell
Firm 203



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NOT TO BE QUOTED

## HELWA CANDY COMPANY

Helwa Candy Co.'s rapid growth over the past five years led to its reorganization into a larger family firm in 1985. It has paid-in capital of LE 6.2 million, three separate factories, and LE 10.7 million in equipment. 1200 employees produce a range of sweets.

The firm distributes through wholesalers. School children seem to be the largest segment of the ultimate consumer market. Helwa's approach to this competitive market is to provide quality products. Quality is said "to work" both in Egypt and in regional export markets. Some 2000 wholesalers are in the queue to become distributors. Exports account for about 15% of all output.

Helwa relies on imported ingredients and, therefore, meeting its FX needs is high on its priority of concerns. PCP provided $175,000 for one ingredient,which was about 10% of the firm's FX and import needs for the year of the loan.

The GOE ministry responsible for PCP has refused subsequent loans under the program, in part because Helwa is not producing a commodity for the mass (popular) market.

It appears that the firm may need up to $1 million in FX over and above its export earnings in order to maintain current production levels and its annual LE 2 million growth rate in sales.

It if had not received PCP funds, the firm would have immediately met its FX needs in other ways.

Although Helwa is denied access to the PCP, the firm continues its imports from the American supplier under the one PCP transaction. This supplier's products are said to be superior; Helwa is market and consumer-conscious; and the firm believes that the American ingredients help explain the market success of the particular American-based product.

R. E. Mitchell
Firm 104
13 Oct. 86



SV

NOT TO BE QUOTED

## WORLD OFFICE SUPPLY CO

This firm's predecessor was nationalized under Nasser but was reborn in 1973 under the Open Door. Two factories manufacture school and office supplies, primarily under European licenses. A new factory in one of the new communities will commence soon and manufacture products under arrangement with an American firm.

All these companies convert polypropolene, polyethelene and other raw materials into final products. Three PCP transactions were used for raw materials.

U.S. raw materials were said to be superior in quality to those from other countries. European raw materials specify a range of melting points,whereas U.S. manufacturers give you an exact melting point. This difference affects the speed with which machines can operate,as well as the quality of the final product.

This company's superior quality is not matched by other firms producing in Egypt. World Office Supply does not perceive much competition in the market.

PCP was important because of the cheap dollars it provides. Neither FX nor credit are especial problems. In fact, this company does not rely on credit; all three dollar transactions involved the direct purchase of dollars for local currency.

The firm is now largely under the management of the founder's son, an American Ph.D. in chemical engineering. He believes that Egyptians have a new-machine bias. Rather than continuing the firm's investment in machinery, the new manager is emphasizing increased productivity and efficiency from current equipment. New equipment will,however, be necessary for the new factory that will open in the near future.

30 Oct. 86
R.E. Mitchell
Firm 222

NOT TO BE QUOTED

## NEW VALLEY PAPER PRODUCTS (NVPP)

NVPP has built its large and expanding operations almost entirely on U.S. equipment and an annual raw-materials import bill of $14 million. Today the company's assets are valued at 13 million Egyptian Pounds; it employs 400 workers and has sales of LE 36 million,up from LE 14 million five years ago.

Started in 1979, the firm provides a quality product on a bespoken basis for industrial and other firms. Two public sector companies manufacture similar but lower-quality products. However, the public sector pays only $200/ton for its raw materials (partly because of trade arrangements with Russia); NVPP pays $800/ton. But the public sector firms want to sell to private sector customers at a price only $100 lower than NVPP's. Other public customers do not contribute to a public sector supplier's profit picture.

PCP's $1,245,000 in FX was used to import raw materials. The first of three transactions was paid upfront in cash by NVPP. Despite the size of the total sum involved, the raw materials were only sufficient for 14 working days.

PCP made three contributions to this firm:(1) it provided cheap FX, (2) it had a psychological effect of providing raw materials so that workers knew the factory could continue to operate; (3) the source of the FX was visable,thereby deflecting government investigators from examining the firm's financial operations.

NVPP is critical of how PCP is administered by the banks. Getting on the banker's approved list is based on personal relations a firm is able to establish with the bank official responsible for PCP transactions. NVPP is one of a family of several large firms dealing with banks. These firms have credit standing. But the bank officials with whom they work are said to make arbitrary decisions on how the funds alloted them will be allocated to private firms. This particular firm does not understand the criteria used to make these allocations. NVPP prefers working directly with AID.

3 Nov. 86
R.E. Mitchell
Firm 122



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NOT TO BE QUOTED

## KARIM'S SPECIALITY GARMENTS

Karim was started two years ago by a returned expatriate and with the financial assistance of his former manager in the Gulf. The new firm manufactures an all-cotton garment for middle-class men and boys.

Output is rising rapidly, up from 285,000 units two years ago to 400,000 this year. The market is growing, along with the number of competitors. It's only a matter of time before others manufacture the same goods for the same market, according to the owner-manager.

Karem operates on an overdraft arrangement with his bank.Working credit is not a problem for him.He pays for new fixed investments out of current revenues.

The owner was attracted to PCP by the low cost of its FX. He only needed $6000 at the time, but the minimum loan value was $10,000. He accelerated his procurement plans to take advantage of the cheap FX. All his equipment to date is from the U.S., although some of it was obtained through an English agent.

Running this kind of factory using Egyptian cotton is a challenge. Suppliers will provide two tons when he only asks for one, or they provide half a ton when he needs two. Although, government does not have price controls for his products, a 15 percent profit margin is imposed on him. This figure is calculated according to a set formula.

2 Nov. 86
R.E. Mitchell
Firm 121



5

# INDUSTRIAL FABRICS CO

Industrial Fabrics is one of three corporations under the direction of a single individual. This year marked the firm's entrance into the export market, the first time since its inception in 1976. Ninety percent of the the company's finished production is being exported to the U.S.

This firm has steadily grown to its present investment in land,factory, and equipment of about LE 40 million. Total output and revenue were said to be fairly stable over the past five years,although employment and investment increased. Two million dollars in investment was made in the firm this year.

Industrial Fabrics depends almost entirely on imported materials and equipment. $60 million was spent on imports over the past five years. PCP provided $439,000 for the procurment of raw materials in 1984. This accounted for 25% of the firm's FX and credit needs.

PCP's importance lay in the cheap FX it provides. However, the interviewee was unable to explain why the firm has not sought a second PCP loan. They "just didn't try."

29 Oct. 86
R E Mitchell
Firm 102

## EAST DELTA EGG & POULTRY CO.(EDEPCO)

Established in 1982 by three brothers on their family farm, this firm has about 130,000 chickens at any one time. They hatch 4-million chicks a year and produce 28 million eggs. The eggs are sold to distributors; chicks are sold directly to local farmers, although the market is so bad today that many chicks are simply destroyed. That is, the firm has two quite different products.

EDEPCO is the leading market force for eggs in the region. This is a good market at present: from 4 p. per egg earlier in the year, the price is now 9 p. The month of Ramadan,however, is a near void in the market for all egg producers. The losses are significant during this period. Because of shortages of feed, the market for chicks has been depressed for some time.

EDEPCO depends almost entirely on imports for all its supplies and equipment. These include feed, medicine, and chicks.

AID's PCP loan for nearly $500,000 was used for layer concentrate. The loan accounted for 80% of the firm's imports the year it was provided. It met 50% of the FX and 30% of the credit needs.

FX was the most important need that was met. However, PCP funds were supportive more generally of an American connection. An Atlanta-based firm provides both eggs and chicks, the latter at a loss to the Georgia firm. (It hopes that EDEPCO will enter the breeding business with the American firm's stock.)

American chicks are said to be more disease-free than European stock. Sickness is a significant concern in this industry, a concern that has a FX dimension: All the medicines must be imported.

EDEPCO has built itself on imports, and the firm's continued existence depends on its ability to secure FX.

However, the firm wants new PCP FX for essentially complementary equipment and cost-saving expansion based on current investments. It wishes to purchase an American silo for about $150,000. This will save up to 10% on the losses incurred from present arrangements. (They come from rodents, brokén bags, etc.) They also need about $100,000/year for medicines.

In the immediate future, EDEPCO would like to procure a feed mill and a drier for manure.

The feed mill is complementary to the broiler operation. Farmers are unwilling to buy chicks unless feed goes along with them. With the new regulations permitting private sector imports of corn and feed, this complementarity is possible--and needed (in order to make the broiler business viable).

While eager for more PCP funds, EDEPCO was also critical of the way the program operates. The firm's bank has been telling it every week for 8 months that new PCP funds will become available. In anticipation that multiple uses of the fund will be possible, the firm is procuring supplies in small amounts. But small procurements have higher per-unit costs.

This beneficiary also believes that his equipment-expansion plans--with a 3-year payback--will require that AID intervene with the banks.

Finally, the limit of one loan per year is criticized as well.

Instead of being a positive force in private sector development, these implementation difficulties add to the unpredictability of the market place. Having received AID funds once, this firm seems to expect still more money, and failure to obtain this money is a source of frustration (with AID).

19 Oct. 86
R.E. Mitchell
Firm 307

NOT TO BE QUOTED

# A EL FAKKA POULTRY COMPANY

Abdel Fakka Poultry Co. is an independent private sector corporation with about 20 shareholders and credit from several banks.

When in operation, the firm will produce "parent breeder" chicken stock based on chicks imported from the U.S. through arrangements with a large Georgia-based poultry breeder. The company considers itself to be in the genetic breeding business.

During Phase 1, three flocks of U.S. chicks will be imported. A flock includes 5050 females,each costing about $22.50, or $125,00 per flock. A new flock will be introduced every 17 weeks.

In Phase 1, the imported chicks will cost about $375,000/year.

Over 100,000 chicks will be sold per year in Phase 1; revenue will be about LE 700,000 the first year (growing to more than LE 2 million). Revenues include sales of male chicks, females to other breeders, spent hens, and manure for the area surrounding the new community site for the operation. The current 10 employees will reach 60.Total fixed investment in Phase 1 is about $4.5 million; annual FX savings are anticipated to reach about $1,625,000 during Phase 1--if everything goes according to current estimates and plans.

This is an import-substitution project. The firm plans to have about 13% of the total market in Phase 1,growing to about 25% later. The company will have about 50% of the market for this particular genetic stock.

Abdel Fakka acquires its technical knowledlge from several sources: (1) the principal has an American doctorate in poultry sciences and spent about 10 years in the U.S.; (2) the Georgia-based American firm also provides technical advice. Through these sources and the principal's visits to the U.S., the firm seems to have obtained fairly complete information on different sources and prices of equipment and supplies.

The firm also receives information and assistance from its parent Middle East Poultry Co. This parent (but independent) firm will buy the new operation's entire first-year output. At the same time, the new firm will launch a marketing effort consisting of (1) standard printed materials, (2) contracts with small farmers for them to take the new chicks, and (3) risk-sharing with existing larger poultry firms that have been going out of business or forced to retrench because of lack of feed and other market forces.

That is, Abdel Fakka Poultry Co. has technical skills from several sources; it has the experiences and backing off a parent (indepenendent ) company, and it has 20 shareholders and the backing of several banks.

PCP FX loans of $769,947 for five transactions are being used to procure hatchery and breeding equipment, feed concentrates, and the parent breeding stock.

Operations have yet to begin,but equipment has arrived and start-up is expected within the year.

Although the firm has equity and credit from several sources, it feels that AID's support is absolutely essential. Without this assistance (which is said to provide cheap FX), it would have been necessary to increase the company's capital share. It is now at less than 50% of the authorizied amount.

It appears that this poultry project was based on the availability of cheap FX. In addition, the AID program was the one stable element in an otherwise unstable business environment (with the unpredictable negative changes in the cost of FX). Without AID FX, the total investment cost--and, therefore, the cost of financing and depreciation--was said to be prohibitively expensive. The firm also feels it will need continuing AID-supplied FX. It would like FX from the PIE fund.

The other figures presented by the firm may not support its contention concerning the need for U.S. support. AID is meeting about 30% of the total credit needs but a large 80% of the FX needs.

If successful, this will be very much an American project: An American-trained owner-technical expert, an American technical counterpart and supplier, American breeder stock, and AID funds.

R. E. Mitchell
Firm 401
9 Oct. 86

NOT TO BE QUOTED

## NEW POULTRY CO

New Poultry is a Law 43 investment company established in 1977 with one fourth of the owners coming from a large family. The firm produces eggs, chicks, and feed, with plans for new products and markets (if the market confusion over the availability of maize is resolved).

This large company produces about 80 million eggs and 30 million chicks a year. These two products and several others yield sales of LE 35 million a year, up from LE 12 million in 1982.

New Poultry is heavily dependent on FX. It uses about $1 million a month. The single PCP transaction accounted for only about five percent of the FX needs in the year it was provided. Although this is a small proportion, the dollars helped meet FX and credit needs equally.

The company deals with several banks, only one of which handles PCP transactions. These banks also deal with the other firms owned by this firm's largest shareholders. Despite these connections, the one PCP bank in this case refused to respond positively to New Poultry's request for additional PCP FX.

A government-created maize (feed) crisis is the major impediment to smooth operations and further expansion. The firm has asked the Minister of Agriculture to move to the free market. The firm feels that once this is done, the company will be much better able to operate.

The interviwees provided an example of problems faced in the past under the administered maize allocation system: one of its smaller competitors was allocated 18 tons of a particular feed a year, a figure based on the number of machines this firm imported. New Poultry produces a much larger number of eggs and chicks but was only allocated seven tons of this feed a year. It was felt that the political influence of the other firm's owners probably accounted for this biased distribution arrangement.

3 Nov. 86
R.E. Mitchell
Firm 323

NOT TO BE QUOTED

# WEST SIDE EGGS

West Side Eggs was founded in 1981 for the sole purpose of producing eggs (not broilers). Output increased from 15 million five years ago to 40 million this year.

PCP funds were used for feed concentrate and chicks.

Neither FX nor credit were said to be problems. Most poultry and egg firms are said to be partially funded by Government banks. The loans include a working line of credit that is used to procure needed (foreign) imports from the local market in local currency.

Firms are interested in reducing their costs, which PCP FX does. PCP's stop-and-go operations contribute to the instability that government policy has created,especially with regard to feed. Feed prices have doubled recently,but,then, so has the price of eggs.

30 Oct. 86
R E Mitchell
Firm 420

NOT TO BE QUOTED

## NORTH DELTA EGG CO

NDEC is one component of a three-site poultry operation owned by one person. This particular site has grown rapidly since its inception in 1978. Five years ago it produced 6 million eggs and no broilers; today the figures are 22 million eggs and 1.8 million broilers. The firm also has a feed mill that it would like to expand,along with its hatchery operations. Gross sales increased 10-fold over the five-year period.

The interviewee was plant manager; he was not familiar with his employer's financing.

Except for the feed concentrate procured under PCP, the firm relies almost entirely on Dutch imports. AID met about 40 percent of the company's feed needs during the year of the transaction; this represented about eight percent of the firm's FX needs.

The plant manager believes the owner needs both FX and credit, and that PCP met both needs. But the firm would have immediately met its FX needs in other ways if PCP had not been available.

R.E. Mitchell
26 Oct. 86
Firm 309

# THE GARDEN MOSQUE HEALTH AND CULTURAL SOCIETY

Garden Mosque is a relatively new building in a middle-income area within Greater Cairo. The Mosque's Health and Cultural Center was built on government-provided land and now includes a clinic, a small science museum, an auditorium, several telescopes, and a library on Ismlamic theology.

AID funds were used to procure a kidney dialysis machine, one of a number of high-technology resources within the clinic. Other equipment includes an electrocardiograph, X-Ray machines, ultrasound, laser equipment to treat retinas, laboratries,etc.

Patient numbers and staff members have significantly increased along with this equipment. Starting with 100 patients 9 years ago, the clinic is now striving to serve 200,000 patients a year with a staff of 600, including 52 medical doctors

Operated as a charity,it serves low and moderate-income patients from thoughout Egypt. Only symbolic charges are made for services--e.g., LE 3 for an electrocardiogram. Zabaat contributions (traditional Islamic voluntary tax payments) support this charity program. However, new efforts are being made to make the clinic economically more self-sufficient

AID funds were important because they provided the needed FX. Without this FX, it is likely that procurement of the new equipment would hve been postponed for at least three years.

A doctor in the kidney dialysis unit of the clinic estimated that the AID-supported machine serves about 3060 patients per year. In addition to providing inexpensive use of the machine, the clinic also pays for needed blood and, also, provides patients with up to LE 40/mo. as a living allowance.

This non-governmental progressive Islamic PVO recently bought a (used) hospital so that in-patient, as well as outpatient services, can be provided. New FX resources will be needed to upgrade the hospital and offer new services--e.g., orthopedic services.

There seems little opposition to paying interest on the FX loan, and there appears to be a clear bias toward western medicine and modern medical equipment.

R. E. Mitchell
Firm 505
13 Oct. 86

## DR. ASNAAN'S CLINIC

Dr. Asnaan started a small private speciality practice in 1977, supplementing his income by working in a private hospital. His clientele is drawn primarily from middle and upper-income families who have a demand for his particular speciality.

PCP FX provided $13,000 for a dental unit consisting of a chair, X-Ray machine,developer, compressor, and related equipment. This was added to his clinic(which is in a building he owns) and other equipment procured out-of-pocket from his own resources. The equipment allowed him to expand his clientele from 300 patients five years ago to about 600 this year. Revenues from the clinic increased from LE 6000 to LE 9000 over the same five-year period.

Dr. Asnaan reports he would most likely have dropped his clinic project if PCP were not available to him. The FX in the project was not especially important.Instead, it was the credit he received.

Although the loan was small, it is a burdem on him. He reports he wishes to expand further and would like another PCP transaction. This will be delayed, however, until he repays his current loan.

4 Nov. 86
R.E. Mitchell
Firm 522

NOT TO BE QUOTED

## CENTRAL EGYPT PEDIATRICS HOSPITAL

This hospital will open soon after about three years of self-financed development by the doctor-owner. He currently directs the pediatrics division of a major hospital, where he also conducts research, supervises graduate training, and assists younger doctors in the development of their careers by having them bring their private practice to his clinic.

PCP funds paid for ten new incubators, some of which replaced existing equipment. This procurement adds to total operating costs but reduces per-incubator expenses.

The owner-doctor of the hospital originally requested a $60,000 loan. Credit barriers established by his bank led to a reduction of the request to $37,000 and to a shift from a loan to an upfront purchase of dollars. He reports that the advantage of the FX was not just the cheaper dollars offered; the American equipment was about one-fourth the cost of other equipment available on the local market in local currency. This particular procurement would have been delayed if PCP were not available.

Over the years, the doctor-owner and his clinic have earned a national reputation. Patients from all over Egypt come for services. The doctor-owner reported that Government sets maximum fees for private services such as his, but his fees are below the maximum. His patients come from all income categories.

Given the constraints of limited time, as well as restrictions on fees, the financial return on this PCP transaction is said to be lower than what could be earned from other investments. He in fact earns a satisfactory income, but his new investment seems to reflect more a sense of professionalism than of purely economic motives. The AID-assisted incubators, together with modest other investments, will allow him to serve more patients, but the major motive for this expansion seems to be to improve the quality of medical services he is able to provide.

R.E. Mitchell
27 Oct. 86
Firm 506

# ANNEX B

## RESEARCH PROCEDURES

A. Sample Design

- A.1: Information Sources
- A.2: Two Sampling Strata
- A.3: Probability sampling procedures within the six cells defined by the two strata

B. Fieldwork Procedures

C. Completion Rates and Non-Respondents

- C.1: Why "Non-Respondents"?
- C.2: Who are the Non-Respondents?

D. Weighting the Sample

## EXECUTION OF THE STUDY

### A. Sample Design

#### A. 1. Information Sources

The USAID office responsible for PCP has file cards and a computer-based management information system including names, addresses and telephone numbers of firms participating in the Production Credit Project (PCP). Other basic information on transactions is recorded as well. All of this information is provided by the participating banks.

An analysis of these materials identified a number of problems for the present survey,--for example:

The universe may be smaller than estimated: Arabic names are alphabetized in English. Because there is no master list of firms, some firms appear under different English names in the computer printout. An early analysis discovered 14 such firms. The subsequent sample produced still another one (it was selected twice, an error corrected for the present report).

Current, accurate locational information is lacking on a number of firms. Several firms had correct telex numbers that could be used; telephone numbers however, were frequently out-of-date or no one answered our calls; and street addresses were insufficient. Banks no doubt have accurate information on borrowers, but it would have been too costly and time-consuming to work with the banks in updating AID's records for this particular research assignment. We anticipated there would be trouble in locating firms and their representatives for interviewing purposes

#### A.2. Two Sampling Strata

A preliminary analysis of materials provided by PCP's management information system indicated there are potentially important differences among the several sectors participating in the project. It was anticipated that the number of transactions a firm had would also indicate potentially important differences among firms in a sector(e.g.,the more frequent users would be more sophisticated).

Normal probability sampling procedures should be able to capture these distinctions. Organizing the files by sector and number of transactions (followed by systematic list sampling with known intervals) would suffice. However, because of the problems of questionable addresses, especially for the agricultural sector, it was anticipated that post-stratification weighting would be necessary. The original sample and replacements for it were to help address this problem. This and other considerations led to stratifying the population of firms by sector(industry,agriculture, and "all other"[AO]). This yielded the following distribution:

Table 1

Polulation Universe, By Sector

| | Number of Transactions | | |
|---|---|---|---|
| Sector | 1 only | 2 or more | Total |
| Industry | 72 (30%) | 63 (26) | 135 (56) |
| Agriculture | 48 (20) | 15 (6) | 63 (26) |
| All other | 38 (16) | 8 (3) | 46 (19) |
| Total | 158 (66) | 86(35) | 244 (100%) |

The percentage figures presented in parentheses are based on an N of 244.

Traders are no longer eligible to participate in PCP. These firms are excluded from the universe and the sample. The "All Other" category includes health, construction, services, tourism, and education. PCP's management information system was not, however, able to exclude all traders: one was subsequently selected(but then dropped) in the final sample.

A.3. Probability sampling procedures within the six cells defined by the two strata.

A table of random numbers was used to select 82 firms,51 for the intended sample and another 31 replacements.

These 82 were reduced to 51 by using a table of random numbers to select those firms wit[illegible] cell to serve as replacements for firms that mi[illegible]e for interviewing.

Each firm had a known probability of falling into the sample. (This probability was altered by the decision to reject multiple interviews with firms selected more than once. This possibility was not permitted. As a result, probabilities changed as new firms were selected for the sample.)

These procedures yielded the following distribution:

Table 2

Sample Design

| Sector | 1 only | 2 or more | Total |
|---|---|---|---|
| Industry | 15 | 13 | 28 |
| Agriculture | 10 | 3 | 13 |
| All other | 8 | 2* | 10 |
| Total | [illegible] | 18 | 51 |

*The [illegible]le calls for 1.5 interviews.

## [illegible] Fieldwork Procedures

Personal interviews were to be scheduled with knowledgeable higher-level officials in each of the firms falling into the sample. Cooperation was voluntary.

Seven USAID staff members--three American and four FSNs--conducted the interviews (with assignments based on the interviewees' English-language abilities). All fieldwork was conducted betweeen October 8 and November 5,1986.

Contacting firms to make appointments proved to be difficult. Telephone calls were made, when possible. Telexes and cables were sent, followed by letters. Because it was not possible to assign FSN staff full-time to this survey, as many interviews as possible were scheduled for AID offices in Cairo. One FSN selected nine firms for which he took personal responsibility for interviewing.

### C. Completion Rates and Non-Respondents

Thirty three of the original 51 firms were successfully contacted and interviewed. (Another firm was found to be a trader and,therefore,excluded from the sample). These 33 were distributed as follows(completion rates are given in parens.).

Table 3

Completed Interviews,
Original Sample

Number of Transactions

| Sector | 1 only | 2 or more | Total |
|---|---|---|---|
| Industry | 12 (80) | 9 (69) | 21 (75) |
| Agriculture | 4 (40) | 1 (33) | 5 (38) |
| All other | 7 (86) | 0 (0) | 7 (70) |
| Total | 23 (70) | 10 (56) | 33 (65) |

The replacement sample was used over the course of the fieldwork. This yielded another seven firms,for the following distribution:

Table 4

Completed Interviews,
Original Sample and Replacements

Number of Transactions

| Sector | 1 only | 2 or more | Total |
|---|---|---|---|
| Industry | 15 (100) | 10 (77) | 25 (89) |
| Agriculture | 5 (50) | 2 (67) | 7 (54) |
| All others | 8 (100) | 0 (0) | 8 (80) |
| Total | 28 (85) | 12 (67) | 40 (78) |

^V

These 40 respondents represent a 78 percent completion rate. (Non-responses to individual questions in the interview schedule will, of-course give lower rates).

C.1. Why "Non-Respondents"?

There are several reasons for non-respondents:

(1) Inadequate addresses were an especially serious problem for the agricultural sector, most of which is in the poultry and egg business.

The number of non-respondents could have been reduced further if the fieldwork period had been extended. For example, four firms called on the work day after the completion of the fieldwork. They reported they had just received the letter sent them nearly three weeks earlier.

(2) The one FSN who assumed responsibility for nine interviews fell especially short of meeting his obligations.

(3) Some participating firms seemed to be dissatisfied with PCP. This is seen in the thumbnail sketch of Ideal Whitegoods Co presented in a separate annex. Another firm was reported to be unhappy over a distressed cargo of PCP materials, although another firm with similar problems willingly cooperated in the study.

C.2. Who Are the Non-Respondents?

More than half the non-respondents are in the agricultural sector. Their non-responsiveness seems attributable to inadequate addresses for rural areas.

On the basis of the qualitative materials collected during the interviewing, there is no reason to suggest that non-respondents are different from respondents on the criteria that are the foci of the present survey. For example, poultry and egg producers seem to be fairly similar in their development,structure, and reasons for seeking PCP resources.

The single exception is in the "All Other "cell for firms with two or more transactions. Two large well-known construction firms were selected for the sample. One firm obtained cranes and loaders under PCP; the other procured concrete-brick manufacturing equipment. The sample for this study underrepresents these larger firms with their often-expensive equipment.

According to AID's records, the median size PCP transaction for non-respondents is higher than the same median value for respondents. Non-respondents tend to include those who received larger dollar benefits from PCP.

D. Weighting the Sample

Given the apparent reasons for non-responding, and given the absence of significant differences among firms in the agricultural sector, the sample sizes within individual cells were weighted to bring them to their originally intended numbers.

The following procedures were used:

1. Industrial firms with two or more transactions: The responding firms were numbered and listed in their numerical order. A random start was selected, and then every third firm was selected. This yielded three firms. Their responses are counted twice in the final sample.

2. Agricultural firms with one transaction only: All five firms are counted twice,thereby bringing the number of firms in this cell to the intended number of ten.

3. Agricultural firms with two or more transactions: One firm was selected by a flip of a coin. This firm is counted twice.

No weighting is needed for the industrial and All Other firms with one PCP transaction only.

The All Other firms with two or more transactions are not corrected. (There was no respondent to make this possible.)

These procedures yield the following sample of 49 firms. This is the sample used in the body of this report. The sample underrepresents the All Other firms with two or more transactions. They comprise three percent of the universe, not a significant source of bias

Table 5

Sample Used For Present Report

Number of Transactions

| Sector | 1 only | 2 or more | Total |
|---|---|---|---|
| Industry | 15 | 13 | 28 |
| Agriculture | 10 | 3 | 13 |
| All others | 8 | 0 | 8 |
| Total | 33 | 16 | 49 |

With the one exception of this three percent, the final weighted sample permits us to refer to the universe of approximately 244 firms that participated in PCP. The other potential biases introduced by the weighting scheme are not considered to be significant. Based on the information available from the study and from the larger universe, the advantages of using the weighting scheme exceed the potential disadvantages of this sampling technique.

# ANNEX C

# THE INTERVIEW SCHEDULE

Identification Number:

A: ______________

B: ______________

## A. FIRM

1. Name: ______________
2. Address: ______________
3. Contact persons: ______________
4. Telephone number: ______________
5. Telex/cable number: ______________

## B. ARRANGEMENT OF APPOINTMENT

1. Date of initial contact with firm: __________ __________
   Date Time
2. Arranged by USAID staff member: ______________
3. Person in firm making the appointment: ______________

## C. INTERVIEW SCHEDULED FOR

1. Date: ______________ Time: ______________
2. With: ______________
3. Address ______________
   Specific instructions for driver ______________

   ______________
4. USAID telex/cable confirmation of appointment on: __________
   Date

## D. INTERVIEWER CONTACTS WITH FIRM

| Date | Time From | Time To | Status |
|---|---|---|---|
| 1. ______ | ______ | | ______ |
| 2. ______ | ______ | | ______ |
| 3. ______ | ______ | | ______ |

OPENING REMARKS

Thank you for your time and cooperation in talking with me this morning/afternoon. Your assistance and views are very important to us.

The purpose of my visit and questions is to learn more about the nearly 1000 private sector industrial firms that have been directly assisted by several American-funded projects in Egypt.

We obviously can't visit all 1000 firms, so we selected a small sample of companies that will represent all 1000. Your firm (or "you") are in this sample, so the information you provide is very important for all 1000.

According to our records, you/your firm participated in the Production Credit Project through foreign exchange loans handled by ____________(bank).

Several of my questions will touch on this project, but most of the questions deal more generally with individual business enterprises--for example, what they produce, how they have changed over time, and what raw materials they use.

We also want to see if we are asking the correct questions and if it is easy to understand them.

Let me emphasize that the information you provide me will be kept strictly confidential. It will be included with similar information provided by other companies so that we come up with a "statistical profile." We will not report on individual firms.

I anticipate it will take about 40 minutes to complete our interview.

A. BACKGROUND ON THE FIRM

If you will permit me, let me ask you some questions about your firm (your business).

1. In what year was it established?

19______

C:

2. Which of the following type of organization best describes the ownership form of the firm: (Read and check one only)

1._____ Sole proprietorship
2._____ Family firm
3._____ Partnership
4._____ Independent corporation
5._____ Subsidiary of another corporation

D:

3. Where exactly is the factory/farm/office located?

Governorate: ______________
District : ______________

E:

3a. Is this in a:

1.________ Larger city
2.________ Medium-size city or town
3.________ Smaller town
4.________ Village or rural area?

F:

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4. What exactly does the firm make/grow/sell? (Be as specific as possible) G:

a. Anything else? ______________________________

b. Who buys your output--that is, do you sell to:

(check as many as apply)

1._____Consumers

2._____Other manufacturers

3._____Wholesalers and distributorships

4._____Government entities

H:

c. How much (if any) of your output do you export?

______Percent (write down amount) I:

______None

ASK ONLY IF OUTPUT IS A CONSUMER PRODUCT OR GOES INTO SUCH A PRODUCT

d. Is the Egyptian market for:

1.______The popular classes

2.______Middle and upper income groups

3.______Everyone

4.______Not applicable

J:

5. Would you say that the market for your products is:

1.____Growing

2.____Stable

3.____Declining

K:

6. How competitive would you say the market is: Is it:

1.____Very competitive

2.____Somewhat competitive, or is it

3.____Not very competitive?

L:

B. GROWTH OF FIRM

Now let's talk about any changes your firm has had since the beginning of 1982. That's nearly a five-year period.

I would like to know if there has been an increase, decrease, or relative stability in output, sales, employment, and investment.

How about (read each of the following below), has the firm increased its (read each item separately), has it remained about the same, or has there been a decrease in (read the item):

| | Increased | Remained the Same | Decreased | |
|---|---|---|---|---|
| 7. Total output: | ____ | ____ | ____ | M: |
| 8. Gross sales and revenues | ____ | ____ | ____ | N: |
| 9. Employment | ____ | ____ | ____ | O: |
| 10. Investment in the firm | ____ | ____ | ____ | P: |
| | 1 | 2 | 3 | |

C. SIZE OF FIRM

To get a better idea of your firm and any changes in it, please give me your best estimates of your firm's output, sales, employment, and investment in 1982 and this year.

11. How about total output, what was the estimated output

1982:__________ Q:

This year:________ R:

(NOTE: Specify the units of output used--e.g., tons, meters, clients served, etc.) S:

12. And how about gross revenue and sales: what are your best estimates for:

1982:__________ T:

U:

This year:________

V:

W:

13. How about employment---I mean full-time employees and part-time employees converted as best as you can to a full-time yearly equivalent. What is your best estimate of total employment in:

1982:__________ X:

This year:________

Y:

14. Finally, what about your best estimate of investment. That is, how much new investment was put into the firm in:

Z/1

1982:__________ AA:

This year:________ AB:

CV

15. Can you estimate what the value is of your:
    a. Factory/office building and land: LE________________ AC:
    b. Equipment, inventory, and other assests of the firm: LE____ AD:

D. IMPORTS, FX, AND CREDIT

Now let's talk about the raw materials and equipment your firm uses.

16. What foreign raw materials and equipment has your firm imported since 1982?
    a. First, please tell me what equipment you have imported? AE:

    b. Now, how about raw materials, what have you imported since 1982? AF:

17. Can you estimate the total dollar value of all your imported raw materials and equipment since 1982? AG:
    $______________________________

18. We are interested in how firms like yours go about their imports--that is, how much shopping around they do for supplies, FX, and credit.

    a. How much shopping around and searching do you do for your imported materials, do you usually:

        1.____Rely on a few traditional sources developed over the past
        2.____ Obtain product and price information from as many suppliers as possible, or do you
        3.____Have someone else handle this for you? AH:

(?)

b. How about your sources of FX: Do you usually:

1. _______ Rely on your bank(s), or do you

2. ______ Draw on several different sources?

AI:

c. And how do you usually pay for the FX required for your imports: Do you usually:

1. _____ Rely on supplier credit

2. _____ Take out a loan from a local bank, or do you

3. _____ Rely on other sources (can you explain what these sources are? ______________________

AJ:

E. PRODUCTION CREDIT PROJECT(PCP) TRANSACTIONS

We have been talking about your firm in general. Now I would like to ask you some questions about the commodities you imported in the AID-supported PCP.

According to our records, your firm (you) had the following transactions:

| Year | Commodity | Dollar Amount | |
|---|---|---|---|
| ________ | ________ | ________ | AK: |
| ________ | ________ | ________ | AL: |
| ________ | ________ | ________ | AM: |
| ________ | ________ | ________ | AN: |
| ________ | ________ | ________ | AO: |

Does this information seem complete?

ANSWER IF TRANSACTIONS INCLUDED NON-EQUIPMENT

19. Can you tell me how(list the non-equipment commodities) affected your firm: Which of the following best describes these effects. Did they allow you to:

1.____Maintain you then-current production levels,
2.____Produce beyond your then-current production levels or
3.____Allow you to produce a new product you hadn't manufactured before?

AP:

ANSWER IF EQUIPMENT INCLUDED IN TRANSACTIONS

20. Did the equipment:
1.___Replace existing machinery/equipment, or was it a
2.___New type of equipment allowing you to do new things not possible earlier?

AQ:

FOR ALL RESPONDENTS

21. We talked earlier about your imports, FX, and credit transactions. Can you now give me your best estimates of the proportion of each that your PCP transactions helped meet.

a. How about your import needs: What proportion of these were met by your PCP transaction(s)?

_______%

AR:

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b. And what about your FX needs, what proportion of these were met by your PCP transactions? AS:

_______%

c. Finally, how about the proportion of your credit needs that PCP transactions helped meet: AT:

_______%

22. At the time, were the products (services) manufactured or provided because of the PCP assistance subject to Government price controls?

1. ___________ Yes AU:
2. ___________ No

22a. What about today, are these products subject to Governemnt price controls?

1. __________ Yes
2. __________ No AV:

23. At the time, what was the most important need that PCP helped you meet:

1.____FX needs
2.____Credit needs
3.____Both needs, or
4.____Didn't it play a very significant role in meeting either set of needs? AW:

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24. Well, what would your firm (you) most likely have done if you didn't get the PCP assistance. Would you have most likely:

1.__Immediately met your needs in some other way
2.__Probably met these needs, but it would have taken somewhat longer, or would you have
3.__Most likely dropped the project made possible by the transaction? AX:

25. Can you tell me if your PCP transaction helped you to:

| | | Yes | No | |
|---|---|---|---|---|
| a. | Maintain then-existing employment levels | ___ | ___ | AY: AZ/1 |
| b. | Increased your employment | ___ | ___ | BA: |
| c. | Allowed you to manufacture grow/provide a new product/ service? | ___ | ___ | BB: |
| d. | Expanded your sales | ___ | ___ | BC: |
| e. | Reduced your normal operating costs | ___ | ___ | BD: |
| f. | Led to an expansion of your firm/business | ___ | ___ | BE: |
| | | 1 | 2 | |

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26. According to our records, you had___ transaction(s) under the PCP program. Can you tell me why you didn't seek more transactions: Was it because:

1.____The funds could not be used for non-American imports
2.____You had met all your FX needs
3.____Your bank wouldn't cooperate
4.____You had the maximum FX allowed under the program,
5.____Or was there some other reason (please explain:________ BF:

________________________________

F. INNOVATION

Finally, let me ask several quick questions about how your firm operates more generally. You can answer these questions by either "yes" or "no".

| | Yes | No | |
|---|---|---|---|
| 27. Does your firm: | | | |
| a. Place high importance on finding new markets? | ___ | ___ | BG: |
| b. Look for new products? | ___ | ___ | BH: |
| c. Try to improve production processes--e.g., through maintenance management, materials-handling, and quality control? | ___ | ___ | BI: |
| d. Employ someone whose primary responsibility is to obtain FX and credit? | ___ | ___ | BJ: |

e. Likely to expand quite a bit. over the next 3 years? ___ ___ BK:

f. Place high importance on reducing costs ___ ___ BL:

g. Part of a group of related companies that deal with the same bank that handled your PCP transactions? ___ ___ BM:

h. Considered quite modern and progressive? ___ ___ BN:

1 2

Thank you very much for your kind assistance and cooperation.

28. Before leaving you, could you please tell me what your name, title, and responsibilities are:

Name:____________

Title:____________ BO:

Responsibilities:______

Interviewer:____________ BP:

Place where interview conducted:____________ BQ:

Others present during interview:____________ BR:

32. Interview was:

1.___ In original sample

2.___ Replacement BS:

33. Sample Strata: BT:

# ANNEX D

## SUMMARIES OF 1984 EVALUATION

## AND

## 1986 IG AUDIT

PROJECT EVALUATION SUMMARY (PES) — PART I

Symbol U-447

**1. PROJECT TITLE**

Production Credit

**2. PROJECT NUMBER**

263-0147

**3. MISSION/AID/W OFFICE**

USAID/Cairo

**4. EVALUATION NUMBER** (Enter the number maintained by the reporting unit e.g., Country or AID/W Administrative Code, Fiscal Year, Serial No. beginning with No. 1 each FY)

☐ REGULAR EVALUATION ☐ SPECIAL EVALUATION

**5. KEY PROJECT IMPLEMENTATION DATES**

A. First PRO-AG or Equivalent FY____
B. Final Obligation Expected FY____
C. Final Input Delivery FY____

**6. ESTIMATED PROJECT FUNDING**

A. Total $ 68 million
B. U.S. $ 68 million

**7. PERIOD COVERED BY EVALUATION**

From (month/yr.) 8/82
To (month/yr.) 12/85
Date of Evaluation Review

**8. ACTION DECISIONS APPROVED BY MISSION OR AID/W OFFICE DIRECTOR**

| A. List decisions and/or unresolved issues; cite those items needing further study. (NOTE: Mission decisions which anticipate AID/W or regional office action should specify type of document, e.g., airgram, SPAR, PIO, which will present detailed request.) | B. NAME OF OFFICER RESPONSIBLE FOR ACTION | C. DATE ACTION TO BE COMPLETED |
|---|---|---|
| *1. Remove the maintenance of value (MOV) provision from the project. | IS/FI and MPIC | |
| 2. Implement training activities. | IS/FI, MPIC | January 198 |
| 3. A Project Committee meeting should be called to discuss how the evaluation will affect future programming. | | March 1985 |
| | IS/FI | January 198 |
| 4. The following issues should be addressed under follow-on credit projects: | NA | NA |
| a. A dialogue should be initiated with the GOE to encourage the development of an interest rate structure that encourages term lending. | | |
| b. A flexible mechanism needs to be developed for adjusting effective foreign exchange rates, taking into consideration U.S. source and origin requirements. | | |
| c. Project local currency generations should be used to encourage improvements in the credit market or to support export development. | | |
| d. USAID should consider providing term credit in both foreign exchange and local currency, particularly to firms with export potential and/or comparative advantage. | | |
| e. A private sector steering committee should be activated. | | |

**9. INVENTORY OF DOCUMENTS TO BE REVISED PER ABOVE DECISIONS**

☐ Project Paper
☐ Financial Plan
☐ Logical Framework
☐ Project Agreement
☐ Implementation Plan e.g., CPI Network
☐ PIO/T
☐ PIO/C
☐ PIO/P
☒ Other (Specify) PIL
☐ Other (Specify)

**10. ALTERNATIVE DECISIONS ON FUTURE OF PROJECT**

A. ☐ Continue Project Without Change
B. ☐ Change Project Design and/or
☒ Change Implementation Plan
C. ☐ Discontinue Project

**11. PROJECT OFFICER AND HOST COUNTRY OR OTHER RANKING PARTICIPANTS AS APPROPRIATE** (Names and Titles)

David Cowles, IS/FI
James Suma, IS/FI 1/16/85
Donald Pressley, AD/IS DLP 1/17/85
George Laudato, AD/DPPE
Arthur Handly, DD

**12. Mission/AID/W Office Director Approval**

Signature

Typed Name
Frank B. Kimball, DIR

Date 13 FEB 1985

*Mission Director does not object to removal of MOV from present PCP program. Agreed, however, future program, i.e. FY86 and onwards, shall include mechanism and/or formula to adjust "cost of funds" to alleviate

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| PROJECT TITLE(S) AND NUMBER(S) | | | MISSION/AID/W OFFICE |
|---|---|---|---|
| Production Credit (263-0147) | | | USAID/Cairo |

PROJECT DESCRIPTION

The Purpose of this project is to expand investment for productive private sector enterprises by financing the foreign exchange costs of raw materials, intermediate and capital goods imported for use by the productive private sector.

| AUTHORIZATION DATE AND U.S. LOP FUNDING AMOUNT | PES NUMBER | PES DATE | PES TYPE |
|---|---|---|---|
| 9/25/82 $68 million | 85-8 | January 1985 | [X] Regular [ ] Other (Specify) [ ] Special [ ] Terminal |
| ABSTRACT PREPARED BY, DATE | ABSTRACT CLEARED BY, DATE | | |
| N. Shafik, DPPE/PAAD January 1985 | D. Cowles/J. Sama January 1985 | | |

The evaluation was conducted by a four person team with expertise in evaluation, banking, economics, and commodity procurement. Three team members were from AID/W and the development banker was recruited through the International Executive Service Corps. The team was tasked with evaluating project purpose achievement and with making recommendations applicable to this and other USAID industrial credit activities.

The team concluded that, while the project was very successful in providing foreign exchange to finance private sector imports, its credit market and institutional development objectives were constrained by implementation problems and macroeconomic policy issues. The project has financed 288 transactions valued at $54 million for an extensive list of raw materials and capital equipment such as plastic inputs, poultry production experiments, construction machinery, and textile raw materials. The team found that effective interest rates under the project, estimated at between 22 and 28 percent, are positive given Egypt's inflation rate of approximately 20 percent. Sixty-eight percent of the transactions have been for end-users of raw materials and capital goods. The vast majority of the commodities financed were identified as appropriate to Egypt's development needs. The training component of the project has not been implemented due to delays in developing an adequate training plan and institutional problems. The Private Sector Steering Committee, originally intended to provide guidance on project-related macro-level issues, never met.

The report identifies many lessons learned from this project. The Central Bank of Egypt's interest rate structure, to which project interest rates are tied, has tended to discourage term lending. The maximum interest rate of 13 percent on industrial credit and the minimum of 16-18 percent on short-term trade credits have encouraged banks to concentrate on more profitable short-term, commercial lending. The existence of a Maintenance of Value (MOV) provision, originally intended to insure that importers would pay a more realistic price for foreign exchange, actually discouraged the use of the project's credit term. Rather than risk of an official devaluation, many importers paid cash during the negotiation of documents and converted the risk to local currency. The Maintenance of Value provision, along with the increasingly subsidized foreign exchange rate (L.E. 84 = $1 U.S.), encouraged the use of the project as a foreign exchange window instead of a productive credit mechanism. Some of the difference between the official rate at which the project provides foreign exchange and the free market rate is justified as appropriate to offset U.S. source and origin requirements that add approximately 20-30 percent to the cost of imports. However, this difference has increased steadily since the beginning of the project and now needs adjustment.

The evaluation affirmed the original purpose of the project but made several recommendations that would make a follow-on project more effective. USAID should pursue an active policy dialogue with the GOE on the need to address interest rate distortions that inhibit the flow of available credit into longer term productive investments, particularly in areas where Egypt has a comparative advantage and that have export potential. However, given the limits of this project, the foreign exchange and interest rate issues should be pursued primarily in the context of the Mission's broader policy dialogue with the GOE. The report did recommend that the maintenance of value provision should be eliminated to promote project credit. Institutional development, training, and the establishment of a Private Sector Steering Committee continue to be critical areas for USAID involvement. The team also recommended that local currency generations of the project should be used to encourage improvement

# Executive Summary

## Production Credit Project

### 1. Overview

The Production Credit Project (PCP) was designed to increase private sector output by providing foreign exchange imports, short-term credit and by improving the capabilities of the Egyptian financial system. Initial project efforts were to be concentrated on foreign exchange imports and short-term credit. As the project developed it would be expanded to include the institutional development component. When measuring project success against these goals it is clear that the goals were very ambitious. It was probably expecting too much to task the project with achieving all of those goals since the achievment of project goals was in large measure dependent upon the success of other Mission private sector projects and in a key sense, on the success of AID/GOE policy dialogue on macroeconomic issues.

The project was very successful in providing foreign exchange inputs to private sector industries that used those imports efficently. It was less successful in providing short and medium term credit. The credit market and institutional development side of the project never got off the ground.

The Evaluation Team has identified a number of project difficulties and has prepared a list of recommended changes. With such changes, a more effective and targeted project could be developed to build on the start made with this project.

### 2. Commodity Procurement Implementation Experience

The Production Credit Project (PCP) was not a completly new effort; during the period from FY 1977 to FY 1981 $137 million had been disbursed under the private sector component of the CIP. The GOE, banks and private sector had gained experience and familarity with AID procurement regulations and procedures under the CIP. Drawing upon this experience, the Production Credit Project was carried on along similar lines with some important improvements.

The private sector CIP had relied on a quota-allocation system with the 5 public sector banks each receiving a share of the total program. The first change in the PCP was to expand the number of banks in order to encourage competition. In addition to the existing 5 public sector banks, 4 private sector banks were added to the eligible list. Since the new banks were private sector banks, they brought a more market-oriented and service-oriented style of banking into the program. The second change in the program was to do away with the practice of giving each bank a fixed share of the total program. The PCP created a transaction-based, client-demand system. Each of the 9 banks was given an inital $3 million allocation. The remaining PCP funds were provided to those banks that were able to move their funds. Those that performed efficently and quickly received more funding. Those that lagged behind did not receive additional funding. The system worked well. By rewarding the efficent banks with more funds, the project was able to move AID funds quickly and effectively.

Transactions seem to be flowing to private sector banks at a rate which approximates their "fair share" of the banking market. The private banks processed 26 percent of the transactions valued at 35 percent of the program value. while it had been hoped that the private banks would receive a larger share, they are generally small and new to the the market. They lacked many of the advantages held by the large, established public sector banks.

The original Project Paper implementation schedule anticipated final project disbursements to be completed by March of 1985. By December 9, 1984 the AID Mission had approved transactions valued at $54 million (80 percent of the program) and letters of credit had been issued for $37 million (55 percent of the program). Recent approvals have averaged $4-5 million a month which means that all funds should be allocated by February 1985 with full issuance of all letters of credits and disbursements following closely behind. The project should reach an 80 percent disbursement level by March 1985 and reach 100 percent before the end of the fiscal year. That is reasonably close to the original implementation plan.

Of the more than $54 million in approved transactions, by far the greatest share (68 percent) have been for end-users of raw materials and capital goods. One of the criticisms of the Private Sector CIP had been that traders received nearly two-thirds of the funds. Traders often imported goods and some made a windfall profit reselling those goods to end users. That problem has been virtually eliminated in the PCP. Traders have received a small share of funds and generally do not appear to be making windfall profits. Most traders using the PCP are distributors of U.S. equipment who are importing equipment and spares to support their regular distribution and service program.

A problem with the Private Sector CIP had been that a few companies and families had monopolized the program. That was not the case with the PCP. By limiting transactions to a

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maximum of $500,000 and allowing a firm to import only $1 million per year, the funds were spread among a wide range of companies. In fact, the average PCP transaction size was only $179,000 and only 8 exceptions were made for procurement over the $500,000 limit.

Analysis of the types of commodities financed and the industries receiving PCP imports showed that the goods were generally appropriate to Egypt's needs and were effectively used. Out of a total of 288 transactions, the Evaluation Team found only 3 or 4 commodities that were of questionable development value. Those commodities were eligible under AID/GOE rules but in Egypt's case they were of a "luxury nature" and did not appear to be of critical developmental need.

There was also a concern that "Law 43 Companies" (Egyptian/foreign joint ventures) might monopolize the PCP program. In theory, since "Law 43 Companies" have a foreign partner and thus access to foreign exchange, their need for PCP imports is less than that of wholly-owned Egyptian companies. The Evaluation Team closely examined all PCP transactions of "Law 43 Companies" and found that they received a very small share of project funds --only $2.3 million or 4 percent of project funds. A close examination of all such transactions turned up only one case where the commodity being imported was not of high developmental value.

3. The Egyptian Credit Markets

The financial system has worked well in mobilizing short-term savings and providing short-term trade credits. Lenders are generally risk averters who require heavily collateralized loans, with a short maturity at high costs to the borrower. In order for the Egyptian credit market to develop into a more sophisticated market which provides term lending, both bankers and borrowers will need a higher level of confidence in Egypt's medium and long-term economic and political environment.

The Central Bank of Egypt (CBE) has a number of controls and limits on bank operations which restrict the development of a term credit market. In the interest of encouraging longer-term investments the CBE has set a maximum interest rate ceiling of 13 percent on industrial credit. In order to discourage short-term trade credits, a minimum interest rate of 16-18 percent has been set. Not surprisingly, banks are lending where the profit lies. They have nearly 85 percent of their loans in short-term trade credits with a maturity of one year or less. The Government regulation

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designed to encourage term lending has had the opposite effect. Another problem is that the CBE is not officially a lender of last resort. There is no central bank discount window in Egypt. Since banks cannot discount their loans, they do not have a readily available source of liquidity. This increases their desire to maintain most of their loans on a short-term basis.

The Evaluation Team analyzed local currency lending rates as they applied to the project. The Team was interested in determining whether project loans were being provided at realistic interest rates. The Team determined that short-term loans under this project cost the borrower between 22 and 28 percent interest. These rates are positive, even with Egypt's current inflation rate of near 20 percent.

4. Economic Analysis

The Egyptian economy is still evolving from the highly centralized system that was created during the 1950's and the 1960's. Many of the price distortions still remain. Rapid growth has been achieved in recent years through high levels of saving and investment, buoyed by worker remittances, oil and export earnings and Suez Canal dues that helped to pay for rapidly growing imports.

The oil-related prosperity has masked some structural weaknesses in the economy which will need to be remedied. Among the most important of these weaknesses is the fact that industrial exports have stagnated for the past decade and recent sources of foreign exchange can be expected to become less reliable as the oil economy cools. Several policy reforms have been initiated by the government of Egypt and still others are needed to successfully address these problems. Credit needs of the private sector can be met by addressing them in light of these new circumstances.

Domestic credit has expanded rapidly in recent years. Indeed the government had to take action to moderate this growth in order to lessen inflationary pressures. Credit has grown as rapidly as is consistent with relatively stable prices. The more serious problem in the domestic credit market is the fact that interest rate distortions inhibit the flow of available credit into longer term productive investments. Aid to the private sector therefore need not focus solely on providing a larger volume of funds. Means should be developed to improve the allocation between short-term and longer-term credit.

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The foreign exchange problem in Egypt is also as much one of allocation as it is of sheer quantity. Indeed in recent years, Egypt's banking system has been a net exporter of short-term funds to the Eurocurrency markets. Because of this, both private and government users often experience difficulty in acquiring foreign exchange. Private users can resort to the "own exchange" market, paying a higher exchange rate, but are normally limited to very short-term credit, and must bear with the additional inconveniences that occur in informal credit markets. To the extent that PCP institutionalizes a more formal credit system, and provides longer term credit, it serves a useful function for the private sector.

Institution building and removal of distortions in the domestic credit market (especially if the changes benefited industries in which Egypt has a comparative advantage), would aid the private sector as much or more than mere provision of additional funds.

5. Conclusions and Recommendations

The Evaluation Team examined the Project's design to see if there were areas that could be improved. The following issues should be examined if a follow-on project is considered:

a. Importers were reluctant to use the financing portion of the program because of the foreign exchange, maintenance of value requirement (MOV). An example will illustrate the problem. If an importer purchased $100,000 of imports under the project he could either pay LE 84,000 or, depending on the type of commodity, finance the LE 84,000 over a 1-3 year period. His local currency liability is fixed at the current foreign exchange rate of LE 0.84 = $1. However, if he takes the 1-3 year credit his liability will depend on the foreign exchange rate in effect when the loan matures. If the Pound devalues to 1.50 = $1 then his obligation would be LE 150,000. Since the risk of devaluation is great, importers were reluctant to take the MOV risk. Very few importers used the credit component of the project. If there is to be a credit component in a future project, the MOV requirement should be eliminated.

b. The failure to implement the training, technical assistance and studies component of the project has limited the developmental impact of the program. The Evaluation Team identified a number of training and institutional needs that could be addressed. They should be an integral part of any future program.

c. Project local currency generation are now placed in the general AID/GOE Special Account. The Team recommends that a separate special Fund be set up for this project. While the actual uses would have to be determined by the design team that puts together the follow-on project, we recommend that the fund be used to encourage improvements in the credit market or to support export development.

d. The Private Sector Steering Committee should be activated as a means of exchanging views between AID, the GOE and the private sector.

e. If the banks do not have adequate incentives they will continue to concentrate on short-term credit. A strategy should be developed to create a positive interest rate structure for terms lenders. This may require negotiations with the CBE and the GOE. Such negotiations might logically be a part of other AID/GOE macro policy discussions.

f. To the extent that there is a net subsidy, the effective cost of capital to the private sector is artificially reduced. This provides an incentive to invest in projects with lower than desirable rates of economic return. The result is lower output, employment and growth than would otherwise occur. When offering foreign exchange at lower than market rates, the donor must choose between providing all the credit that is demanded at that rate, or of restricting the amount while allocating it by nonprice rationing. In the former case, one must ask how long the donor intends to supply all that the market will take. In the latter, first come first served rationing will probably lead to an inefficient portfolio of investment projects.

g. As a rule, therefore, generalized exchange rate subsidies which lower the effective cost of capital are not an economically desirable feature to underpin an overall private sector strategy.

h. Events have increased the spread between the official rate and the free market rate. A spread that could be defended as appropriate to offset U.S. source and origin requirements at the outset of this project has now been exceeded. The applicable foreign exchange costs should be raised. There could still be a spread to offset higher U.S. source and origin costs. Beyond that, the Evaluation Team felt that the exchange rate subsidy issue is not an appropriate one to resolve in the context of this one single, and relatively small, project. There is a need for a flexible mechanism that can adjust effective foreign exchange rates over the life of the project. The appropriate forum in which to deal with exchange rates is at the Mission program/policy dialogue level, where incentives for policy reform can be brought to bear. Parity of treatment between the public and private sector import programs is also a consideration. When the CIP and other AID programs are brought under a more rational exchange rate, Production Credit should be as well.

i. In the Egyptian economy effective interest rates are in many cases negative. This discourages saving and leads to investment misallocation. Rational resource allocation would suggest interest rates sufficiently in excess of the rate of inflation to effectively ration capital and to stimulate saving. This issue, is however, not one which can be resolved in the context of a single project. It is a macroeconomic policy objective to be negotiated at the highest levels by various donors, and not one which can be effected by partial adjustments in one sector or one project. It is important that project interest rates be tied in some way to either market or to central bank rates so that they would follow appropriate macroeconomic adjustments.

j. Medium and longer-term local currency credit, and export credit, may be as important a constraint as foreign currency availability. The Team recommends that in the future, credit programs aim more at these problems and take advantage of recent policy changes by GOE and efforts by other donors, such as the IBRD, to identify additional useful areas where credit needs should be met, rather than focusing exclusively upon imports. Firms and sectors with viable export potential and those for which comparative advantage considerations would suggest as efficient import-competing enterprises should receive special attention in designing future AID credit projects.

End - Executive Summary and Recommendations

AUDIT OF
PRODUCTION CREDIT PROJECT
USAID/EGYPT PROJECT NO. 263-0147
Audit Report No. 6-263-86-11
September 30, 1986

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## EXECUTIVE SUMMARY

USAID/Egypt entered into a $68-million grant agreement with the Government of Egypt in September 1982 funding the Production Credit Project, No. 263-0147. An additional $20 million was authorized in March 1985 making the project total $88 million and extending the project completion date into fiscal year 1986. The primary project goal was to increase the private sector's contribution to Egyptian productive output by providing foreign exchange on credit terms. By expanding credit availability, the project was to directly facilitate increased private sector involvement in the Egyptian economy, thereby promoting long-term economic growth and employment. The Production Credit Project was followed by the Private Enterprise Credit Project estimated to cost $235 million. This new project included a Private Sector Commodity Import Program Facility funded at about $117 million that essentially continued the activities carried out under the Production Credit Project.

The objectives of this program results audit were to: determine whether project goals were achievable; assess whether the indicators for measuring project success were valid; determine whether the project was being implemented in a manner likely to bring about the desired outcomes; assess compliance with applicable laws and regulations; and test internal controls.

The audit showed that the project goals could not be achieved, indicators for measuring project success were invalid, and the project was being implemented in a manner that was unlikely to bring about the desired outcomes. Tested items were in compliance with applicable laws and regulations. Internal controls were adequate in regard to the transactions traced through to participating bank records.

Several changes were made during the period of project implementation that improved the way in which the project functioned. Fundamentally, however, the project was incapable of achieving its broadly stated goals. Inability to overcome the constraints of a subsidized exchange rate and an interest rate structure imposed by the Government of Egypt precluded the project from being effectively implemented on a market-oriented basis. These problems, combined with the lack of incentives for participating banks to make the types of loans intended, allowed project funds to flow to firms least in need of the financial assistance provided. This latter problem could have been lessened had the Mission established priorities for private sector development and channeled project funds to firms in these sectors, but this was not done.



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With a relatively modest funding level, the project did not contain sufficient leverage to achieve the broadly stated goals of increasing Egyptian private sector productive output and expanding investment for productive private sector enterprises. Neither the project goal nor purpose were supported by detailed economic analysis of the development need to be addressed, nor were they linked to the specific design problems identified in the Project Paper as major constraints to private sector development. Indicators of goal achievement were neither valid, verifiable, nor quantifiable as required by AID Handbook 3. Many of the design issues addressed in this section of the report were raised when the project was in the approval process, but were never dealt with effectively by USAID/Egypt prior to project approval or in the four years since. The issues, therefore, were present throughout the life of the project and adversely affected implementation. Government of Egypt actions exacerbated the project design problems and further impeded chances of project success.

We recommended that the follow-on Private Sector Commodity Import Program Facility be redesigned around realistic project goals and a specific developmental need that it is capable of addressing, and that objectively verifiable indicators to measure goal achievements be developed. USAID/Egypt said the follow-on project met the intent of our recommendation.

USAID/Egypt was unsuccessful in getting the Government of Egypt to make the policy reforms that were prerequisites to project success. These reforms centered on the exchange rate at which project transactions were to be repaid and the interest rate to be charged borrowers of project funds. The Mission's inability to get the Government of Egypt to move on these issues meant that the exchange rate used to repay project transactions was far below the actual market rate, and that the interest rate charged borrowers of project funds was undervalued and discouraged long-term lending. The Mission was unsuccessful in overcoming these constraints through a policy dialogue with the Government of Egypt prior to project approval and in the four years since. This precluded effective project implementation with the exchange rate issue having the most serious consequences.

We recommended that USAID/Egypt find a solution to the exchange rate problem for the follow-on Private Sector Commodity Import Program Facility that is not tied to ongoing policy dialogue with the Government of Egypt. USAID/Egypt said that this was neither possible nor realistic. We also recommended that USAID/Egypt determine what the real market interest rate would be for the types of loans to be made, and justify any deviation from this rate in terms of attaining project goals. USAID/Egypt agreed that the interest rate structure in Egypt discouraged long-term lending and encouraged short-term trade financing but felt obligated to use the existing structure while seeking changes in it.



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Project success was conditioned ultimately on the quality of implementation by the nine participating banks. These banks, however, were not provided incentives to align their interests in the project with those of the Mission. For example, banks received the same flat fee regardless of whether the transaction was paid in cash or on credit terms. This fee did not vary with the credit risks involved or other costs associated with the transaction. Further, these banks were required to assume the full financial responsibility for both principal and interest payments when credit terms were used, but received no added compensation for this risk. As a result, bank officials we interviewed tended to restrict participation in the project to their best customers with the highest credit ratings. These were not the firms most likely to make the best use of the funds in a manner supporting project goals.

We recommended that USAID/Egypt establish a system of incentives for the participating banks to align their interests in the project with those of the Mission and thus make the types of loans that would best support project goals. USAID/Egypt saw no need to provide further incentives to participating banks.

The project was successful in moving funds into the private sector, but not necessarily in ways supporting the project goals of expanded Egyptian private sector output and employment. USAID/Egypt did not identify priorities for private sector development nor establish criteria to ensure project funds were targeted to meet these priorities. Further, because the project was not operated on a market-oriented approach, market forces could not be relied on to determine the appropriate allocation of project resources. As a result, assurance was lacking that project funds were used in the manner intended. Based on discussions with selected Egyptian importers, there were many indications that this was not happening.

We recommended that USAID/Egypt establish priorities for private sector development along with criteria for targeting project funds to sectors and firms that are most likely to achieve project goals of expanded output and employment. USAID/Egypt said that it had examined the issue of targeting and had rejected it.

Office of the Inspector General



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# ANNEX E

## SCOPE OF WORK FOR PRESENT STUDY

## A. INTRODUCTION

Since its inception in 1982, the banks participating in the PCP disbursed $87 million in short-term credit to approximately 304 firms for about 590 transactions. In addition to its intended effects on credit institutions and the credit market, the project was to:

-- Increase the private sector's contribution to productive output.

-- Expand investment for productive private sector enterprises.

The project was evaluated late in 1984. The RIG audit conducted of the project in early 1986 also asked evaluation-type questions. Both reviews focussed primarily on credit and banking-related issues, not the end-users.

## B. PURPOSES

The present user-profile survey is designed to provide information on end-users, those who receive the commodities procured under the 590 transactions. (This definition of the universe for the project's sample is qualified in Section E below.)

Descriptive information will be collected on:

-- Who participates in the program
-- Why they participate one or more times, and
-- What economic and social benefits participation helps realize.

This descriptive information can also serve evaluation purposes. In specific, to what degree does the PCP help firms to:

-- increase their productive output?
-- expand their investment?

These questions, taken from the project's goals and purposes, ask whether PCP plays a facilitative role in effecting expansion of the private sector, or whether project funds primarily replace other sources of FX and credit that the participating firms would have used if they did not have access to PCP.

Finally, descriptive and evaluation information can serve design and implementation purposes. A better understanding of who makes "best" use of the program can help participating banks and project managers in refining project procedures. Private sector demand for project funds seems to far exceed available resources. Decisions on how to allocate these scarce resources must be made. The present user-profile will help in assessing the probable consequences of alternative allocation criteria.

C. FOCI

Two series of computer printouts of project transactions were run and analyzed. (See Attachment C.) One series looked at multiple users; the other focussed on intra and inter-sectorial differences.

Attachment B provides some illustrative hypotheses and questions suggested by this analysis.

This preliminary examination of users and transactions, together with a review of project materials and discussions with Mission staff, helped narrow the focus of the proposed field survey of PCP clients.

The attached draft interview schedule (Attachment A) gives special attention to four broad dimensions of PCP transactions and beneficiary firms:

1. Description of firms according to their trajectories of change, especially along dimensions relating to project goals and purposes—e.g.,:

   — changes in output, sales, and employment
   — changes in the degree to which a firm is operating at design capacity.
   -- whether the firm entered new markets, expanded existing production, has a larger share of its (traditional) market, and whether the PCP loan was for a new activity.

2. Description of the FX and credit history of the beneficiary firms--e.g,:

   -- how much FX and credit they need, how much they have obtained over time, and where they usually get FX and credit

   — what proportion of the FX and credit needs are met by PCP

   -- what they would have done if PCP was not available (for FX and credit separately)

   --- why they came back twice or more, or why they only tried once.

3. A classification of commodities and end-products—e.g.,:

   -- the exact end-products made possible by the transaction (e.g., consumer goods, intermediary, etc.)

   — the market for the final product (e.g., Egyptian popular market, higher-income Egyptians, export...)

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At least three independent samples will be drawn. The first-- of around 10 firms-- will be used to test the research instrument. The second sample will be of modest size--that is, large enough to provide fairly stable percentages. This second sample will incorporate the first one.

The third small sample will be used only if time allows.

Procedures will also be built-in to provide replacements for firms not cooperating in the research.

2. Stratified samples using different sampling ratios: There are 81 transactions involving polyethylene (14% of all transactions). If it is assumed that there is "relative" homogeneity among firms with these transactions, then it is not necessary to weight the sample so that 14% of all respondents are from firms with these transactions. A smaller number can be selected and then multiplied to bring their number back to the 14% they in fact represent.

At this stage, it is not clear how best to stratify the universe and samples from it. It would be possible to stratify by sector and broad commodity groups within sectors. The resulting sample could be examined with regard to multiple users and the value of the transactions. It may be desirable to select a special sample of heavy users.

One crucial piece of information is lacking for the sample: The number of firms that traders serve. This is important if the sample is based on the universe of (1) end-users, rather than on the universe of (2) firms with PCP transactions or (3) the number of transactions. We might limit our universe to "firms with transactions" (not transactions nor end-users), but interview a sample of end-users served by traders. This special sample would then be compared with the appropriate population of end-users in the larger sample.

At this stage, we need to discuss the advantages and disadvantages of defining the universe as all firms participating in the project vs all transactions.

We will have to play with the sample-- and complete the first of the three independent parallel samples--before making a final decision on this key design matter.

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# ANNEX F

## LOGICAL FRAMEWORK

AID 1020-21 (7-71)

ANNEX F

# PROJECT DESIGN SUMMARY
## LOGICAL FRAMEWORK

Life of Project:
From FY 82 to FY 85
Total U.S. Funding $68.0 million
Date Prepared July 20, 1982

Project Title & Number: Production Credit (263-0147)

| NARRATIVE SUMMARY | OBJECTIVELY VERIFIABLE INDICATORS | MEANS OF VERIFICATION | IMPORTANT ASSUMPTIONS |
|---|---|---|---|
| Program or Sector Goal: The broader objective to which this project contributes: To increase the private sector's contribution to Egyptian productive output.<br><br>Sub-Goal: To develop Egyptian financial system capability to service full range of private sector financing needs. | Measures of Goal Achievement:<br>Value added created by Egyptian private sector increases in real terms.<br><br>Sub-Goal: Egyptian financial system serving full range of credit needs of productive private sector and assisting in its growth. | (1) GOE published economic statistics.<br>(2) IMF published reports.<br>Sub-Goal:<br>(1) GOE published statistics.<br>(2) Central Bank of Egypt reports.<br>(3) Participating bank record<br>(4) Project records | Assumptions for achieving goal targets:<br>GOE continues to liberalize economy, foster private sector growth initiatives & accept AID program intervention in credit sector.<br><br>Sub-Goal: (1) Project incentives adequate to encourage banking system to lend to private sector. (2) Private sector enterprises achieve greater market shares, adequate ROI (3) ~~Banks release personnel to be trained~~ |
| Project Purpose:<br>To expand investment for productive private sector enterprises. | Conditions that will indicate purpose has been achieved: End of project status.<br>(1) Documented increases in availability of short-term credit for imports.<br><br>(3) Training in improved credit use completed; studies on credit needs and opportunities completed. TA provided. | (1) AID records<br>(2) Bank records<br>(3) Special studies/evaluations<br>(4) Project evaluations | Assumptions for achieving purpose:<br>(1) Egyptian financial system responsive to AID project initiatives.<br>(2) Financial system continues to expand its own internal capacity/capability concomitant with AID initiatives. (3) Private sector projects requiring term financing are otherwise viable from a bankability perspective. |
| Outputs:<br>(1) Funding mechanisms for Short-Term Credit (STC)<br><br>(2) Expanded number of participating banks and (3) Technical Assistance, Training and Studies undertaken in support of financial system and private sector development. | Magnitude of Outputs:<br>a) Greater private sector access to & use of short-term credit (b) Larger number of banks serving private sector credit needs ;<br><br>Trainees returning & utilizing improved credit & loan procedures; credit regulation changes made. | (1) AID records<br>(2) Bank records<br>(3) Evaluations | Assumptions for achieving outputs:<br>(1) Banks actively participate in STC as planned.<br>(2) Private Sector Steering Committee operates and functions as planned; active dialogue undertaken overtime with USAID resulting in affirmative recommendations supporting private sector development. |
| Inputs:<br>(1) Short Term Credit<br>(2) TA, Training and Studies | Implementation Target (Type and Quantity)<br>(000)<br>(AID) (FX + LE) / EGYPT* (LE) / Total (FX+LE)<br>$67,000 / 16,750 / $83,750<br>1,000 / 250 / 1,250<br>$68,000 / 17,000 / $85,000 | Project records | Assumptions for providing inputs:<br>(1) Grant Agreement negotiations successful.<br>(2) Conditions Precedent met in timely manner. |

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