

Draft Suggested

TERMS OF REFERENCE FOR STUDIES OF
EGYPT: SMALL SCALE INDUSTRIES

May 1980

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133
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I. PROGRAM DESCRIPTION

A. Introduction

The Agency for International Development (AID) has a requirement for a study in Egypt that will:

1. Identify the kinds or types of small scale private sector manufacturing firms that offer the most potential for inexpensively expanding employment (including the employment of women), output, and income.
2. Identify and rank the major constraints on the expansion of different types and kinds of small scale industrial (SSI) firms.
3. Indicate the kinds of assistance that SSI firms, especially the high potential firms, need and demand in order to remove these constraints.
4. Specify what banks and other institutions must and can do in order to effectively deliver this assistance.

"Small" is not specified by size in this proposal because the expansion of employment, output, and income are the major policy objectives. The artisanal sector (1 to 9 employees), therefore, is to be appropriately considered.

The research will be expected to provide:

1. A ranking of subsectors or types of firms according to these three objectives.
2. A ranking of the significance that different constraints have for the expansion of the types and subsectors ranked above.

3. Alternative strategies to remove these constraints--with information on the likely cost, benefits, and feasibility of the alternatives.

B. Background

1. Policy Objectives: Given Egypt's high birth rates, a sizeable number of new jobs must be created in the years ahead in order to absorb a rapidly expanding labor force. Employment-generation was identified by USAID as a significant challenge in the Egypt CDSS, as well as by the GOE and others. These sources also indicate that most of this employment must be found in off-farm pursuits.

Strategies to achieve expanded employment must be consistent with other significant objectives as well, including (1) increased output in order to better meet basic human needs, (2) the generation and conservation of foreign exchange, (3) equity and justice, as partially reflected in improved levels and distribution of income, (4) financial and economic feasibility, as partially reflected in low-cost solutions and high profitability, (5) benefits for women, and (6) a constructive expansion of the private sector of the economy.

There are, therefore, multiple objectives to be satisfied in any employment-generation strategy. One of the major purposes of the present research is to identify which segments of the private manufacturing sector offer the greatest potential for realizing these objectives.

2. Small and artisanal sector enterprises: The industrial sector in general is a large, significant, and growing segment of the Egyptian economy. In 1978, the sector employed about 1.2 million workers, or 12% of the civilian labor force.

There are no exact figures on the relative sizes of the public and private industrial sectors, but the best estimates indicate that:

The private sector accounts for about half the industrial labor force. Within the private sector:

- The artisanal sector, which for present purposes is considered to be firms with less than 10 employees, has been estimated to number more than 113,000 firms and employs anywhere from 350,000 to more than 500,000 workers.
- The more than 4,000 SSI and larger firms employing 10 or more workers; 90% of these firms employ 10 to 50 workers and account for 57% of the total employment of these 4,000-plus enterprises.

The public sector consists of about 200 firms, which are most of the nation's large and medium scale enterprises. These 200 employ about half the industrial labor force and claim two-thirds of the industrial value-added.

Greater Cairo and Alexandria are the major centers for private sector industry, accounting for 77% of all employment and 72% of all establishments with 10 employees or more.

The GOE, AID, and IBRD have published reports with more detailed classifications of firms by size, subsector, and region, but the figures are estimates with unknown biases. There is a general consensus, however, that the private sector small scale industrial sector (SSI) has been growing, despite major dislocations in its foreign markets; it is relatively cheaper to create jobs in smaller than in larger firms; the sector has not received as much credit as it is thought to need; and there are many

promising opportunities for further expansion of firms and employment, especially in selected subsectors.

During 1972-74, private sector output was fairly stagnant; public sector growth in real terms was probably less than 3%. Whereas the public sector output increased to about 8-9% in real terms per annum during 1975-77, the private sector was increasing at an annual rate of 15% during the same years, although it dropped to 8% in 1977. This decline is attributed to the reduction of exports to East European countries under bilateral agreements.

Based on an analysis of industrial licenses issued by GOPI (General Organization for Development) in 1977, private sector projects have a capital/labor ratio of about LE 5086 (\$US 7000); the artisanal sector has an especially low capital intensity, with about 75% having fixed assets valued at less than LE 100 and an estimated 4% having over LE 1000 in these assets.

The private sector averaged only about 4% of total industrial investment during 1969-74, but following the "open door" policy, the private sector's share of investment increased to about 10-12% during 1975-78. Investment licenses issued by GOPI to the private sector increased from LE 67 million in 1975 to LE 167 million in 1978, and there has been an additional LE 1339 million of private sector investment licensed for 243 manufacturing firms licensed until the end of 1978 by the Investment and Free Zones Authority (IFZA). It is expected that most of this surge of activity is led by the larger--but still modest-sized--private sector firms.

IBRD and others have concluded that:

"Egyptian industry has significant long-term prospects to

grow... Small and medium scale industrial private sector enterprises appear to have potential for growth because of such factors as relatively low scale economies, relatively low capital intensity and high income elasticities of demand for many products, strong backward and forward linkages and substantial possibilities for efficient import substitution and export."

The subsectors that have been identified as having the greatest potential for growth are "engineering (fabricated metal production, electrical and non-electrical machines, transport equipment, and professional and scientific equipment), food processing, ready-made garments, footwear and leather products, wood products and furniture, plastics, and construction materials."

3. Current strategies to strengthen private sector SSI firms:

Preliminary overview studies of the SSI have been completed, key institutions have been identified, policy guidelines suggested, and particular institution-building programs have been initiated.

Most of the studies have been based on available official statistics- e.g., the World Bank's 1977 Arab Republic of Egypt: Survey of Small Scale Industry, its 1980 staff appraisal report of the Development Industrial Bank (DIB), and the 1978 AID-sponsored "Preliminary Review of Small Artisan Cooperatives and Small-Scale Industry and Industrial-Support Cooperatives" by the Cooperative League of the U.S.A. The World Bank is currently in the second year of its effort to initiate a study of the artisanal sector, an enquiry that will involve the collection of primary data. Particular projects assisted by bilateral and multilateral aid

agencies have collected other data.

These various overviews have a number of limitations. For example, they cover only a portion of the topics that would be included in an ideal sector review. (For one approach to this "ideal," see AID's 1979 Project Analysis Manual for Agribusiness and Rural Enterprises.) The data have been limited; the purposes have been to provide a broad overview rather than to focus on particular high-priority policy concerns; the bases for identifying priority subsectors have not been provided or precisely measured; and no priorities have been indicated regarding the constraints on the development of the sector.

Major institutions with some responsibility for assisting SSI firms have been identified. According to a World Bank study, "administrative responsibility over SSI is divided among half a dozen Ministries." This dispersal itself has been labeled a problem.

Banks, especially private banks, have played only a minor role in providing financial and other assistance to SSI. Egypt has two industrial development banks--the Development Industrial Bank (DIB) and Misr Iran Development Bank (MDB). DIB has been promoting and financing domestic private small and medium industries through local and foreign currency loans. Four State-owned banks (National Bank, Bank Misr, Bank of Alexandria, and Banque du Caire), Cairo Barclays (one of a number of joint-venture banks), and two Cairo-based international banks (Arab African bank and Arab International Bank) have provided term financing primarily in the form of equity investments.

The four State-owned banks dominate commercial banking, including short-term lending. Public sector business accounts for about 80% of the total commercial banking business. Only the Nation Bank of Egypt has

shown an interest in small business financing. Although the foreign exchange and domestic resources of the banking system have been growing, the banks themselves have had very little experience with private sector industrial firms in general and SSI in particular.

According to a World Bank report:

"While the Government is appreciative of the potential of the private sector including the SSI in Egypt's industrial development and growth, it has yet to properly define the prospective role of the SSI sector, to strengthen the administrative and policy framework... to devise a strategy conducive to self-sustained growth, and finally, to address actively the problems constraining the sector's development."

AID, the World Bank, and others have supported efforts to strengthen SSI and, at the same time, help the GOE in its efforts to develop more effective strategies to strengthen the private sector, including the SSI.

The World Bank, UNDP, ILO, German Government, Ford Foundation, and other donors target particular individual institutions for financial or technical assistance--such as the DIB, National Bank of Egypt, Design Center, etc.

USAID has developed a private sector program as one part of an overall strategy to assist in the creation of a base for economic progress, increased productivity, employment generation, technological transformation, and mobilization of savings. A \$32-million loan was channeled to the private sector through the DIB; the private sector has also benefitted from the Commodity Import Program. The Private Investment Encouragement Fund, with a minimum size loan of \$1 million, and the Private Sector

Feasibility Studies project will both concentrate on larger scale investments, not the SSI sector. Annex A provides a summary of AID's private sector programming. Items 1d and 3b refer to possible responses that the present research is intended to help design.

The World Bank has also supported the DIB, a financial intermediary, as a means of strengthening SSI. Under the proposed DIB-III loan, a pilot program within the DIB will provide technical assistance along with financial assistance to SSI, together with selected training programs for skilled and unskilled workers. The DIB has established an SSI Department, and it will also liaise with other technical assistance (TA) agencies in referring clients to them when appropriate. Although the Engineering and Industrial Design and Development Center was funded to provide extension services and engineering consulting services to SSI, the scheme has not yet been fully implemented.

Under the terms of the World Bank's first loan to the DIB, 20 to 25% of the loan was to be targeted to borrowers whose fixed assets, excluding land and buildings, did not exceed LE 150,000 (in 1977 prices). These targets have been met, but the DIB has not been successful in reaching the smaller firms specified for assistance under an OPEC Special Fund it administers. It has had difficulty identifying suitable borrowers among smaller SSI.

The DIB has had some success and it will continue to play a role. But its dependence on donor and government resources will limit its total impact. It also attempts to keep a diversified portfolio, thereby further limiting its SSI role. It is, furthermore, primarily a reactive mechanism, responding to traditional banking criteria rather than assertively seeking-out

subsectors targeted for their potential contribution to employment generation and other objectives. As of December 1978, it had 2100 loans outstanding, representing LE 46.1 million; 52% of the loans were to SSI projects (of which 14.6% were in short-term loans). The DIB has offices in Cairo, Alexandria, and Tanta, and it is considering possibilities of opening branches in other regions as well.

c. Objectives

Based on the prior description and analysis, USAID has identified a series of policy questions and options that the present research is to address:

1. Is it necessary to target credit and technical assistance in order to achieve income, employment (including the employment of females), and output goals? That is, how much more (and at what cost) can a targeting approach achieve over what would be achieved by normal banking and technical assistance delivery procedures?
2. Is (a) the lack of credit the major constraint on the expansion of high potential SSI firms, or (b) must other constraints (e.g., access to raw materials, power, skilled labor, marketing connections, effective demand for output, etc.) also be removed in order to create and/or expand these firms?
3. Should and under what conditions can banks--other than the DIB--serve as effective outreach mechanisms to deliver credit and other services to SSI?
4. What can and should AID do to encourage private banks to lend their own funds to SSI?

5. What can AID do to increase the ability of existing or newly-created technical assistance institutions to deliver constructive assistance to SSI firms, and how can these institutions be best linked to credit institutions?

D. Statement of Work

The Contractor will be expected to conduct a comprehensive but focussed study of the private small scale industrial sector; its potential for expanding income, employment, and output; the constraints to the creation and expansion of firms; the services that will best help remove these constraints; and the adequacy of different strategies and institutions to deliver these services.

1. Sector Profile

The Contractor will conduct such surveys and other investigations that are necessary in order to identify, classify, and, if possible, rank types of SSI firms according to their potential contributions to expanding employment, output, and income, as well as their contributions to other AID and GOE economic and social goals. Attention is to be given to recent changes and evolving trends, not just to current conditions treated in a static fashion.

Relative to public sector firms, most SSI are medium and small scale. The Contractor will describe firms according to number of workers, fixed assets, labor intensity (including costs per job), and profitability, but no rigid definition of small, medium, factory, or artisanal will be imposed. This is because the primary purpose is to develop targeting strategies best designed to achieve employment, income, and output objectives. In this respect, measures of backward and forward employment-related linkages may be much more significant than number of workplaces (i.e., 12 person-months of work) for a firm.

The studies should focus primarily on urban SSI, including closely-linked service enterprises (e.g., equipment maintenance). Other USAID contractors are studying rural off-farm employment opportunities; a World Bank-funded study of the artisanal sector is to begin soon; and AID, the World Bank, the GOE, and others have sponsored studies that will be of use to the Contractor. It should be emphasized, however, that this study is not a standard sector profile; it instead is to address the policy and programming questions noted earlier.

The Contractor's proposal is to specify what tables and information are to be provided (e.g., by product type, scale, region, etc.) by sample surveys and/or other processes; exactly how the information presented is relevant to the policy decisions to be made; the required accuracy of the information (sample size, sample design, etc.); and how aggregated firm-level data will be compared with sector-level and macro-economic materials.

2. Identification and Ranking of Constraints

The Contractor will identify and rank constraints on the creation and expansion of types of firms that are in turn ranked according to their contributions to the earlier-mentioned employment, income, and output policy objectives. The ranking of constraints will refer to measurable impacts the individual constraints have; another ranking will be based on the difficulty and/or feasibility of removing the constraints.

Proposals in response to this RFP must indicate the basis for the rankings. The constraints themselves refer to firm-level behavior; the sector profile and assessment will consider broader sector-level opportunities and constraints, including promising opportunities for the creation of new firms in particular subsectors.

USAID is aware of different typologies of constraints--e.g., resource "use" constraints (efficiency and price constraints) and resource "availability" constraints (referring to resources in contrast to marketing system constraints). The Contractor's typology must refer to identifiable needs to which known intervention strategies can be related. These constraints will include but not be limited to:

- Raw materials
- Equipment/technology
- Management/entrepreneurship
- Marketing
- Public Policy
- Labor force skills
- Credit

The Contractor will give particular attention to SSI (a) access to, (b) uses of, and both (c) demand and (d) need for credit. From the individual firm's perspective, information should be provided on credit "search procedures"; the uses to which credit is or could be put (e.g., fixed vs. working capital); existing sources of credit (including self-financing and family sources); the degree to which credit demand and need are a reflection of poor management, a shortage of raw materials, or other constraints; the extent to which firms are willing to assume more liability; major reasons why firms are able or unable to secure credit; interest rates and credit terms provided; how much demand there is for credit offered at different interest rates and terms; major reasons why certain credit sources are approached or not approached; and what changes are required before firms will approach banks and

other formal institutions for credit.

From the perspective of different types of lenders, information should be provided on what requirements and procedures they have with regard to different potential borrowers--for example, how they process loans, the costs of administering a loan, collection procedures, repayment schedules, required collateral, loan terms, loss rates, conditions under which they would extend more of their own credit to SSI, their concern with non-credit needs of SSI, and conditions under which they would collaborate more closely with various technical assistance agencies providing services to firms.

3. Feasibility of Alternative Intervention Strategies

The Contractor will identify and assess the feasibility of alternative intervention strategies to remove constraints. "Feasibility" will be determined by various criteria, including but not limited to:

a) The demand for and acceptability of services intended to overcome various constraints. In addition to credit, as previously noted, attention will be given to different types of technical assistance the Contractor identifies. The "demand" for services should be distinguished from either expressed or unexpressed "need" for them, and attention should be given to the conditions under which assistance will be accepted on cost and/or other bases.

5) The past performance and potential ability of different institutions to deliver services to a large number of small scale industrial firms that have limited business, accounting, technical, marketing, and other skills. Although it is not intended that this portion of the research be an in-depth exhaustive investigation, the Contractor will identify, classify, and assess the significance of the different bottlenecks that will be encountered in

delivering services. Alternative AID-assisted institution-building strategies should be suggested and evaluated.

c) The likely overall benefits and other impacts that delivering these services and removing the constraints will have on employment, income, and output goals. Attention should also be given to estimating the degree to which these services can be effectively delivered, the likely costs associated with different intervention strategies, and the balance of costs and benefits for different strategies. Estimates of the number and socio-economic characteristics of beneficiaries also should be provided. Again, it is not intended that this be definitive assessment.

E. Methodology

It is anticipated that the study will be executed, in part, by means of:

- An analysis of available reference materials
- Sample surveys of SSI firms
- Sufficiently in-depth studies of individual institutions (banks and technical assistance agencies) possibly capable of delivering different services to SSI firms.
- An analysis of existing policies

Prior to the commencement of the surveys, the Contractor will be required to prepare and submit to USAID for approval a brief methodological report describing in detail the statistical issues associated with the methodology, including sampling concerns, reliability, and validity.

Proposals in response to this RFP will be evaluated according to the proposals's presentation of the sample design, including the size

of the sample, the organization of the fieldwork for the studies, instruments to be used, preparation of the data for analysis, and the analysis strategy itself.

(TO BE ADDED TO THE RFP)

F. Reports

G. Logistic Support

II. CRITERIA FOR EVALUATING PROPOSALS

III. INSTRUCTIONS TO OFFERORS (these will depend on whether it is a host-country or AID/W contract);

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PRIVATE SECTOR PROGRAM SUMMARY

By the end of FY 81, AID will have undertaken projects addressing the major constraints to private sector development. Many of the projects address more than one constraint and provide a broad approach to sub-sectors of private industry. We expect to have underway projects with all principal Egyptian institutions involved with private sector development. These projects, listed by key target area, are:

1. Mobilization of Finance:

- a. Sub-loans of \$31.5 from the Development Industrial Bank, chief financier of new private sector investment; other donors include World Bank Group, African Development Bank, and OPEC Special Fund.
- b. Procurement of more than \$68.5 million of imported equipment and materials for private sector enterprises, under the Commodity Import Program.
- c. A new Private Investment Encouragement Fund of \$30.0 million in cooperation with Egyptian banks to finance larger-sized new investments; participating banks and investors are expected to invest at least an additional \$30.0 million.
- d. A new Small Scale Enterprise fund of \$15.0 million with Egyptian Banks, to finance smaller-sized new investments; banks and investors are expected to provide more than an additional \$15.0 million.
- e. Improved effectiveness of Egyptian financial intermediaries, principally through increased bank operating efficiency and regeneration of the stock market, as a result of advisors and equipment for \$6.4 million.

2. Improvements in Business Climate:

- a. A new fund of \$5.0 million to finance sector studies, cost-sharing of feasibility studies by potential U.S. joint venture investors, and training for the Investment Authority;

- b. Completion of three existing Industrial Free Zones at a cost of \$22.0 million by financing equipment and advisory services;
 - c. Improved capabilities of Egyptian Investment Center's Information and promotion activities to attract new investment, for \$2.0 million, by financing of equipment and advisory services;
 - d. Reduced government controls on development of small scale enterprise activities.
 - e. Financing of advisors and equipment for modernization of government regulations, business law, taxation, accounting, education, planning and finance.
3. Upgrading Private Sector Work Force:
- a. Improved operating efficiency of the Development Industrial Bank, by financing \$2.5 million of advisors and equipment.
 - b. Improved quality of Private Investment Encouragement Fund participating bank staff by financing advisors and training programs in project appraisal;
 - c. Improved quality of assistance provided to Small Scale Enterprise by Egyptian banks and support institutions, by financing of \$6.0 million of advisors, training, and equipment.