

3. Foreign Direct Investment in Egypt

=

Maryse Louis, Alia El Mahdy and Heba Handoussa

INTRODUCTION

In this chapter, we present in greater detail the institutional and policy environment for FDI into Egypt, before analysing the findings from the Egyptian survey. In the first section, we outline the evolving policy environment with respect to FDI into Egypt. We go on to consider methodological issues, in particular the representativeness of our sample with respect to size, sectoral and regional distribution of foreign affiliates. This permits us to introduce the characteristics of the foreign direct investment sector in Egypt. In the fourth section, we present the findings of the Egyptian survey, following the structure employed in Chapter 2. We conclude by evaluating FDI into Egypt during the 1990s. The discussion is developed through the three Egyptian case studies in the subsequent chapter.

POLICY AND INSTITUTIONAL ENVIRONMENT

Economic Environment

Egypt under Nasser followed a highly regulated economic policy, with state control over a significant proportion of the economy and an inward looking trade policy that relied on import substitution. However an “open door” policy was adopted in 1974, aiming to reduce state control over an economy that was largely dominated by the state sector. This led to sizeable amounts of foreign assistance, workers’ remittances and foreign investment, and a major increase in growth. But, the economy remained inward looking and rapid growth ended in 1986 when oil prices fell significantly. The late 1980s saw an unstable period of decreasing growth rates, increasing inflation and budget and current account deficits. Under the auspices of the World Bank and IMF, the government launched a comprehensive Economic Reform and Structural Adjustment Programme (ERSAP) in 1991⁸.

Despite the apparent success of the ERSAP programme in terms of growth, the economy remained weak and vulnerable to external shocks such as the Asian and Latin American financial crises in 1997 and 1998. There was a recession in 2000 and the economy faced a devalued local currency, an increase in imports, slow growth and an increasing inflation. The September 11th attack on the US thus came at a time when the economy was already suffering.

Egypt was directly affected by the shock; tourism revenues (normally around 25 per cent of total exports and the second largest source of foreign exchange) fell by 26 per cent in 2001/2002 and unemployment in the sector increased. The authorities also faced a large financing deficit that could not be balanced by portfolio and direct investment inflows. GDP grew at less than 1 per cent in 2002, with inflation rising to 4.3 per cent and the budget deficit jumping to 6.2 per cent of GDP. Despite these problems, Egypt has continued to attract foreign investors. In 2000, the FDI flows reached US\$ 1.2 billion, but dropped to US\$ 510 million with the recession in 2001, rising slightly in 2002 to US\$ 647 million.

Our survey of foreign investment firms was conducted between November 2001 and January 2002. From the end of 2000, the Egyptian economy was in a severe recession. In addition to the low growth, we observed:

- An increase in bankruptcy levels among large and small firms;
- A high unemployment rate, estimated at between 8 and 15 per cent;
- A reduction in the amount of FDI flowing into the country, which fell by two thirds, from US\$ 1,500 million in 2000 to about US\$ 500 million in 2001.

The downturn from the September 11th tragedy worsened the negative conditions of the economy. In consequence, a pervasive feeling of pessimism prevailed, not only in the business community, but also among the population at large. This mood of general depression was reflected in the survey – the response rate was relatively low, 10 per cent, and responses often reflected a pessimistic view. The findings of the survey must be interpreted, keeping these factors in mind.

Infrastructure

As a manifestation of its commitment to a growing role for the private sector, after the ERSAP the government started to invest in projects that would crowd-in the private sector; the ERSAP had stressed the role of private investment in growth. New legislation in recent years has contained provisions for the private sector to invest in infrastructure and telecommunications. These moves have been quite successful; the World Competitiveness Report of the World Economic Forum (WEF) ranked Egypt

5th out of 59 countries in terms of having investment in infrastructure as a priority for the government (see WEF 2000).

As a result of these changes, private sector participation in the construction sector has been growing, increasing the growth rate of the sector to an average of 7 per cent between 1999 and 2003. This is in line with the government's long-term plan to increase the habitable area of the country from 3 to 20 per cent by the year 2020 (see Euromoney 2000). Also the government has approved private sector investments in the form of Build Operate Transfer (BOT) projects in power generation, telecommunications, airports and highways that will substantially increase the number and quality of service of infrastructural projects. The implementation of new industrial projects in industrial zones and new communities (such as the 10th of Ramadan and the 6th of October cities) is also being encouraged by offering 10 years of tax exemptions (as opposed to 5 years in other areas). These industrial zones have been specially constructed to host heavy as well as light industrial projects, and contain infrastructure, electricity, water and environmental protection.

One of the main objectives of the ERSAP programme was to reduce the public sector share of the economy. The privatisation programme in Egypt was considered one of the most successful in the world in its starting phase. In 1999, the IMF announced that Egypt's privatisation programme ranked fourth in the world, with proceeds from privatisation amounting to 1.5 per cent of GDP per year (EIU 2000.)

Under law 203 of 1991, 314 public sector enterprises (almost 70 per cent of the industrial sector) were to be moved out of government control. Sixteen independent holding companies were assigned to restructure these enterprises, to operate as private companies with full financial and managerial accountability. The Public Enterprise Office (PEO) established in 1991 was in charge of overseeing public sector reform and privatisation under the supervision of the Minister of Public Enterprise.

Several methods were used in the execution of the privatisation programme:

- Selling 100 per cent of assets to strategic investors (such as Coca-Cola and Pepsi-Cola);
- Selling 95 per cent of the company to Employees Stockholder Associations (ESAs), who then sell them to the employees (ten companies adopted this procedure);
- Selling a significant part of the company's shares through the stock market;
- Selling company debts; and
- Selling a number of small companies and unused public enterprise real estate by auction.

After several consecutive years of success to 2000, during which 180 firms with a value of LE15.8 billion were sold, the pace of privatisation started to slow. In 2001, only 13 transactions were made (sales, leases and

liquidations) down from 23 in 2000 and 33 in 1999. This was mainly due to the fact that most of the well-performing companies had already been sold and the remainder were either heavily indebted, over-staffed, using outdated technology or in need of radical restructuring. Another reason for the slowdown in privatisation has been the government's hesitancy to worsen unemployment, which has increased as a result of the privatisation, especially when the economy as a whole is going through a recession. Although the government has relaxed its ban on the privatisation of utilities by selling 15 per cent of the state telecommunications, the privatisation of the four state-owned banks has been stalled.

Governance and Institutions

Good governance and transparent and efficient institutions are key issues to promote and encourage investment. The 1990s in Egypt marked tremendous government efforts to orient economic policies towards an open free market. But this positive record has been slowed by a lack of institutional reforms. One important reason why Egypt has been slow to achieve its economic objectives is due to the cumbersome and ineffective character of the structural and institutional systems (El-Mikawy and Handoussa 2001).

Most surveys have suggested that the ineffectiveness of the taxation system and petty corruption have increased business costs. Distorted competition taxes tend to be very high and the incentives given tend to offset each other and so have little incremental effect. Also, cumbersome procedures of the tax administration and the time consuming processes add a significant element of uncertainty to private investment in Egypt. Tax evasion is still considered a problem that reflects corruption. Bureaucracy has also been identified as a key constraint by business in Egypt, hindering investment and especially FDI. Starting a new business in Egypt can be extremely difficult when faced with bureaucratic procedures, licenses and paper work.

Egypt still has a large inefficient and underpaid civil service with weak professional incentives and performance, and which is resistant to reform. Interviews with businessmen in Egypt suggest that substantial reforms to government administration are difficult given the immense political power of this sector.

The commercial legal system in Egypt is often accused of being slow and expensive. Corruption in the legal system in terms of irregular payments to judges, experts and personnel is not very common (the WEF report ranked Egypt 30th out of 59 in terms of corruption in the legal system). The clearance rate⁹ was reported in the mid-1990s to be 36 per cent (as opposed to 80 or 100 per cent in most developed countries), and the average time period to resolve a case is 6 years. This poor performance is probably due to the limited number of judges and their low remuneration, the exaggerated use

of court experts, the lengthy procedures and poor court facilities¹⁰. Some positive steps have been taken to upgrade the financial sector towards international standards with respect to the variety of services, quality, price and efficiency. These include the introduction of new financial instruments and services, development of stronger institutions through mergers and acquisitions, further strengthening prudential regulations and a monetary policy that is punctually reactive to the market demand. The government declared the Central Bank to be independent from the end of 2001. However the public sector role in the financial system remains dominant, with more than half of the loans in the hands of the four banks that remain state owned.

The persistence of a poorly performing institutional framework is perceived as the main bloc that has undermined the process of reforms and limited the flow of foreign investment into the economy. The legacy of public sector domination and of centralisation continues to impact negatively on the functioning of the markets.

Legal Environment affecting FDI

Since the mid-1970s, the government has introduced various laws increasing Egypt's openness to foreign investors. These include: Law 43 in 1974 as amended; Law 230 in 1989; Law 159 for 1981 and the new Investment Law 8 in 1997; Sector Law No. 203 in 1991, Capital Market Law No. 95 in 1992, tax laws no.96 in 1992, a law regulating the ownership of real estate by non-Egyptians and a law allowing the private sector establishment of airports No.3 in 1997. Further legislative reforms are planned, including a unified companies law institutionalising equal treatment for companies regardless of their country of domestic or ownership status. Reforms are also planned to reduce procedures, define minority shareholder rights, improve rules for mergers and to amend corporate taxes.

However, Handoussa and El-Mikawy (2001) report that the legislative system in Egypt still contains a number of weaknesses:

- The absence of a unified policy framework for the reforms;
- The vague and arbitrary nature of laws, often referring to other laws or parts of laws annulling or amending them;
- The unconstitutionality of many laws;
- The speed with which the laws are passed, reflects negatively on the credibility of the legislative process;
- The frequent amendment of laws, brings into question their credibility.

The Companies Law No.159 of 1981 is the basic law governing the establishment and operation of companies in Egypt. Investment Law No.8 of 1997 introduced more incentives to private and foreign investment in Egypt and is considered an improvement to the regulatory framework. Among its most essential provisions is the grant of national treatment to foreign

investments. However, official approval remains required for all foreign direct investment firms.

The majority of foreign companies now choose to register under the Investment Law No.8, under the administrative authority of the General Authority for Investment and the Free Zones (GAFI). The law allows 100 per cent foreign ownership and permits foreign investment in 16 distinct fields, some of which were previously restricted, including industry and mining, tourism and oil production and related services. The Executive Decree of August 1997 added petroleum refining and cinema production. Other fields still require prior approval from interested ministries before an investor can approach GAFI (for example, all military products and related industries; tobacco and tobacco products; any investment in the Sinai).

Investment law No.8 does not impose any restrictions on the number of Egyptian employees that have to be hired in the foreign company, but Companies Law No.159 requires that the majority of the directors must be Egyptian and employees must be represented on the board. Under Law No.8, companies – regardless of the level of foreign ownership – have the right to possess and own buildings and land as necessary for exercising and expanding their business. Companies and projects are protected against nationalisation or confiscation by article 9 of the Egyptian Constitution and article 9 of the Investment Law No.8.

Foreign investors also now have the right to remit profits and to repatriate invested capital. Transfers are made in freely convertible currency and the market exchange rate. Companies under Law 159 however are subject to some restrictions in terms of the amount of capital transferred. The institutional environment is summarised in Table 3.1 below.

Egyptian law provides the following organisational forms for investors:

- Joint-stock companies and partnerships limited by shares. These are suitable for projects with a capital of at least LE250 thousand, but difficult to establish without an Egyptian partner;
- Limited liability companies which are suitable for smaller project of LE50 – 250 thousand of capital;
- Joint partnerships and limited partnerships, which are more suitable for small projects but which would require a minimum of 51 per cent Egyptian shareholding;
- Branches and representative offices for a foreign parent company.

Within this framework, the most favourable form of foreign investment is the joint stock company normally set up under Law No.8. Acquisitions and takeovers must be through GAFI for firms that are established under Law No.230 and Law No.8, although foreign takeovers remain rare.

Investment Strategies in Emerging Markets

Table 3.1 Comparative matrix of investment laws in Egypt

Category	Law 43/1974 as amended	Law 230/1989	Law 159/1981	Law 8/1997
Fields of activity	Reclamation and cultivation of barren and desert land, industry, tourism, housing and real estate development.	Same as Law 43	(Not applicable under this law)	Same as Law 230, plus infrastructure (electricity, water, transport), services for oil digging and exploration; transport and delivery of gas; financial leasing, risk capital, and guaranteeing subscription to securities. Executive Decree included petroleum refining and cinema production.
Egyptian participation in equity	Mandatory but no minimum specified.	Not mandatory	Minimum 49% Egyptian equity	Not mandatory
Capital and profit repatriation	Allowed	Allowed	Not allowed	Allowed

=

Foreign ownership of land	Not allowed	Allowed	Not allowed	Allowed
Price controls	None	None	Possible	None
Exchange	No exchange controls	No exchange controls	Subject to controls	No exchange controls
Trade	No import or export licenses	No import or export licenses	Subject to controls	No export/import licensing
Income tax holiday	5 years and up to 8 years 10 and up to 15 years for land reclamation and new cities	5-10 years 0-15 years 15-20 years on low-cost housing	50% tax relief on shares quoted on stock exchange. Projects in “new communities” enjoy tax privilege of Law 59/1977	5 years 10 years for new industrial zones, remote areas (*) and new projects financed by the Social Development Fund 20 years for outside the Old Valley.

Foreign Direct Investment in Egypt

=

=

Customs exemption	Customs exemptions on capital goods for some projects	No customs exemptions	No customs exemptions	A unified rate of 5% on value of machines, equipment, instruments imported
Worker participation in profit	At discretion of company	10% of profit with no ceiling	10% of profit up to ceiling of one year's wages	At discretion of company
Implementing body	GAFI	GAFI	Capital Market Authority	The General Authority for Investment and Free Zones.

Source: UNCTAD 1998.

Investment Strategies in Emerging Markets

Table 3.2 FDI distributed by sector and origin in Egypt

Sector	FDI						No. of Projects	Investment Costs
	June 2000			June 2002				
	Arab	Foreign	Total	Arab	Foreign	Total	June 2002	
Manufacturing	3191	5202	8393	4150	6412	10562	2176	59107
Agriculture	499	211	710	626	242	868	344	7405
Construction	338	1782	2120	382	1958	2340	181	19519
Tourism	3377	1363	4740	3140	1881	5021	360	22766
Financing	2953	2222	3175	4356	3264	7620	629	34325
Services	342	515	857					
Sub-total	10700	11295	21995	12654	13757	26411	3690	143122
Free zones	2666	2926	5592	3373	2441	5814	345	81594
Total	13366	14221	27587	16027	16198	32225	4035	224716

Source: GAFI, 2002

=

Values in LE million-

FOREIGN DIRECT INVESTMENT IN EGYPT: AN OVERVIEW AND SAMPLING METHODOLOGY

In this section, we report on our methodology in selecting a representative sample. Fuller information on sampling methodology is reported in Louis *et al.* (2003). In Table 3.2, we report the distribution of all foreign direct investments into Egypt between June 2000 and June 2002, by sector, size and investment source. The survey target was 150 completed questionnaires of foreign investors in Egypt meeting the following criteria: i) established between 1990 and 2001, ii) a minimum of 10 per cent of foreign investment, and iii) a minimum of 10 employees. We selected a sample of 350 firms randomly, but the response rate was low, so we enlarged the sample size to the 1,500 firms that satisfied the criteria¹¹.

The data on the distribution of the population of foreign firms in June 2002 by sector and location show a total number of 4,035 foreign firms. Our survey was conducted in late 2001 when the total number of foreign firms was 3,824. Data about foreign firms distributed by sector and location were only available for 2002.

Sectoral Distribution

In comparing the sectoral distribution of the sample with that of the base population, we find some differences in the definitions of the sectors. For comparability across the four countries studied, the survey uses the ISIC UN Rev.2 Classification, while the General Authority for Free Zones and Investment (GAFI) uses its own definitions of sectors. The base population sectors are aggregated in such a way that it is not always possible to compare it to the sample sectors, but we present what one can do in Table 3.3.

The manufacturing sector in the base population represents 54 per cent of total foreign firms in Egypt while in the sample it represents only 40 per cent. But the population includes all foreign firms, including those established before 1990, whereas the sample only includes those established after 1990. Moreover, some sectors in the sample are not available in the base population, so the base population sectors could include more sub-sectors than the sample¹². Table 3.2 shows that FDI directed to the manufacturing sector represents 33 per cent of total FDI stock, which is even lower than the proportion in the sample.

Distribution by Nationality of Investors

In Egypt, more than half of the stock of foreign investors are from neighbouring Arab countries, amounting to 57.1 per cent in 2001 and 57.6 per cent in 2002 (see GAFI (2002)). In the sample, only 31 per cent of the total firms surveyed represent investments from the Arab world. This could be because, given that most of the foreign firms in Egypt are of Arab origin,

Table 3.3 Sample properties: industry in base population versus sample

Sector	Base Population June 2002		Sample	
	No. of firms	Per cent	No. of firms	Per cent
Agriculture & mining	344	8.5	5	3.4
Manufacturing	2176	53.9	60	40.3
Construction	181	4.5	21	14.3
Tourism	360	8.9	7	4.7
Financing & insurance	N/a	N/a	16	10.7
Services	629	15.6	19	12.8
Trade & distribution	N/a	N/a	13	8.7
Transport, storage & comm.	N/a	N/a	7	4.7
Total	3690	91.4	149	100
Free zones	345	8.6	0	0
Total	4035	100	149	100

Source: GAFI 2002

they are most affected by the business slowdown and hence more reluctant to reply to the questionnaires. The largest Arab investors are from Saudi Arabia, with a share of 14 per cent of total foreign firms in the FDI stock. Europe's share comes second amounting to 26.1 per cent of total firms in 2001 and 25.7 per cent in 2002, but rather more in the sample. This is probably because more recent investment is from Europe, and, with the signing of the partnership with the EU, the share of European investment in Egypt could well increase further. US investment in Egypt amounted to 8.4 per cent of FDI stock and a similar share in our sample. The involvement of firms from South East Asia, for example Japan, into Egypt is very small in both the sample and the population.

Location of Foreign Investments

Almost 73 per cent of our sample firms are located in Cairo. There is no data on the location of FDI firms, but only 26 per cent of all the firms, including both foreign and local firms, are located in Cairo. Thus our sample still looks unbalanced towards Cairo. A possible explanation is the high proportion of non-manufactured firms (89 of 149). Most service firms are located in Cairo, while the location where the service is provided depends on the project. In the construction sector for example, the location of 22 out of the 23 surveyed firms is in Cairo, whereas the projects are often located outside Cairo.

Conclusion

This discussion has highlighted significant methodological problems for research of this sort in Egypt. However, despite some important anomalies between the population data and our sample, we conclude that in most cases these probably represent differences of definition or timing, which are unlikely to cause major biases in our findings.

INTRODUCTION TO THE FIRMS IN THE SAMPLE

Table 3.4 shows the distribution of our sample by sector and employment. The highest frequency of firms is concentrated in three main sectors: infrastructure and construction, financial and business services and intermediate products respectively. Of those three, intermediate goods-producing companies are the largest in size, in terms of number of workers, with 57 per cent of these companies employing more than 100 workers, while 50 per cent of infrastructure firms are small (10 to 50 employees). This reflects the fact that construction firms find it less costly to sub-contract workers on construction sites than to employ them directly.

For the whole sample, the data reveal that 58 per cent of the companies are of small and medium size (less than 100 workers). This phenomenon – though similar to the general economic structure of firms in Egypt – is surprising given the common belief that FDI companies are usually large in scale in terms of capital and labour. The sample contains very few large firms (>100 workers), all in basic consumer manufacturing and tourism. Table 3.5 shows that the highest concentration of FDI originates from European countries (43 per cent), followed by Arab countries (33 per cent) and North American countries (19 per cent) respectively. Given the data on FDI stocks, this suggests that more recent investments have tended to come from Europe and North America rather than Arab countries. European firms are mainly concentrated in producing intermediate products; infrastructure and construction; trade and tourism; and pharmaceuticals. This concentration, especially in the case of the first, second and last sectors is consistent with their fields of specialisation and excellence, whereas the investment in tourist companies is more related to the competitive advantage of Egypt. Arab FDI is more evenly distributed among economic activities, with at best, minor concentration in the financial sector, machinery and equipment and infrastructure and construction. Asian investment, though very modest, is concentrated in the machinery sector, and North American companies are concentrated in the financial sector. More than one third of all American investments go to this sector, though it only represents one sixth of total FDI to Egypt. A possible explanation is that the banking, insurance and financial investment have become a thriving and growing field in Egypt since the early 1990s. US firms, with less tradition in the region but international experience obtained elsewhere in banking, have entered the financial sector disproportionately.

As to the concentration of new foreign investments in infrastructure and construction, this could be explained by the fact that there is a growing demand for housing in Egypt, and foreign companies may have ventured into the sector to benefit from this momentum.

The distribution of the companies according to their age, as shown in Table 3.6, reveals that a large proportion (48 per cent) started their businesses between 1995 and 1998.

Several favourable conditions were behind this. First, this period coincides with the successful implementation of the ERSAP, monetary and financial stability, and an excellent international standing, as confirmed by international rating institutions. Moreover, the implementation of the privatisation programme encouraged foreign investors to buy firms' shares from the stock markets and to enter the Egyptian market in brownfield and acquisition investments. Entry was especially marked in the financial and infrastructure sectors. Also, the new investment law was implemented, giving more incentives to foreign investors and allowing full foreign ownership.

Table 3.4 Numbers of companies by sector and employment size, Egypt

Local Sectors	Employment Size of Local Firm (No. of workders)					Total
	10-50	51-100	101-250	251-1000	>1000	
Primary	1	1	0	1	0	3
Basic consumer	1	4	7	2	3	17
Intermediate	6	3	5	7	0	21
Machines & equipment	4	4	2	3	0	13
Infrastructure & construction	12	3	4	4	1	24
Trade, tourism, & recreation	13	1	2	1	2	19
Financial & business services	10	6	1	5	0	22
Information technology	1	1	1	1	0	4
Pharmaceuticals	2	1	0	0	1	4
Total		24	22	24	7	127

Table 3.5 Number of companies by sector and home country region, Egypt

Local sectors	North America	Europe	Japan & East Asia	Middle East & North Africa	Other	Total
Primary	0	4	0	0	0	4
Basic Consumer	3	8	1	7	0	19
Intermediate	2	13	0	7	0	22
Machines & equipment	1	4	9	8	9	13
Infrastructure & construction	5	13	0	8	0	26
Trade, tourism, & recreation	2	12	0	6	2	22
Financial & business services	10	4	2	9	1	26
Information technology	4	2	0	2	0	8
Pharmaceuticals	1	3	0	1	0	5
Total	28	63	3	48	3	145

Table 3.6 Number of companies by sector and age, Egypt

Local Sectors	Year of Operation Start			Total
	1990-1994	1995-1998	1998-2001	
Primary	0	3	1	4
Basic consumer	7	9	3	19
Intermediate	9	9	4	22
Machines & equipment	5	6	3	14
Infrastructure & construction	7	14	6	27
Trade, tourism, & recreation	4	9	9	22
Financial & business services	5	13	8	26
Information technology	0	5	3	8
Pharmaceuticals	1	3	1	5
Total	38	71	38	147

An Introduction to the Investors

Parent firms that have invested in Egypt have the following characteristics. Firstly, the majority (68 per cent) have worldwide employment exceeding 1,000 workers and 40 per cent of them employ more than 10,000 workers. This implies that a considerable number of the foreign companies are affiliated to relatively large parent companies. Although 32 per cent of the FDI parent companies generate no more than 0.1 per cent of the global turnover of their parent companies, there are still 15 per cent of the FDI companies that contribute more than 20 per cent of their parent companies turnover. The latter group is mainly concentrated in companies that produce intermediate products and basic consumer goods, and is usually made up of smaller firms from Arab countries.

Table 3.7 shows that exploitation of intangible assets such as technology or patented brands is probably not a key motive for FDI into Egypt. The majority of the parent FDI companies (72 per cent) allocate less than 2 per cent of their total sales to R&D. Around 54 per cent of parent firms are engaged in infrastructure, trade, tourism and financial activities, which normally do not require high investment in R&D. 30 Per cent of these spend more than 2 per cent of global sales on R&D. Firms engaged in manufacturing (consumer goods, intermediate and machines and equipments manufacturing which represent 37.8 per cent of the firms in the sample) are spending more on R&D. 26 Per cent of these firms spend more than 2 per cent of global sales on R&D.

The vast majority of the parent companies have experience of investing in other emerging market regions, especially in Latin America and Africa. This probably lends them greater capabilities to adapt to a developing countries environment. Moreover, most of the parent firms are either focused on one main business activity or diversified to related activities. We find conglomerates only among firms in the infrastructure and construction sector.

Choice of Entry Mode

All the main entry modes were feasible in Egypt during the 1990s, and perhaps acquisitions and partial acquisitions represented an easier entry path. Despite this, greenfield and joint ventures are found to be the major modes of entry; Table 3.8 reveals that greenfield entry represents 46.5 per cent of the total FDI's and JVs represent nearly 37 per cent.

This phenomenon could be explained by the fact that acquisitions were mainly channelled through the privatisation process. Hence, when the privatisation programme slowed after 1997, with most successful firms sold, foreign investors started to engage in greenfield investment. Moreover, the total number of privatisations was modest, while growing market needs for

Table 3.7 Number of firms by sector and R&D expenditure, Egypt

Local Sectors	R&D Expenditure as % of Global Sales							Total
	0-0.5%	0.5-1%	1-2%	2-4%	4-8%	8-15%	>15%	
Primary	0	0	0	1	0	0	0	1
Basic consumer	8	0	3	1	3	0	0	15
Intermediate	13	1	2	2	1	0	0	19
Machines & equipment	3	1	0	2	2	0	0	8
Infrastructure & construction	15	2	1	3	1	2	0	24
Trade, tourism & recreation	10	0	1	2	1	2	0	16
Financial & business services	11	2	0	3	1	3	0	20
Information technology	5	0	1	0	0	1	0	7
Pharmaceuticals	0	1	0	0	0	0	0	1
Total	65	7	8	14	9	17	0	111

Table 3.8 Number of firms by entry mode choice and sector, Egypt

=

Local Sectors	Mode of Entry				Total
	Greenfield	Acquisition	JV	PA	
Primary	0	1	3	0	4
Basic consumer	12	1	5	1	19
Intermediate	10	1	9	2	22
Machines & equipment	3	0	7	3	13
Infrastructure & construction	13	0	11	3	27
Trade, tourism & recreation	11	2	7	2	22
Financial & business services	10	2	7	5	24
Information technology	4	0	4	0	8
Pharmaceuticals	4	0	0	1	5
Total	67	7	53	17	144

new products and services led foreign investors into new economic activities. The new Investment Law No.8 of 1997 also encouraged foreign investment.

These explanations are strengthened by the fact that most of the greenfield and joint venture companies in the sample started operations between 1995 and 1998. Almost 47 per cent of the firms established between 1990 and 1994 were greenfield while another 47 per cent were newly established JVs with a local partner. Between 1995 and 1998, almost half the firms established were greenfield, as privatisation only involved a small number of firms (134) but acquisitions and partial acquisitions represented only 17 per cent of the total.

There is no particularly strong sectoral pattern to the choice of entry mode. However foreign firms producing basic consumer goods (including food processing) slightly prefer to invest as greenfield (63 per cent). Also, most of the newly established pharmaceutical firms surveyed (80 per cent) prefer to invest in Egypt as greenfield. This was not the case in the 1980s, when most pharmaceutical firms entered the market as a joint ventures or acquisition.

RESOURCES FOR SUCCESS

When the affiliates were asked about the most crucial resources behind their successful performance, each firm had to choose and rank the three most important ones. Tables 3.9 and 3.10 reflect their answers.

Key Resources by Sector

Technological know-how was identified as one of the most important resources of success by companies working in producing primary goods, IT, intermediate products, machinery and equipment industries and pharmaceuticals. This result is understandable since one of the main advantages of FDI is its ability to introduce new technologies to emerging markets. The technical know-how helps the incoming companies in securing a niche in the Egyptian market¹³. The managerial capabilities of labour in Egypt ranks second and this applies to almost all companies, while the influence of using Brand names comes in the third position. It is especially important to pharmaceutical companies, consumer goods producing companies, tourism and trade, and financial and business services.

Technological know-how is the most important resource for the success of 26 per cent of firms producing basic consumer goods and of 50 per cent of the firms working in the intermediate sector. "Brands" and "Technology know-how" were each considered the first choice for 21 per cent of the firms working in machinery and equipment sector. In the infrastructure and construction sector, 63 per cent of the firms agreed that the "managerial

capabilities” was one of the most important resources for success, 26 per cent of those had this as their first choice. 50 Per cent of the firms working in the trade and tourism sector considered that brand names was one of the most important resources for their success, 35 per cent of them considering it to be the most important resource. In the financial and business sector, managerial capabilities and business networks were seen as important resources for success by 58 and 54 per cent of the firms respectively. Unsurprisingly, 75 per cent of the IT firms choose the technology know-how as one of the most important resources and 50 per cent of these considered it to be their first choice. 50 Per cent of firms chose the business network as one of the most important resources where only 23 per cent of those made it as their first choice. In the pharmaceutical sector, 60 per cent of the firms chose brands names; managerial capabilities and technology know-how to be three most important resources of success and 60 per cent of those chose brand names to be their most important source of success.

Key Resources by Mode of Entry

Both greenfield and JV firms depend largely on the technological know-how, managerial and marketing capabilities as their sources of success, whereas the acquisitions and partial acquisitions rely on brand names. These results are not surprising since for new projects, greenfield and joint ventures, it is very important to introduce new technology to the markets and to have good managerial staff in the initial phase of the operation. In contrast the most important resource for an acquisition or partial acquisition investment, is a pre-existing brand and the distribution network. In Egypt, successful partial acquisitions in pharmaceuticals, beverages, tobacco companies and hotels have been motivated mainly by the objective to acquire famous and successful brand names.

-Key Resources by Source of Resource

As to the sources of the major resources, we find that brand names and technological know-how mostly originate from parent firms, while managerial capabilities skills and equity shares derive largely from foreign sources and all other resources are provided largely by the local firms (Table 3.10). The availability of several resources in the Egyptian market represents a major source of attraction to FDI.

Key Resources by Size

The same importance and ranking of the resources for success becomes evident when the companies are considered by size of employment. Brand names seem to be increasing in importance with the size of company =

Table 3.9 Percentage respondents selecting the resource as necessary for success, Egypt (%)

Top Three Resources (1 st choice)	Industrial Sectors									Total
	Primary	Basic Consumer Goods	Inter-mediate	Machinery & Equipment	Infrastruc- ture & Construct- ion	Trade, Tourism & Recreation	Financial & Business Services	Infor- mation tech- nology	Pharma- ceuticals	
Brands	0 (0)	42 (21)	23 (18)	29 (21)	28 (19)	50 (35)	31 (19)	25 (16)	60 (60)	32 (22)
Business networks	50 (50)	5 (0)	32 (9)	7 (7)	30 (7)	30 (10)	54 (23)	50 (25)	20 (0)	30 (12)
Distribution network	0 (0)	11 (5)	18 (0)	43 (7)	4 (0)	10 (0)	12 (0)	13 (0)	0 (0)	13 (1)
Equity	0 (0)	5 (5)	5 (5)	7 (0)	15 (0)	15 (5)	19 (4)	13 (0)	0 (0)	11 (3)
Mach. & equipment	25 (0)	26 (11)	32 (0)	36 (14)	22 (7)	15 (10)	0 (0)	0 (0)	20 (0)	19 (6)
Manag. capabilities	50 (0)	42 (11)	36 (5)	50 (0)	63 (26)	30 (0)	58 (27)	25 (0)	60 (20)	47 (12)
Mrkting. capabilities	0 (0)	32 (5)	27 (5)	33 (7)	44 (11)	45 (10)	31 (8)	25 (0)	0 (0)	33 (7)
Technol. know-how	100 (25)	53 (26)	82 (50)	43 (21)	44 (7)	20 (0)	35 (8)	75 (50)	60 (0)	50 (19)
No. of observations	4	19	22	14	27	20	26	8	5	145

Note: By industrial sector of the respondent

Table 3.10 Percentage of firms that selected resource of primary importance, Egypt

Source of resource	Resources for Success							
	Brand network	Business network	Distribution network	Equity	Machinery & equipment	Managerial capabilities	Marketing capabilities	Technological know-how
Local firm	15	70	75	48	55	35	62	18
Parent firm	80	19	0	21	41	23	28	73
Local source	0	10	25	6	4	3	10	1
Foreign source	5	1	0	25	1	40	0	8

Note: By source of resource

increases. Thus we find 83 per cent of the firms with more than 1000 employees consider brand names to be one of the most important resource for success and 67 per cent of those consider it to be the most important. Business networks however, are only important for small size firms. Machinery and equipment becomes an important source as the size of the firm increases (except for very large firms of more than 1000 employees). All size groups of firms agree that managerial capabilities are important resources for success. Technology know-how is important for all firms but especially for smaller ones.

INSTITUTIONAL AND MARKET ENVIRONMENT

In this section, we consider the perceptions of the CEO's of our sample of foreign affiliates about the Egyptian business environment. The material is grouped into evaluation of labour markets, factor inputs and the policy environment.

Labour Markets

Table 3.11 indicates that recruiting executive management is difficult and is only sometimes available for all sectors at the initial phase but that there has been an improvement over time. Shortages are particularly marked in financial and business services, and infrastructure. The IT sector also has problems with operations management. However, most of the sectors agree that professionals, operational management and skilled labour are 'mostly available' and that availability is improving.

The Egyptian Input Market and the Business Environment

According to Table 3.12 input markets in Egypt offer sufficiently reliable utility services such as electricity, water, sewage, telecommunication and IT, professional services and real estate. There are still visible deficiencies however in the availability of machinery & equipment, and raw materials & components, as expressed by companies operating in the production of basic consumer goods, intermediate products and pharmaceuticals. The need to import these items can cause delays, such as shipping problems and discontinuity in production from unpredictable changes in the exchange rates.

In Table 3.13, we report the evaluation of the Egyptian business environment by the managers of foreign affiliates. We find that in most sectors, producers perceive the institutional framework as a whole to be "somewhat conducive". There was discontent with certain procedures however:

Table 3.11 Change in evaluation of local labour market by industrial sector of the respondent, Egypt

Sector	Labour Markets								No. of firms
	Executive management		Professionals		Operational management		Skilled non-management labour		
	Initial	2001	Initial	2001	Initial	2001	Initial	2001	
Primary	3.50	3.75	3.75	4.25	3.75	4.00	4.25	4.75	4
Basic consumer goods	3.32	3.84	4.42	4.68	3.74	4.42	4.21	4.42	19
Intermediate	3.59	3.82	4.05	4.23	3.73	3.82	4.05	4.18	22
Machinery & equipment	4.21	4.50	4.07	4.29	4.07	4.36	4.07	4.57	14
Infrastructure & construction	3.44	3.54	3.92	4.27	3.81	4.19	4.00	4.15	26
Trade, tourism & recreation	4.18	4.50	4.36	4.59	4.18	4.55	4.33	4.57	22
Financial & business services	3.42	3.92	3.77	4.19	3.65	4.15	4.23	4.50	26
Information technology	3.50	4.25	4.25	4.38	3.43	4.14	4.29	4.57	8
Pharmaceutical	4.20	4.60	4.20	4.60	4.60	5.00	4.60	5.00	5

Note: on scale from 1 to 5, 5 = readily available

Table 3.12 Change in evaluation of local labour by industrial sector of the local inputs, Egypt

Sector	Local Inputs												No. of firms
	Utility		IT & telecomm.		Professional service		Real estate		Machinery & equipment		Raw materials		
	Initial	2001	Initial	2001	Initial	2001	Initial	2001	Initial	2001	Initial	2001	
Primary	4.00	4.25	3.75	4.00	4.00	4.25	4.25	4.25	3.75	4.00	3.00	3.00	4
Basic consumer goods	3.79	4.11	3.68	4.58	4.21	4.37	4.25	4.00	1.79	2.11	2.74	3.00	19
Intermediate	3.77	4.27	3.73	4.18	3.91	3.73	3.35	3.53	2.14	2.27	2.71	2.86	22
Machinery & equipment	4.07	4.43	3.64	4.36	4.00	4.25	3.69	4.31	3.07	3.29	2.92	3.31	14
Infrastructure & construction	3.82	4.37	3.19	4.22	3.96	3.92	3.88	4.16	2.62	3.23	3.31	3.69	26
Trade, tourism & recreation	4.14	4.48	3.86	4.50	4.05	4.41	4.21	4.32	3.24	3.57	2.25	2.25	22
Financial & business services	4.50	4.81	3.69	4.62	4.00	4.31	4.12	4.31	3.91	4.36	3.60	3.80	26
Information technology	4.25	4.63	3.75	4.63	3.88	5.88	4.14	4.14	3.86	3.71	3.33	3.00	8
Pharmaceutical	5.00	5.00	4.60	4.80	4.80	4.40	5.00	5.00	2.60	2.60	2.20	2.20	5

Notes: on scale from 1 to 5, 5 = readily available

- Business licenses are not easy to obtain;
- The legal framework has also been criticized for its slowness in resolving business disputes and commercial matters such as unpaid checks...etc;
- Rules and regulations are unstable and hard to predict;
- The role of central government in facilitating establishment procedures, determining economic policies that influence business operations and decisions such as the exchange rate policies, import and export regulations, transfer of profits, etc;
- The role of the local governments, especially in granting approvals, business licenses and real estate titles.

The overall sense of pessimism may have been in part due to the recession at the time of the survey. It was much reflected in investors' evaluations of the institutional framework and some institutional environment components were not found to be improving over time, but rather remaining unchanged or deteriorating. Producers of intermediate goods and IT were the most dissatisfied with the institutional framework.

FIRM LEVEL PERFORMANCE

In this section we examine the degree to which affiliates fulfilled expectations in terms of investors' original objectives. Four criteria were chosen to reflect performance: productivity, profitability, revenue growth and domestic market share. Due to the high correlation between profitability and revenue growth, they were used to calculate a "new performance" index; the average of those two variables, scaled from 1 to 5 where 1 reflects low performance while 5 indicates high performance compared to the original objectives. In the following Tables (3.14 and 3.15) we report the value of the index, rebasing it to a range of 1 to 3, where 1 represents 1 and 2 in the original 1 to 5 scale; 2 represents 2.5 and 3.5 and 3 represents 4 and 5.

= Data in Table 3.14 show how greenfield and JV companies enjoy relatively higher performance compared to acquisitions and PA companies. This confirms the fact that newly establishment firms, either greenfield or JV, are more capable of adapting to the market, despite the difficulties they may face in the installation phase, that is in getting up new technologies, and the introduction of new products and services to the market.

Turning to performance by sector in Table 3.15, four sectors seem to enjoy high performance relative to the rest. These are basic consumer goods, intermediate products, infrastructure and construction and financial and business sector companies. These sectors witnessed rapid growth during the nineties, which helped to boost expansion in the construction sector and the exceptional development in the IT and telecommunication sector.

=

Table 3.13 Change in evaluation of institutional environment by industrial sector of the respondent, Egypt

	Business License		Real Estate		Visa & Work Permit		Environment	
	Initial	2001	Initial	2001	Initial	2001	Initial	2001
Primary	3.00	2.50	2.25	2.00	2.75	2.50	3.00	2.75
Basic consumer goods	2.74	2.47	2.36	2.29	1.94	1.88	2.21	1.89
Intermediate goods	3.86	3.32	3.65	2.94	3.11	2.84	2.64	2.64
Machinery & equipment	2.86	2.64	2.75	2.58	2.70	2.70	2.14	2.14
Infrastructure & constr.	2.77	2.89	2.65	2.55	2.58	2.63	2.57	2.65
Trade & tourism	2.80	2.30	2.50	2.30	2.60	2.70	2.10	2.10
Financial services	2.70	2.60	2.30	2.20	3.00	2.90	2.60	2.60
Information Technology	3.10	2.80	2.00	2.00	2.70	2.60	2.70	3.30
Pharmaceutical	2.00	3.60	2.00	2.00	1.70	1.70	1.60	2.00

=

UM

Table 3.13 (continued) Change in evaluation of institutional environment by industrial sector of the respondent, Egypt

	Legal Framework		Predictability		Central Government		Local Government	
	Initial	2001	Initial	2001	Initial	2001	Initial	2001
	Primary	2.25	2.00	2.50	2.50	3.00	3.75	3.00
Basic consumer goods	2.42	2.42	2.74	2.74	2.68	2.47	2.47	2.47
Intermediate goods	3.50	3.32	3.25	3.50	3.33	3.52	3.36	3.36
Machinery & equipment	3.21	3.50	3.00	3.07	3.00	2.93	2.93	3.14
Infrastructure & constr.	3.19	3.08	3.31	3.35	3.30	3.35	3.00	3.05
Trade & tourism	3.20	3.40	3.20	3.70	2.90	3.10	2.90	3.00
Financial services	2.90	3.00	3.00	3.20	3.00	3.10	3.10	3.20
Information Technology	3.00	3.10	3.40	3.40	3.90	3.60	4.20	3.70
Pharmaceutical	3.00	3.00	4.00	4.00	3.20	3.20	3.00	3.20

Table 3.14 Performance relative to entry mode choice, Egypt

Respondents Performance Rating	Number of firms established through mode of entry				Total
	Greenfield	Acquisition	Joint Venture	Partial Acquisition	
Expectations not fulfilled (rating 1-2)	15	1	8	3	27
Expectations partially fulfilled (rating 2.5-3.5)	25	4	16	9	54
Expectations mostly fulfilled (rating 4-5)	25	0	25	5	55
Total	65	5	49	17	136

UO-

Investment Strategies in Emerging Markets

Table 3.15 Number of firms by performance and sector, Egypt

=

Local Sectors	Expectations not fulfilled (rating 1-2)	Expectations partially fulfilled (rating 2.5-3.5)	Expectations mostly fulfilled (rating 4-5)	Total
Primary	0	2	1	3
Basic consumer goods	2	7	10	19
Intermediate	2	7	12	21
Machines and equipment	4	5	5	14
Infrastructure and construction	5	9	12	26
Trade, tourism & recreation	8	6	5	19
Financial and business services	4	14	7	25
Information technology	0	4	3	7
Pharmaceuticals	2	1	2	5
Total	27	55	57	139

FDI AND SPILLOVERS

In this section we draw together our findings about FDI entry mode, and the impact on spillovers to the host economy. First, we note that the motives for entry are correlated with company performance post-entry. We find in Table 3.16 that firms with a highly domestic focus generally enjoy a higher performance index. Almost half of the firms that have domestic market focus between 25 per cent and almost 100 per cent have the highest performance index. However, only a third of firms that have exactly 100 per cent domestic market focus have a high performance index. Perhaps performance of a firm can improve when focused on the large market that is available in Egypt. However, a 100 per cent focus on the domestic market can prevent the firm from being exposed to international markets and hence could affect negatively its performance.

= The relationship between company performance and the business environment as given by: a) availability of a suitable workforce, b) availability of the necessary inputs to the production including physical infrastructure and financial services; c) working in a market where the local industry is relatively inferior to that of the affiliate; d) availability of an encouraging institutional environment. The findings are reported in Table 3.17, and suggest that a – c are closely correlated to high performance, while d does not seem to differ among the various performance levels. This is understandable since dealing with the institutional environment is usually done in the initial phase of establishing the firm. Hence, it does not really affect the performance of the firm in a later stage, except in the case of extending the business or getting involved in producing new products.

Table 3.16 Number of firms by performance and degree of market focus, Egypt

Respondent's Performance Rating	% of Sales in Domestic Market					Total
	0	0- 25	25- 50	75- 100	100	
Expectations not fulfilled (rating 1-2)	2	3	6	4	12	27
Expectations partially fulfilled (rating 2.5-3.5)	4	3	15	6	23	51
Expectations mostly fulfilled (rating 4-5)	2	3	16	12	21	54
Total	8	9	37	22	56	132

Table 3.17 Change in evaluation by performance, Egypt

Category	Performance					
	Expectations not fulfilled		Expectations partially fulfilled		Expectations mostly fulfilled	
	Initial	2001	Initial	2001	Initial	2001
Labour markets	3.65	4.07	3.87	4.21	4.13	4.40
Local inputs	3.50	3.65	3.45	3.46	4.09	4.22
Local industry	2.79	2.65	2.68	2.71	2.11	2.25
Institutional environment	2.96	3.04	2.75	2.72	2.66	2.76

We also find a correlation between high performance and the absence of competitors or their limited number. Only 37 per cent of firms that are facing more than 10 competitors have a high performance index, while 43 per cent of the firms that have between 0 and 5 competitors have a high performance index. Data also reveal that increasing competition from abroad does not affect performance. The performance of these firms improves as their market share grows. This phenomenon is evident in several industries in Egypt such as steel, cement, financial services and pharmaceuticals.

One might also expect that the longer an affiliate is in operation, the more chance it gets to raise its performance. This remark is confirmed by the data. Half of the surveyed firms that started operating in the period between 1990 and 1994 have a high performance index of 4 to 5, though this declines somewhat for firms created more recently.

We conclude by considering spillovers from FDI. The majority of affiliates in Egypt (64 per cent) spend less than 2 per cent of their total sales on training, though in a few sectors more than 2 per cent of total sales is allocated for training, in some cases 15 per cent or more. Thus primary commodities sectors (100 per cent of the companies), IT companies (80 per cent of the companies) and the financial and business services (57 per cent of the companies), spend more than 2 per cent of their sales is spent on training. IT and primary goods companies spend 3.76 per cent and 3.33 per cent of sales on training, which is relatively higher than other sectors, but still relatively low with respect to international standards.

Small and medium enterprises (10 to less than 250 workers) are major contributors to training. This may be due to the need of workers in small and medium scale companies to get training to become more capable of dealing with new and advanced technologies.

Diffusion of new technology is another important spillover from FDI. We are able to investigate the role of the parent firm in supporting the affiliate with its needs of the different technological resources. We find in Table 3.18 that the majority of affiliates (68 per cent) 'rarely' or 'never' receive technological resources from the parent firms. Only small percentages of machinery and equipment producers (38 per cent), trade and tourism sector (41 per cent), financial and business sector (31 per cent) 'always' or 'usually' receive technical support. Moreover, 75 per cent of greenfields 'rarely' or 'never' receive technological support from their parent firms, while only 17 per cent of those firms 'always' or 'usually' receive technological support. This could be due to the fact that greenfields, as a newly established business, do not require technological acquisition from the parent firm as it is already established with a minimum acceptable level of technology. As for acquisitions, 71 per cent 'rarely' or 'never' receive technological support while only 14 per cent 'always' receive technological support. This is unexpected, as normally acquiring an already existing firm requires a great deal of technological transfer and reconstruction. Joint ventures and partial acquisition are the luckiest since 25 per cent and 24 per cent of those firms respectively 'always' or 'usually' receive technological support from the parent firms.

We also fail to identify any clear relationship between technology transfer and company performance; the best performing firms have limited access to parent firms' technology. This is surprising since it was expected that there would be a strong positive correlation between high performance and the transfer of technology by the parent firms.

CONCLUSIONS

Egypt has made considerable progress over the past twelve years in liberalising its business environment and encouraging foreign direct investment. However, our brief summary of the changes suggest that much more remains to be done, especially with respect to governance, transparency of institutions and efficiency of government. Even so, Egypt has managed to attract growing sums from foreign investors during the 1990s, branching out from a largely Arab base to attract significant investment from North America and Europe.

The survey suggests that most investment has been concentrated in three sectors: infrastructure, financial and business services and intermediate products. The majority of entrants are small, though a few large firms have come into basic manufacturing and tourism. The dominant entry modes are greenfield and joint ventures, with acquisitions being rather rare and unknown - in infrastructure, IT and pharmaceuticals. The key resources for

US- *Investment Strategies in Emerging Markets*
 Table 3.18 *Technology acquisition relative to industry sector, Egypt*

Sector	Number of Firms Acquiring Technology					Total
	Always	Usually	Sometimes	Rarely	Never	
Primary	0	0	1	2	1	4
Basic consumer goods	2	0	1	4	11	18
Intermediate	1	0	0	6	15	22
Machines & equipment	4	1	0	4	4	13
Infrastructure & construction	2	0	6	2	17	27
Trade, Tourism & recreation	6	3	1	4	8	22
Financial & business services	4	4	5	5	8	26
Information technology	0	1	0	3	3	7
Pharmaceuticals	2	0	2	0	1	5
Total	21	9	16	30	68	144

Notes: on scale from 1 to 5, 5 = never

success are technological know-how and brands. Greenfield entrants stress the importance of technology, management and marketing, while acquisitions see brand names as the crucial resource.

Managers of foreign affiliates assessed the Egyptian business environment relatively positively, though improvements during the 1990s were at best only moderate. Neither labour nor infrastructure is viewed as a major problem for foreign investors, though the influence of the government, the bureaucracy and the frequent and unpredictable state intervention was seen as a persistent problem. Despite this most firms reported positively on performance, and the survey also isolated significant spillover benefits from FDI.